December 13, 2011
Minutes #475

Minutes of the Board of Trustees' Meeting -1-

Call to Order: Chairman Pinard called the meeting to order at 8:42 a.m.

Present: Trustees: Chairman Pinard, Richard Molan, Dianne Mercier, Paul Porter and Michael Woitkowski arrived at 8:45 a.m.

MECRS Staff: Gerard Fleury, Sandi Aboshar and Suzanne Wilson

Absent: Trustees: William Sanders and Mayor Theodore Gatsas

In Attendance: Attorney John Rich of the McLane Law Firm, Kevin Leonard and Sebastian Grzejka, Advisors from NEPC

Approval of the Minutes of the Previous Board Meeting October 11, 2011:

Trustee Molan moved to approve the minutes of the meeting of October 11, 2011, seconded by Trustee Woitkowski and passed unanimously by all trustees present.

Approval of the Immediate Meeting Agenda:

A motion was made by Trustee Molan to approve the immediate meeting agenda, seconded by Trustee Porter, and passed unanimously by all those trustees present.

Previous Business:

NEPC representatives Mr. Kevin Leonard and Mr. Sebastian Grzejka were in attendance for a follow-up discussion on "Value Added" private real estate investment opportunities and to present a detailed recommendation to consolidate existing core real estate investments with a single manager. Mr. Leonard began by reminding the board of previous discussions on the subject and NEPC's recommendation to further diversify MECRS' Private Real Estate portfolio, excluding Timber. Mr. Leonard stated that today, he would be providing the trustees with greater details regarding NEPC's earlier recommendation.

Mr. Leonard asked that trustees refer to a handout entitled "Real Estate Program Review & 2012 Strategic Investment Plan" which had been distributed at the start of the meeting. He noted that MECRS' target allocation to real estate is current at 5.0% but that current exposure to the class only amounts to about 2.2% of total plan assets, which means that MECRS is under allocated to real estate. Mr. Leonard also noted that 100% of MECRS' existing commitment is through US-focused open-end core funds. He went on to say that NEPC's real estate recommendation is to allocate additional funds toward a long-term target allocation of 60% core and 40% value-add/opportunistic so that the new allocation will move the overall allotment closer to the target level. He further noted that doing so would increase the return profile of the real estate allocation by 100 basis points but would also increase the illiquidity/expected risk associated with the allocation.

Mr. Leonard stressed the importance of consolidating MECRS core exposure to a single manager instead of the existing two managers and he elaborated specifically that the board should consider terminating Morgan Stanley and Prudential with one of the following managers: UBS Trumball Property Fund, AEW Core Property Fund or Heitman America Real Estate Trust. Mr. Leonard suggested that the board make the decision whether to stay with one of their existing managers or to go through the search process and look at the NEPC preferred managers.

Trustee Mercier expressed concern about the opportunistic component of NEPC's recommendation and asked Mr. Leonard, why the board wouldn't consider a 60/40 split consisting of just core and value added properties. She asked Mr. Leonard to quantify the additional beta risk associated with the opportunistic component which the board would have to assume in order to obtain the increase in relative yield.

Mr. Leonard replied that NEPC is recommending a fund of funds structure which inherently will have value added with a minimal amount of opportunistic risk. He went on to explain in detail the difference between the investment strategies of core, value-add, and opportunistic as well as providing the expected rates of return.

Trustee Molan inquired about the present real estate managers, Morgan Stanley and Prudential and their 100% core investment. He recollected that when last reviewed, both were sitting on a substantial amount of raw land.

Mr. Leonard responded that Morgan Stanley is the manager with raw land and that while every core manager will have some ability to include a value-added component to their portfolio, it is very rare that one elects to buy land. He then suggested that if the board were to decide to keep one of its existing managers that they should keep Prudential because NEPC feels that Morgan Stanley takes on too much non-core risk.

Trustee Mercier stated that she is uncomfortable with the opportunistic strategy and feels that the return does not compensate for the risk.

Mr. Leonard acknowledged Trustee Mercier's concern and defended the investment style.

Attorney Rich referred to details in the NEPC materials on recommended managers for the value-add and opportunistic investment noting that they were private equity like and that the agreements appear to have a fixed duration. Attorney Rich asked Mr. Leonard if all the property in the portfolio were intended for sale at the end of the investment term.

Mr. Leonard responded that yes, all the property would be sold. He then provided a worst case scenario whereby markets might be depressed at the end of the investment period. He stated that should such a situation occur, proper diversification would play an important role.

