October 11, 2011
Minutes #474

Minutes of the Board of Trustees' Meeting -1-

Call to Order: Chairman Pinard called the meeting to order at 8:37a.m.

Present: Trustees: Chairman Pinard, Richard Molan, Michael Woitkowski, William Sanders and Dianne Mercier arrived at 8:49 a.m. and departed at 10:33 a.m.

MECRS Staff: Gerard Fleury, Sandi Aboshar and Suzanne Wilson

Absent: Trustees: Paul Porter 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 August 9, 2011:

Trustee Molan moved to approve the minutes of the meeting of August 9, 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 Woitkowski, and passed unanimously by all those trustees present.

New Business:

Discussion on "Value Added" private real estate investment opportunities – Chairman Pinard called upon NEPC representatives; Mr. Kevin Leonard and Mr. Sebastian Grzejka, to present their materials and facilitate discussion on investment opportunities in real estate program and to deliver NEPC's recommendation to the Board

Mr. Leonard began NEPC's presentation by stating that Mr. Grzejka would first provide a review of the August 31, 2011 Investment Performance "Flash" Report and a general third quarter market update.

Mr. Grzejka noted that because the August results were stale at this point, he would focus on the year-to-date column of the Flash Report. He reported that because of cumulative losses incurred since the start of the year that the System's portfolio is down 1% since January first. Mr. Grzejka

Minutes of the Board of Trustees' Meeting -2-

Then began a review by manager noting that the Mellon composite was down 80 basis points since the start of the year but that it compared favorably to the S&P500 which was down 1.8%.

Continuing his presentation, Mr. Grzejka next focused on the equity mangers segment, reporting separately on the domestic equity and the international equity composites. He explained that in periods of heightened volatility like those experienced over the past couple of months, the expectation should be for value managers to outperform their relative indices, especially protecting in downside scenarios. For the most part, the report indicated that MECRS managers were achieving that objective.

Mr. Leonard stressed the value of the manager's role by calling attention to the five year composite return on the international equity. He pointed out that the benchmark is down 80 basis points while the MECRS portfolio is up 5.2%, and he attributed that substantial outperformance to the manager's skill.

Moving on, Mr. Grzejka reported on the fixed income composite, year-to-date, with Income Research & Management up 5.6% and Loomis Sayles, up 5.3%. The first month of performance with Standish Emerging Market Debt was down about 60 basis points however, which Mr. Grzejka attributed to the volatility.

Mr. Grzejka addressed Hedge Fund of Funds next, and the stated that while he felt that Permal Asset Mgmt. and Archstone Investments would do better in the in the long term, they were unfortunately down during the month of August, 4.2% and 3%, respectively.

Mr. Grzejka informed the trustees that real asset manager; Wellington Diversified Inflation Hedge continues to do well and is up slightly year to date.

Having completed a cursory review of the Flash Report, Mr. Grzejka turned the trustee's attention to a Third Quarter Market Update booklet which had been distributed. He explained that the booklet provides a detailed explanation of the third quarter which he described as a challenging market environment with key fundamental risks. Directing their attention to the Investment market update as of September 30, 2011, Mr. Grzejka noted that any kind of fixed income investment was up year to date, with the exception of the Barclays high-yield index. On the equity side, the MSCI EAFE is down 15% and domestically, the S&P 500 is down 8.7%. Emerging Markets also has a poor showing, down 22%.

Trustee Sanders voiced his concern on the declining markets and asked Mr. Leonard if the Plan should be thinking about a more conservative posture in the market such as gold and commodities.

Minutes of the Board of Trustees' Meeting -3-

Mr. Leonard responded that most pension plans are below 60% funded. NEPC at this point has not recommended to their clients that they should be allocating specific allocations to gold; however, NEPC continues to research the potential for gold in portfolios. Mr. Leonard reminded the Board that if the they contemplated amending the portfolio's structure to obtain a more defensive posture then they would need to lower the return assumption which would increase the employer contribution rate.

Trustee Sanders stated that the City has been putting more money into the Plan over the last 10 years. He reiterated his concern over the next three to five years and stated that the Plan could be in serious trouble and that the City could be called upon to fund more than twice as much than it does at present.

Mr. Leonard replied that when looking at the 2011 assumptions, NEPC modeled the System's portfolio, looking out over five to seven years. In doing so, the return came in around 6-61/2 %. Also he noted that NEPC did not forecast a 10% loss in 2011.

The board continued to discuss at length the effects of the assumed rate of return in the System's portfolio.

Mr. Leonard noted that NEPC has been recommending that their clients lower their equity exposure to be more diversified and replace equities with a global asset allocation mandate which allows the managers to make shifts within their portfolio in response to market conditions. He stated that MECRS has already done that to a greater extent than many plans and he further noted that in light of other long term investments which tend to be illiquid, if a pension plan needs investment income for operations, NEPC would recommend that liquidity sources come 100% from fixed income.

