

November 10, 2015
Minutes #517

Minutes of the Board of Trustees' Meeting -1-

- Call to Order:** Chairman Pinard called the meeting to order at 8:35 a.m.
- Present:** Trustees: Donald Pinard, William Sanders, Bob Lynch and Dianne Mercier
MECRS Staff: Gerard Fleury, Sandi Aboshar and Suzanne Wilson
- Absent:** Michael Woitkowski and Mayor Gatsas
- Excused:** Dick Molan
- In Attendance:** Attorney John Rich of the McLane Law Firm, Kevin Leonard and Sebastian Grzejka, both of NEPC

Approval of the Minutes of the Previous Board Meeting:

Chairman Pinard entertained a motion to approve the previous board minutes of August 11, 2015.

Trustee Lynch moved to approve the board minutes of August 11, 2015, seconded by Trustee Sanders and passed unanimously by all those trustees present.

Approval of the Immediate Meeting Agenda:

Trustee Lynch motioned to approve the immediate meeting agenda, seconded by Trustee Sanders and passed unanimously by all those trustees present.

Report of the Executive Director – September , October & November

Computer Issues with Imaging System: Beginning with the September report, Mr. Fleury reported that the computer system used to scan and catalogue member documents, ceased to be usable sooner than originally anticipated. He explained that the machine was to have been replaced in 2016 but storage capacity was exhausted and immediate attention to the problem was required. The operating systems and hardware architecture for that machine were so obsolete that software upgrades and hardware replacement were both required. He further indicated that there has always been a contingency appropriation in the budget for exactly such events and so steps have been taken to update the process before an extensive backlog of documents could accumulate.

Research on Website and Security Issues Continues: Mr. Fleury informed the board that discussion on website upgrades and security concerns have been addressed and that cost estimates for each project have been included in the budget for 2016.

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Preparation for Affordable Care Act Compliance: Mr. Fleury explained that a “dry run” of Affordable Care Act reporting was completed using actual data for 2014, which will make compliance for 2015 straightforward. The forms are ready for submission at the close of 2015.

MECRS Budget Review: Originally, Mr. Fleury stated, the draft MECRS budget review had been scheduled for October, however, the review by the Administration & Accounting Committee was re-scheduled and the committee met last Thursday, November 5, 2015. Mr. Fleury indicated that at the December Board of Trustees meeting, Committee Chairman Woitkowski will deliver his report of the A&A meeting, inclusive of the committee’s recommendation for the MECRS 2016 Administrative Budget.

Document Upgrade Completed: Moving on to the October report, Mr. Fleury stated that for a number of years, organizations which provide forms to their clients via a website have migrated to a format which the client can type in using Adobe Reader. Mr. Fleury was pleased to announce that MECRS recently obtained the software necessary to convert all of its forms to forms which can be typed in and the entire forms inventory has been converted and loaded to the MECRS website.

Attendance at Berry Dunn Seminar: Mr. Fleury reported that on September 24th, he and Executive Assistant, Ms Sandi Aboshar, attended a free seminar sponsored by Berry Dunn which included segments on Solutions for Affordable Care Act Implementation and also Protecting Assets through Information Technology Security and Internal Controls. He stated that the information gained, allows staff to plan more effectively for future IT security checks and to improve understanding and ensure compliance with ACA requirements..

Attendance at HealthTrust Seminar: One September 29, 2015, Mr. Fleury attended a free seminar sponsored by Local Government Center and HealthTrust on the Future of Healthcare Coverage in NH, Cadillac Tax Strategies, Plan Design Strategies to Contain Costs, and Empowering Employees to Engage in their own Healthcare. He stated that obtaining facts on trends and strategies will be helpful in providing effective benefits in the future for the least cost.