The trustees continued to display misgivings about the recommendation so Mr. Leonard suggested bringing in a few value-add only managers and maybe one or two fund of funds mangers who have some exposure to an opportunistic strategy, for the trustees' consideration.

Mr. Leonard asked that the trustees turn to page 24 of the presentation booklet and he provided them with real estate plan projections.

Chairman Pinard asked Mr. Leonard if the plan projections are all U.S. based properties.

Mr. Leonard replied that if the board decides to stay with Prudential, they are U.S. only. The Fund of Funds strategies that NEPC is recommending include some non-U.S. exposure however. There are other value-added funds that are 100% U.S., but the fund of funds typically will have up to 20-25% in non-U.S. components.

Mr. Fleury expressed his concern regarding the cash flow implications of liquidating and transferring funds. He noted that MECRS has a considerable cash position in anticipation of private equity commitments which are difficult to predict. He cautioned that further uncertainty on the timing of capital call in private equity like real estate investments coupled with less than instantaneous access to proceeds upon withdrawal from existing investments might result in cash flow problems. Mr. Leonard played down that concern by stating that MECRS over allocation to cash in recent months had spared it from a decline in equity prices.

Mr. Leonard stated that NEPC would be comfortable with the MECRS's portfolio staying with Prudential and terminating Morgan Stanley to make 60% of target real estate with Prudential.

Summarizing the discussion held during the meeting, Mr. Leonard stated that NEPC is recommending that the board adopt a new investment policy and set the target allocation to 60/40, and to move to a core and value-add strategy. As a first step, MECRS should put in a redemption request with Morgan Stanley and investigate steps to be added to the entry queue with Prudential. The objective would be to match the funding call from Prudential with the availability of proceeds from Morgan Stanley as best as possible. The next step would be for NEPC to bring fund of fund managers before the board for consideration.

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After brief discussion the board agreed that this decision should be delayed until it can be more thoroughly considered by the Investment Committee and it set Monday, January 9, 2012 for that purpose.

Moving on, Mr. Leonard turned the trustee's attention to another handout entitled "MECRS 2012 Work Plan" which had been distributed at the beginning of the meeting by his colleague, Mr. Grzejka. He noted educational sessions for Global Asset Allocation, which he said is a topic which should be revisited. The Work Plan also included the periodic review of performance reports on a quarterly basis and a review of the MECRS asset allocation which can be amended at any point in the year should the need arise.

Given the Work Plan's focus on Global Asset Allocation, Mr. Fleury asked if NEPC was concerned about the performance of the existing manager, Mellon Capital.

Mr. Grzejka replied that NEPC is not concerned about the performance of Mellon. Mellon's positioning has been tilted toward equities over the long run which has helped them. NEPC feels however that a lot more diversification can be added by adding another fund that compliments Mellon.

Next, Mr. Grzejka briefly went over the somewhat dated October Flash Report noting that declines in the third quarter were largely regained and that all the active managers outperformed their indices with the exception of international equities. On the fixed income side of the Flash Report, Loomis Sayles and Standish Emerging Market Debt were up 4.7% and 6.2% respectively.

Changing the focus to the Investment Performance Update through November, Mr. Leonard noted that performance for that month was just the opposite of October with the S&P 500 through November 30, 2011 up 1.1% for the year.

Mr. Fleury asked Mr. Leonard how comfortable he felt about the performance with MECRS' portable alpha manager, Gottex Management.

Mr. Leonard responded that Gottex has only added 40 basis points above the S&P 500 over the last three years and that NEPC's expectation had been that they would have clearly added more. Hedge funds were significantly hurt in 2008 and 2009, however Gottex has shown pockets of opportunity where they added value. He noted that NEPC will continue to closely monitor their performance.

That having concluded NEPC's report and there being no further questions from the board, Mr. Leonard and Mr. Grzejka thanked the board for their time and departed.

Chairperson Comments:

Chairman Pinard reported that due to the lack of a quorum for the November board meeting, the MECRS board could not conduct a meeting. He noted the importance of the trustees' attendance in order for scheduled agenda items to be addressed on time sensitive matters. Chairman Pinard asked whether the present practice of meeting on the second Tuesday of each month was problematic for members and stated that he is open to any suggestions that the trustees may have. There were no comments or suggestions for alternate meeting times.

