Joint Meeting of the Investment Advisory Committee and Board of Trustees

May 17, 2016

ERS

Employees Retirement System of Texas

Presented for Review and Approval
August 16, 2016

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JOINT MEETING OF THE
BOARD OF TRUSTEES AND
INVESTMENT ADVISORY COMMITTEE
EMPLOYEES RETIREMENT SYSTEM OF TEXAS

May 17, 2016
ERS Auditorium
200 E. 18th Street
Austin, Texas 78701

<u>COMMITTEE MEMBERS PRESENT</u>
James "Jim" Hille, Chair
Robert "Bob" Alley, Member
Ken Mindell, Member
Lenore Sullivan, Member
Vernon Torgerson, Member

<u>COMMITTEE MEMBERS ABSENT</u>
Caroline Cooley, Vice-Chair
Monty Jones, Member
Laura Starks, Member

<u>TRUSTEES PRESENT</u>
I. Craig Hester, Chair
Doug Danzeiser, Vice-Chair
Brian Ragland, Member
Ilesa Daniels, Member

<u>TRUSTEES MEMBERS ABSENT</u>
Cydney Donnell, Member
Frederick E. (Shad) Rowe, Jr., Member

<u>ERS STAFF PRESENT</u>
Porter Wilson, Executive Director
Tom Tull, Chief Investment Officer
Catherine Terrell, Deputy Executive Director
Sharmila Kassam, Deputy Chief Investment Officer
Paula Jones, General Counsel and Chief Compliance Officer
William Nail, Special Projects and Policy Advisor
Tony Chavez, Director of Internal Audit
DeeDee Sterns, Director of Human Resource
Kelley Davenport, Executive Office
Christi Davis, Customer Benefits
Machelle Pharr, Chief Financial Officer
Pablo de la Sierra Perez, Investments
Leah Erard, Governmental Affairs
Robin Hardaway, Customer Benefits
Neil Henze, Investments
Andrew Hodson, Investments
Robert Lee, Investments
Jonathan Puckett, Internal Audit
Tim Reynolds, Investments
Tanna Ridgway, Investments
Leighton Shantz, Investments
Robert Sessa, Investments
John Streun, Investments

Chris Tocci, Investments
Mary Jane Wardlow, Governmental Affairs
Karla West, Investments
Keith Yawn, Office of Management Support
Betty Martin, Investments
Gabrielle Stokes, Director of Procurement and Contract Management
Brannon Andrews, Legal
Amanda Burleigh, Legal
Cheryl Scott Ryan, Legal
Wesley Gipson, Investments
Tony Cardona, Investments
Annie Xiao, Investments
Ken McDowell, Investments
Amy Cureton, Investments
Tom Roberts, Investments
Andrew Okun, Investments
Benjamin Bowman, Investments
Adam Cibik, Investments

ALSO PRESENT
Kristen Doyle, Aon Hewitt
Andrew Clark, Office of Speaker Joe Straus
Bryan Burrham, Pension Review Board
Joseph Halbok, Office of Senator Schwertner
Bobby Wilkinson, Office of the Governor
Laura Zarate, TCEQ
Dan Krivinskas, RVK
Mark Bartmann, RVK

Mr. Jim Hille, Chair of the Investment Advisory Committee (IAC) for the Employees Retirement System of Texas (ERS), called the meeting to order and read the following statement:

> "A public notice of the Joint Meeting of the Board of Trustees and Investment Advisory Committee containing all items on the proposed agenda was filed with the Office of the Secretary of State at 9:03 am on Thursday, May 5, 2016 as required by Chapter 551, Texas Government Code, referred to as 'The Open Meetings Law.'"

IV. REVIEW AND APPROVAL OF THE MINUTES TO THE FEBRUARY 23, 2016 JOINT MEETING OF THE BOARD OF TRUSTEES AND INVESTMENT ADVISORY COMMITTEE

Ms. Lenore Sullivan introduced a revision in the minutes to the Board of Trustees (Board) and Investment Advisory Committee. The Investment Advisory Committee then took the following action:

> **MOTION** made by Mr. Bob Alley, seconded by Ms. Lenore Sullivan and carried unanimously by the members present that the Investment Advisory Committee approve the amended minutes of the February 23, 2016 Joint Meeting of the Board of Trustees and Investment Advisory Committee.

The Board of Trustees then took the following action:

> **MOTION** made by Mr. Doug Danzeiser, seconded by Mr. Brian Ragland, and carried unanimously by the members present that the Board of Trustees approve the amended minutes of the February 23, 2016 Joint Meeting of the Board of Trustees and Investment Advisory Committee.

V. REVIEW AND DISCUSSION OF THE INVESTMENT PERFORMANCE FOR FIRST CALENDAR QUARTER 2016

Ms. Sharmila Kassam, Deputy Chief Investment Officer, and Ms. Kristen Doyle, consultant from Aon Hewitt, presented the review and discussion of the investment performance for the first calendar quarter of 2016.

Ms. Kassam reminded the Board of the new performance presentation format and that staff continues to seek Board's input on their thoughts on effective reporting. Ms. Doyle began the presentation of the Fund's performance. In accordance with the contract for performance evaluation services and Section 3 of the Employees Retirement System (ERS) *Investment Policy*, Aon Hewitt (Aon) reviews and evaluates, on a quarterly basis, the ERS investment performance as calculated by ERS custodian BNY Mellon.