Cash Flow and Investment Activities: Mr. Fleury indicated that, as is customary during the summer months, contribution revenue dropped, as many school district participants were not in pay status during the school summer vacation period. However, reduced revenues, combined with monthly annuity payments which now exceed \$1.2 million, caused the level of MECRS operating cash to decline. Adding to the decline, Mr. Fleury reported, was a final capital call on the real estate commitment to PRISA in the amount of \$1.4 million at the end of September. With the PRISA funding completed, that still leaves the System’s portfolio with over \$8 million in future unfunded commitments to private equity and private debt obligations. Exchange – Traded Funds previously allocated by the board to meet those needs have been fully utilized

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after \$2 million was redeemed in October and November to meet obligations to the end of the year.

Recent Events with Property Lien: Referring to his November report, Mr. Fleury briefed the board on an ongoing situation discussed at prior meetings whereby the System took the relative of a deceased member to small claims court in order to recover an overpayment, which was inappropriately collected and spent by the defendant. Mr. Fleury further explained that the court directed the defendant to make monthly payments in restitution and that it would take 8 years to recover the entire overpayment. Subsequent to the court's decision, the System placed a lien on the defendant's property. While monthly payments have been forthcoming, Mr. Fleury was pleased to report that the property in question has come up for short sale and the System's lien is blocking the sale. Mr. Fleury indicated that the System has been offered a lump sum cash settlement of the amount owed in exchange for a release which will allow the System to close the matter. Steps are being taken to ensure that the title is not released until the System has been paid.

Privatization of School Food & Nutrition Services: Mr. Fleury informed the trustees that he had become aware of a pilot study on the privatization of the School Food & Nutrition Program. That pilot study is reportedly underway at one Manchester School. He indicated that it is too soon to tell what, if anything, will come from this pilot, but should a decision be made to privatize SFN Services, it could result in fewer MECRS plan participants. Mr. Fleury stated that he will continue to monitor the situation since a permanent reduction in the number of plan participants could have an impact on the accrued liability and that further reports will follow as the situation develops.

New Monthly Cash Flow Report: In closing his report to the board, Mr. Fleury referred to Informational Item #2, in the trustees agenda packets, MECRS Cash Flow Report. He informed the board that moving forward, the new report will replace a cash reconciliation chart for the most recently closed month. The Cash Flow Report contains cumulative values by income and expense category and reveals the extent to which the fund pays out more than it takes in. The report will provide valuable information, he stated, at times when the board is asked to make investment decisions or decide on the affordability of anything which requires cash expenditures. Mr. Fleury went on to report that for the third quarter, the Fund is down \$4 million which is not necessarily alarming, in light of one time capital calls which have now been satisfied. Mr. Fleury also indicated that he will be providing NEPC with the new Cash Flow report on a monthly basis.

Report of the Administrative & Accounting Committee: Due to the absence of Committee Chairman Woitkowski, Mr. Fleury reported that an A&A Committee meeting was held on Thursday, November 5, 2015, and that there was not adequate time to summarize the results of the meeting and including them for consideration by the full Board did not exist. Committee Chairman Woitkowski will, therefore, deliver his report at the MECRS December board meeting, inclusive of a recommendation on the MECRS Administrative Budget for 2016, for the full board's consideration.

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Report of the Investment Committee:

Due to the absence of Committee Chairman Molan, Mr. Fleury delivered the report of the MECRS Investment Committee held Thursday, August 13, 2015.

He informed the board that in addition to Committee Chairman Molan and himself, present were Committee Members Mike Woitkowski and Bill Sanders, NEPC Consultants Kevin Leonard and Sebastian Grzejka as well as Executive Assistant Sandi Aboshar.

Mr. Fleury reported that the objective of the meeting was to formalize a "Pacing Plan" which NEPC has previously addressed in only general terms, and to also discuss sector performance for assets classes whose longer term returns have not positively contributed to the current earnings assumption for the Plan.

Mr. Fleury provided a summary of the "Pacing Plan" stating that NEPC representatives addressed the firm's view on energy related opportunities and recommended that in the fall timeframe that MECRS interview private energy investment opportunity managers to help fill the balance of the target allocation to real estate and real assets. Along those same lines, NEPC recommended the MECRS consider an additional investment in real estate. NEPC was asked to include DSF (Digital Solidarity Fund) when vetting potential real estate managers and they agreed to do so.