Trustee Molan noted that he and Trustee Porter will not be attending the February board meeting and so the board should plan accordingly.

Executive Directors Report:

Progress Report on PTG Project - Mr. Fleury reported that MECRS is now live on the Pension Pro pension administration system. After exhaustive tests, the application went live on Monday, October 17th and has been operating well since that time. Mr. Fleury noted that, included in the trustees' packets this month as informational items, are population statistics provided by the new system which were very difficult to compile with the legacy software. He predicted that this type of analytical ability will improve as history is built on the new system and as staff continues to fill gaps in the data structure which were transparent in the past and which resulted from shortcomings in legacy systems and previous data conversion processes.

Release of Retiree Pension Amounts - Mr. Fleury informed the board that in November, MECRS received a request from the Manchester Union Leader for a list of pension recipients, their pension amounts and the names of the city department from which they had retired. After some clarification was received, MECRS provided all the requested information even though, in the strictest interpretation of the Right to Know Law, it may not have been obligated to do so. Ironically, MECRS does not compute or store an annualized pension amount for its retirees. Determining the amount being paid at any given time for a particular month is simple enough but determining an annual amount depends upon a number of variables which can affect total payment in any year. As a result, the Executive Director and the staff had to spend a considerable amount of time to locate all requested information found in multiple sources and compile the information in a single document that was provided to the Union Leader.

Transition to Replacement Server Environment - Mr. Fleury stated that the old MECRS server whose specifications were insufficient to accept an up-to date operating system and whose operating system was no longer supported by Microsoft has been retired. The new machine should serve the organization for the coming decade. It acts as the repository for MECRS files, is the platform from which Great Plains General Ledger, accounts payable and budget operate, and it uses a more reliable procedure for protection against data loss and down time than the previous server.

Annual Audit of Pension Beneficiaries Completed – Next, Mr. Fleury noted that each year, MECRS conducts an audit of pension recipient's beneficiaries to ensure that none have passed away, absent notification to the Retirement System. This is important because pensioners can sometimes forget that a pop-up provision applies and MECRS cannot apply that provision unless it is notified of the beneficiary's passing. Mr. Fleury reported that this year the process of identifying beneficiaries was automated through the use of the new system which went live in mid October. The records identified by the new system were verified by service providers the same day and four previously unknown cases were detected. Because of the ease, speed and reliability of this process, the cases have been resolved and will accurately be reflected in end of the calendar year reporting.

Monthly Cash Flow Reports Revised- Mr. Fleury announced that beginning January 1, 2012, the monthly reports included in the Board packets, which list sources and uses of cash and are reconciled to the State Street cash reports, will consist of two separate sheets. Until now, a schedule of capital calls for long term private equity commitments was included at the bottom of the cash flow report. The size and complexity of that schedule begged for segregation from the cash flow trends contained in the traditional report. That report's primary objective is to provide a gauge for liquidity. Mr. Fleury asked that if the trustees find the change confusing or should they have any questions regarding either schedule, to please let him know.

Administration & Accounting Committee:

Committee Chairman Woitkowski reported that the A&A Committee met the day before to review the 2012 Draft Budget which was approved by the committee and is 23% less than the previous year.

Chairman Woitkowski continued his report by informing the board that with Attorney John Rich was in attendance and the System's Actuary, Mr. Ken Alberts of Gabriel, Roeder, Smith & Co., linked via conference call, that the committee members received a report on potential revisions to Administrative Rule 7, which presently regulates COLA processes. The review of Rule 7 had been requested by the full board earlier in 2011 and was brought before the Committee to ascertain that the direction was clearly understood. After hearing the findings of counsel and the actuary, the committee voted unanimously to have counsel proceed with recommended revisions to Rule 7 and to return with a formal draft which it could then carry forward to the full board.

Mr. Fleury explained that it is the Committee's role to workshop any prospective rules or rule amendments and then to bring them forward to the full board with a recommendation. The full board would then authorize the release of a draft for public comment for a period of 30 days, followed by a public hearing which would be conducted by the full board to hear comments and reflect upon them as a prelude to further action. Following that process, the full board would then have the authority to enact the rule or amendment, defeat it, or remand it back to Committee for further consideration.

Attorney Rich asked Mr. Fleury if the report of the review of Admin. Rule 7 was provided to all the trustees.

Mr. Fleury responded that it was not provided to all the trustees and agreed to send it to them via e-mail.