Mr. Leonard felt the importance of noting that over the last 10 years, the System's composite is up 6% so that the System has underperformed the assumed rate of return and accrued more liabilities; however, a 6% return over the last 10 years, in light of the declining market is pretty good.

Trustee Sanders replied that the current economic situation is very poor and it just doesn't seem to be getting any better. No one is talking about a solution to the problem and expressed concern about what will happen within the next 18 to 24 months. He stated that he believes that the asset return rates are going to decline and the City of Manchester will be in serious trouble.

Trustee Mercier expressed a concern that there could be a fundamental flaw in the Pension Plan given the current environment. She stated that a defined benefit plan could be a dinosaur and that Corporate America has figured that out in moving to defined contribution plans. The current portfolio is being managed with a 7 to 8% return expectation and she further stated that running it and investing in it with a 7 to 8% return assumption is not a problem for a young, newly hired Plan Participants, but might not be suitable for the current retirees and those contemplating retirement. For an older segment of the population, given market conditions, those assumptions may not work.

Mr. Leonard spoke about the current volatility and the irrational behavior of investors, which drives the market. Strategies are changing drastically, he noted. Some Public Plans have closed their Defined Benefit (DB) Plans and switched to the Defined Contribution or Hybrid Plans.

Trustee Sanders reiterated Trustee Mercier's comments and voiced his concern for what might happen in the coming months. The trustees continued to discuss their role and due diligence to the Plan as well as the role of the Board of Mayor and Aldermen and the MECRS Advisory Committee.

Having completed the report on market performance, Mr. Leonard began the presentation on a potentially expanded MECRS Real Estate Allocation with a long term target allocation of 5%. He noted that the entire current real estate allocation is invested in private real estate which has been a great hedge to inflation. Referring to a chart in a Real Estate Market Update booklet which had been distributed, Mr. Leonard noted that the RMK Timber investment is currently included at a value of $2.7 million, which is one parcel of land.

Mr. Leonard turned the presentation over to his colleague Mr. Grzejka to elaborate further on the real estate portfolio construction and target allocations. Referring to a chart, Mr. Grzejka explained the investment strategies of core, value-added and opportunistic real estate as well as providing detailed examples of potential target allocations.

Mr. Leonard directed the trustees' attention to page 23 of the presentation booklet and stated that NEPC sees more of an opportunity in "value-added" and "opportunistic distressed" type real estate, due to the current environment. He further noted that NEPC's recommendation is for MECRS to adopt new target sub allocations to real estate which would focus on 60% Core and 40% Value-Added & Opportunistic investments. The overall portfolio target of 5% to real estate would not change. Given today's assumptions in place, Mr. Leonard explained to the trustees that the model expected rate of return would be 8.5%, with 60% coming from income and 40% coming from capital appreciation. NEPC would also like to see MECRS consolidate core real estate to one manager and determine the role of the RMK Investment within the overall real estate allocation.

Mr. Leonard reiterated NEPC's recommendation of adopting a value-added & opportunistic mix and for MECRS to consider a Fund of Fund structure, hiring a manager that would manage multiple underlying funds.

Mr. Leonard made reference to a report which has been distributed in which NEPC recommends Fund of Fund Manager, Siguler Guff & Co, LLP as a possible candidate for a FOF manager role.

Mr. Fleury asked Mr. Leonard if there were other Fund of Fund Mangers that NEPC would consider.

Mr. Leonard explained that the Siguler Guff Real Estate Opportunities Fund is supported by NEPC and NEPC is suggesting that the System allow Siguler Guff to come before them for consideration but that other Fund of Fund Managers could be available early next year. There was little indication that the Board was disposed to pursue the recommendation so aggressively and so no action was taken.

Moving on, Chairman Pinard called for a roll call vote to go into executive session at 9:59 a.m. pursuant to RSA91A:II(d) "for the acquisition sale or lease of personal property of which, if discussed in public, would likely benefit a party or parties who's interests are adverse to those of the general community".

Roll Call Vote:

Ayes: Messrs. Pinard, Woitkowski, Molan, Mercier and Sanders

Nays: None

Motion Carried.

Roll Call Vote to end executive session and resume the board meeting at 10:32 a.m.

Ayes: Messrs. Pinard, Woitkowski, Molan, Mercier and Sanders

Nays: None.

Motion carried

NEPC Representative, Mr. Leonard and Mr. Grzejka thanked the board for their time and departed.

Executive Directors Report:

Progress Report on PTG Project - Mr. Fleury reported that the System continues to move toward a "go live" date for the new pension administration system. Every caution is being taken to ensure that the new system is performing accurately and implementation is not being rushed as the new system is tested for functionality. The obsolete MECRS server on which the Systems' general ledger and budget systems operate has been replaced and is also in parallel test mode. Once the pension administration system goes live, legacy hardware which operates on an operating platform which is no longer supported by the manufacturer will be discontinued.