Mr. Fleury stated that the committee discussed the portfolio performance review in some detail with the NEPC representatives, in light of a few sectors which have experienced losses in recent years or since inception. Discussions included the possibility of making the present earnings assumption for the next few years.

Mr. Fleury reported that as a result of the Investment Committee's meeting with NEPC, the committee voted to move NEPC's recommendations on energy opportunities and real estate, forward, for approval by the full board. Also, Mr. Fleury stated that NEPC plans to return to the board with recommendations for slight changes in the asset allocation model, designed to improve the return expectation within the liquidity constraints faced by the System.

Mr. Fleury then indicated that if Committee Chairman Molan had been in attendance, he was planning to offer a motion that the MECRS Board accept the recommendation of NEPC to conduct interviews with managers in the private energy and real estate asset classes, and to move closer toward the present target allocation for real estate and real assets.

Chairman Pinard expressed his concern with the potential motion, and stated that in light of the board's recent negative cash flow discussion, he asked for clarification and rationale on NEPC's recommendation, that MECRS move towards the real estate allocation.

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Trustee Sanders agreed with Chairman Pinard's concerns and stated that the Investment Committee did not totally embrace the strategy of moving forward with the private energy opportunities and real estate, however, NEPC believed it to be a significant investment opportunity.

Trustee Mercier recapped the motion, stating that the recommendation was only to conduct interviews with the potential managers and to explore the investment opportunities.

Trustee Sanders felt that the board should continue to have a broad conversation on investment opportunities and that the interviews should be part of the board's discussion and consideration moving forward. He also stated that in his view, the System's current assumed rate of return of 7.25% should be reviewed and possibly lowered. Trustee Sanders also expressed his view that the overall investment policy should be expanded to possibly move towards more preservation of capital.

Trustee Sanders moved to have accept the recommendation of the investment consultant to arrange interviews with potential managers in private energy opportunities and in real estate.

For discussion purposes, Chairman Pinard seconded Trustee Sanders motion, to accept NEPC's recommendation to arrange interviews with recommended managers in private energy opportunities and in real estate.

Upon the arrival of NEPC Consultants, Kevin Leonard and Sebastian Grzejka, Mr. Fleury recapped the pending motion, authorizing NEPC to arrange interviews with managers in real estate and to explore private energy opportunities.

Chairman Pinard provided the consultants with a summary of the trustees earlier discussion regarding the board's concerns on cash flow, preservation of capital, and energy opportunities.

NEPC Representative Sebastian Grzejka stated that NEPC strongly believes in the allocation of private energy and real estate, both being private equity like vehicles, however, it would require some lock-up of capital, which would be counter to the cash flow needs of the MECRS portfolio.

Mr. Grzejka mentioned that recently, Executive Director Fleury reached out to NEPC regarding his concerns of cash flow and the impact of future commitments in the private side of the portfolio.

Mr. Fleury referred to the new Cash Flow Chart in the trustee's agenda packets and pointed out that an illiquid investment can be mutually exclusive from its cash flow components. He cited illiquid investment managers from the chart where the income component is being returned to the System which is helping to fund the cash flow requirements.

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The board continued to discuss the rationale of illiquid investments, as well as the long term forecast as investments mature.

Mr. Grzejka detailed NEPC's Pacing Plan and the Liquidity Study along with the recommendation to use the S&P Index Fund as a source of capital calls. The model indicated that there would be enough distributions coming in from the private equity portfolio and the private debt portfolio. He suggested a review of the model at the beginning of 2016.

Trustee Mercier asked for NEPC's outlook on investment opportunities with the rising interest rates.

Mr. Grzejka responded that from the standpoint of real estate, which is one of the areas NEPC is recommending, that traditional trophy properties are less attractive and don't offer an attractive investment opportunity in the near term. Mr. Leonard indicated that value added real estate was a possible alternative with the other being a foray into European real estate opportunities which he described as being very timely.