Turning to the subject of the MECRS 2012 operating budget, Chairman Pinard commented that the 2011 annualized numbers are accurate, but asked Mr. Fleury for clarification regarding the 2010 actual numbers.

Mr. Fleury responded that the 2010 actual costs were lifted from the amounts that went into the MECRS Comprehensive Annual Financial Report.

Next, Chairman Pinard asked about the Pension Pro software which had a budgeted amount in 2010 but did not reflect any expenditure. Mr. Fleury explained that the Pension Pro Project had been in the planning stages for a couple of years and while it might have been conducted in 2010 the project did not commence and no payments were made until 2011.

Referring to the line item, legal fees, Trustee Mercier asked Mr. Fleury to explain the projected, annualized amount of $140,000, when the total for period ending October 2011 only amounted to $66,000. She asked how he had derived at that annualized amount.

Mr. Fleury explained that the amount projected to be spent to the end of the year was just a crude projection and the cited difficulty in projecting the fees that will occur regarding particular legal matters.

Trustee Mercier stated that she felt that from a budgeting prospective, where the budget was recently prepared within the last couple of weeks, and knowing what the November expenses will be, she expected that anticipating the 2011 annualized amount should be pretty accurate.

She asked if the budgeted figures are simply being carried forward, as opposed to projecting what we think is the projected annualized amount.

Mr. Fleury responded that some budget lines are not expended in anything close to a linear manner and that for those lines, anticipated spending is predicated on what has actually transpired in past years. In other cases, where the trend is linear, a formula divides year to date actual by the number of months transpired and then extrapolates to the end of the year. Mr. Fleury reiterated that in budget lines where there is a lot of volatility in the amount of the billing, such as legal fees, it is difficult to predict.

Mr. Fleury stated that he understood Trustee Mercier's concern regarding the inaccuracy of the estimate and he promised to refine his estimation of the line item in the future. He concluded by stating that he would compile statistics over a period of time, showing the volatility in legal fees and forward those results to Trustee Mercier.

It was moved by Trustee Molan to accept the budget for 2012 in the amount of $807,586.02, seconded by Trustee Porter and passed by all those trustees present. Note: Committee Chairman Woitkowski had stepped out of the room and was not present during the vote.

Mr. Fleury noted that there will be a meeting of the Administration & Accounting Committee scheduled for 8:30 a.m., January 9, 2012, to receive a draft of Administrative Rule 7 followed by a meeting of the Investment Committee that same day and scheduled time approximate for 9:30 a.m. or immediately following adjournment of the A&A Committee meeting.

November Consent Agenda:

Trustee Molan moved to accept the November Consent Agenda, seconded by Trustee Mercier and passed unanimously by all those trustees present.

December Consent Agenda:

Trustee Molan moved to accept the December Consent Agenda, seconded by Trustee Woitkowski and passed unanimously by all those trustees present.

Work-Related Disability Request for Michael Bachand - Mr. Fleury explained that the trustees packets included a recommendation for Mr. Bachand, who has filed for a work-related disability and has completed all the requirements on time as well as attending the two IME appointments showing the disability to be total and permanent. Mr. Fleury stated that it is his recommendation that the board find favorably in the request for disability retirement.

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It was moved by Trustee Molan to grant the work-related disability request for Mr. Michael Bachand, seconded by Trustee Mercier and passed unanimously by all those trustees present.

<u>Request For A Motion</u> – Mr. Fleury informed the trustees of a cost over-run in the budget line for membership in the National Council of Public Employee Retirement Systems (NCPERS) in the amount of $50 and he requested a transfer of funds from the advertising expense line to the NCPERS dues line to cover the shortfall. Mr. Fleury also requested a transfer of $493 for a cost over-run for insurance on security and privacy coverage with proceeds to come from a surplus in the line for Officers and Directors insurance. In total, the two transfers amount to $543 but do nothing to increase the total authorized amount of the budget for 2011.

It was moved by Trustee Molan to accept the requested transfer of funds, seconded by Trustee Woitkowski and passed unanimously by all those trustees present.

Chairman Pinard noted for the record that the next scheduled board meeting will be held on January 10, 2012 at 8:30 a.m.

<u>Motion to Adjourn:</u>

Having completed all of the items of business for the day, Chairman Pinard entertained a motion to adjourn. Trustee Woitkowski moved to adjourn at 10:12 a.m. seconded by Trustee Molan and passed unanimously by all those trustees present.

Respectfully Submitted,

Gerard E. Fleury
Executive Director