Budget Formulation for 2012 Underway - Next, Mr. Fleury informed the board that the DRAFT 2012 MECRS Operating Budget was presented this morning to the Administration & Accounting Committee. Owing to the completion of important technological updates in 2011, the total expenditure level for 2012 will reflect decreases in a number of lines associated with technology.

Other line by line changes are not expected to be significant and the A&A Committee will be reviewing the budget in the coming months.

Earthquake & Hurricane Damage to Commercial Real Estate - Since the last meeting, Mr. Fleury noted that an earthquake and a hurricane have both occurred along the east coast of the U.S. where some of MECRS commercial real estate holdings are located. Reports on both events indicate that no meaningful damage resulted from either event.

Report on 5% Holdback by Attalus Capital – Mr. Fleury stated that in the process of terminating Attalus Capital and trying to determine when the final proceeds from liquidation, ($335,091.06) would be distributed, a was reminded of a paragraph on page 17 of the subscription agreement which reads: "With respect to each full redemption, payment of ninety-five percent (95%) of the redemption proceeds will be made (as detailed above) and the Investment Manager will establish a reserve equal to five percent of the remaining redemption proceeds pending the audit of the Fund's books and record for the fiscal year in which the redemption occurs."

Since the fiscal year ends on December 31st for Attalus and since an audit of the fund takes six months or more, the System is not likely to receive the 5% retainer until the summer of 2012. As a result, Mr. Fleury informed the board that they have begun seeing an accounts receivable on the monthly balance sheets which represents the amount of the retainer.

Revised Service Credit Upgrade Worksheets & New Additional Contribution Worksheets - Mr. Fleury reported that because the Additional Contribution Program has gained popularity and has seen increased participation, an internal review of controls on contribution limits was conducted and a few compliance questions arose. The issues of concern were documented in a letter to counsel on August 23, 2011 and a reply was received on September 22, 2011 containing a number of recommendations. Mr. Fleury noted that contribution limits have not been exceeded by any plan participant but as the program has seen greater interest, the case could be made for improved controls. Acting upon counsel's letter of September 22, 2011, an existing contribution limit worksheet for service credit upgrades was revised and a new and similar worksheet was implemented for the Additional Contribution Program. These changes should posture MECRS well to ensure that IRS contributions limits are not inadvertently exceeded by any plan participant who elects to participate in either or both of the optional programs.

In concluding his Executive Directors Report, Mr. Fleury announced that the System has received its' eighth Public Pension Coordinating Counsel Award. Mr. Fleury explained that the PPCC Award is a distinguished award that recognizes a well structured Plan and its administrative practices and policies.

Report of the Administrative & Accounting Committee:

Committee Chairman Woitkowski updated the board that at its A&A meeting held just prior to the Trustees' Board Meeting, the committee reviewed the DRAFT 2012 budget and it has been tabled for further review at this time.

Elaborating further, and given the presence of Attorney Rich, Mr. Fleury reminded counsel that the A&A Committee is waiting for a recommendation from legal counsel on potential revisions to the COLA regulation and Attorney Rich noted the concern.

Consent Agenda:

Trustee Molan moved to accept the September Consent Agenda seconded by Trustee Sanders and passed unanimously by all those trustees present.

Trustee Molan moved to accept the October Consent Agenda seconded by Trustee Sanders and passed unanimously by all those trustees present.

Chairman Pinard posed a question on the effects to the Plan by MECRS participants who elect to delay their retirement past normal retirement age.

Mr. Fleury responded that to the best of his knowledge, there is no effect to the Plan as long as the required annual contribution is being met. The delay by a member in filing for retirement would have no impact on the funding ratio of the Plan.

Mr. Fleury explained that a key condition that can affect cost of operating the Plan, expressed as a percentage of wages is, if a member retires and there is a decision not to fill the position they vacate, it then it causes the accrued liability which was associated with that position to be distributed across all of the remaining Plan Participants.

Trustee Molan expressed his concerns and stated that he is in agreement with the sentiments of Trustee Sanders and Trustee Mercier regarding the funding of the Plan. He then inquired as to the mission of the MECRS Advisory Committee.

Chairman Pinard responded that the Advisory Committee is a group of representatives from selected departments within the City that only has authority to communicate membership concerns to the board as well as making any recommendations for the Plan.

Trustee Molan suggested that the board consider scheduling a meeting with the Advisory Committee regarding the current economic environment the current investment performance of the Plan, simply to educate Advisory Committee Members as to future possibilities.

Trustee Sanders suggested continued discussion by the board on the seriousness of the past months and current market conditions, at the November 8th board meeting as well as requesting a revised liquidity study from NEPC.

Motion to Adjourn:

Having completed all of the items of business for the day, Chairman Pinard entertained a motion to adjourn. Trustee Molan moved to adjourn at 10:50 a.m. seconded by Trustee Woitkowski and passed unanimously by all those trustees present.

Respectfully Submitted,

Gerard E. Fleury
Executive Director