Mr. Fleury noted the size of the MECRS portfolio and asked the NEPC representatives if they would be recommending the hiring of new real estate managers or adding to the Fund's existing core managers. Also, Mr. Fleury noted that other public plans actually hire real estate advisors for the real estate sector of their portfolio and he questioned NEPC's comfort level on selecting the managers.

Mr. Leonard stated that NEPC does have the expertise to advise on the real estate sector, and has an exceptional real estate/real asset investment team.

Mr. Grzejka explained that there is a potential to build up the allocation with current manager PRISA, however, NEPC is not comfortable with a recommendation to add to TA Associates, due to a significant amount of turnover within the firm, with the departure of four senior staff members.

Next, NEPC advisors and the board had a lengthy discussion regarding REITs allocation.

Mr. Fleury inquired as to the timeframe regarding the real estate manager selection and the funding amount in which NEPC is recommending. Mr. Leonard replied that NEPC will begin the process of choosing real estate managers to be reviewed as well as the funding commitment, but he offered no dates at the present time.

In response to comments by Trustee Sanders relating to the positive impact of lowering the assumed rate of return which included greater predictability in meeting the earnings assumption on an annual basis, Mr. Leonard stated that he agreed with Trustee Sanders reasoning for the

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MECRS board working to lower the investment rate of return. The board discussed the possibility of investment policy changes as well as lowering the MECRS earnings assumption.

The board continued to discuss the actuarial and investment assumptions, and the desired level of risk within the MECRS portfolio.

Mr. Leonard stated that when discussing investment risk, it's not how to lower the risk, it's how to allocate the risk. He opined that MECRS is not in an environment to have a very low risk portfolio.

Executive Director Fleury stated that NEPC is very strong on active management and inquired about the role of active management in achieving positive returns. He asked if the NEPC representatives were looking at manager selection within the composition of the portfolio as well as which sector they plan on allocating to.

Mr. Leonard stated that NEPC does feel strongly that over time, active management will add incremental alpha on a net of fee basis. NEPC predicts, based on future environment expectations, that active managers will outperform the indices.

Trustee Sanders moved to accept NEPC's recommendation that the MECRS board conduct interviews of value added managers for the board's consideration. Trustee Mercier seconded the motion and the motion passed unanimously by all those trustees present.

Regarding the motion, Attorney Rich suggested an additional motion be in order that would give authorization to NEPC to come back with alternative asset allocation models for the board's consideration.

Trustee Sanders moved to authorize NEPC to submit asset allocation models, with different variables, for the boards review and consideration, seconded by Trustee Mercier and passed by all those trustees present.

New Business:

Investment Status Update – Mr. Fleury asked that the board entertain a motion granting him authorization to liquidate portions of the S&P 500 Exchange Traded Fund in order to be able to make payroll and other commitments.

Rather than liquidating funds from the S&P 500 ETF, Trustee Sanders suggested that Executive Director Fleury present an estimate of the funds needed at the December board meeting. He recommended that alternate funding sources be included in that summary.

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Consent Agenda:

Trustee Mercier moved to approve the Consent Agenda for September, October & November, seconded by Trustee Lynch and passed unanimously by all those trustees present.

New Business:

Request For Motion – Mr. Fleury explained that a request to re-authorize the original action of the Board taken December 17, 2006 , granting authority to the Executive Director to obtain health insurance coverage for staff, by enrolling in the Local Government Center, (LGC) and such authorization should now reflect the organization's new name, Health Trust New Hampshire.

Trustee Sanders moved to grant authority to the executive director to obtain health insurance coverage for staff in Health Trust New Hampshire, seconded by Trustee Lynch and passed by all those trustees present.

Motion to Adjourn:

Having conducted all the business of the day, Trustee Lynch moved to adjourn the meeting at 10:16 a.m. seconded by Chairman Pinard and passed unanimously by all those trustees present.

Respectfully Submitted,

Gerard E. Fleury
Executive Director