Ms. Doyle focused on performance at a Trust level. She mentioned that the markets have been volatile and short-term performance was difficult the past couple of quarters. Absolute returns in particular for public markets have been fairly muted.

The performance for the total fund for the calendar year to date was 0.4% compared to the benchmark of 1.5%, and the fiscal year to date total fund performance was 0.9% compared to the benchmark of 2.4%. Ms. Doyle explained that 2016 was actually the third most volatile year in markets since the 1930s. After much market volatility, global equities ended up basically flat for the first quarter of 2016, and rates continue to fall.

Ms. Doyle presented the long term public benchmarks. The Fund has outperformed the policy benchmark over the 10- and 15-year period. The comparison of other benchmarks showed the importance of diversification, especially to combat volatility, as well as the current low return environment.

During this quarter, $220 million was deducted from the Fund through net additions/withdrawals and $98.7 million in investment returns was added. The Trust started the quarter at about $24.9 billion and ended the period with a market value of $24.8 billion. The Trust underperformed by 103 basis points (bps) for the quarter, and underperformed by 81 bps for the trailing 12-month period.

Ms. Doyle discussed the performance of the asset classes. During the trailing 12-month period, there was an underperformance and negative allocation effect in global public equity. The negative allocation effect was driven by an overweight to global public equities and an underweight to U.S. Treasuries in a period of time where equities were performing poorly and U.S. Treasuries were performing well.

In terms of global public equity, domestic equity and international equity underperformed their respective benchmarks for the quarter and the one-year period. Regional equity returns were notably varied over the quarter, with U.S. equities performing better relative to other developed regions. Both the internal and external portfolios underperformed, specifically, the internal large cap core portfolio and Barrow Hanley, which is an external advisor within the domestic equity component of the portfolio. The international component underperformed as well, driven mainly by the internal portfolios, but also the external advisors. Lazard was the one manager to outperform during this period.

Ms. Doyle continued to discuss risk metrics of the Fund. The three-year tracking error increased, which shows that increase active risk has been paying off in excess returns.

Ms. Doyle concluded the presentation with market trends and next steps for portfolio management to increase returns. She recommended maintaining diversification of the asset allocation as it has been effective over the long-term and to continue to increase active risk for stronger risk-adjusted returns.

There was no further discussion, and no action was required on this item.

VI. REVIEW AND DISCUSSION OF THE FISCAL YEAR 2015 GLOBAL INVESTMENT PERFORMANCE STANDARDS COMPLIANCE PERFORMANCE REPORT

Ms. Betty Martin, Director of Investment Services, presented the review and discussion of the fiscal year 2015 Global Investment Performance Standards (GIPS). The GIPS standards are voluntary ethical standards set for the calculation and presentation of an investment firm's performance results.

These standards were advanced globally to encourage investment managers to present their performance history in a fair and comparable way. Verification assesses whether or not the firm has complied with all the composite construction requirements of the GIPS standards, and also that the firm's policies and procedures are designed to calculate and present performance in compliance with the GIPS standards. But it is not like an audit, where they are looking at the accuracy of the numbers.

Ms. Martin presented and explained a summary report that showed the difference is custodian reports and reporting under GIPS standards. In a custodian report, net of fees is net of just the external manager fees. Under GIPS standards, net of fees includes internal costs and overhead. The difference between the numbers showed a trend of between eight and ten bps for ERS internal management costs.

Ms. Martin pointed out that the externally managed assets percentage has grown, which is a reflection primarily of the increase in the private market allocation that is considered to be externally managed.

This report is as of August 2015 due to the time required to accumulate data from the last five years. One of the requirements of the standards is the report be presented to the governing body annually. Going forward, the GIPS compliance performance report will be presented at the December meeting for the previous fiscal year end.

There were no questions or further discussion, and no action was required on this item.

VII. REVIEW, DISCUSSION AND CONSIDERATION OF THE ERS INVESTMENT POLICY

Ms. Sharmila Kassam, Deputy Chief Investment Officer, presented the review, discussion and consideration of the ERS *Investment Policy.* The ERS *Investment Policy* is determined by the Board of Trustees (Board), and in accordance with Section 2.3 of the *Policy*, staff will recommend changes as needed to the Investment Advisory Committee (IAC) and Board.

Ms. Kassam stated the changes to the ERS *Investment Policy* were proposed to acknowledge the growth of tradeable investments. The main changes include expanding personal trading exemptions to include the trading of closed-end funds, which are regulated like mutual funds. Also, proposed changes are to exclude derivatives of closed-end funds and exchange traded funds (ETFs). Separately, direct investment plans were also proposed for exemption from personal trading preclearance guidelines.

Mr. Hille asked why closed-ended funds and ETFs should not receive preclearance. Ms. Kassam replied that like mutual funds, closed-ended funds are similarly regulated. Furthermore the broad based nature of closed-end funds and ETFs as defined in the proposed policy revision are routinely traded with high trading volumes such that staff does not believe that personal trades will have an impact. Ms. Kassam also noted that the CFA Code of Ethics requires staff to put investment decisions for the benefit of ERS as the priority over any personal trading for their own accounts. Staff also certifies on a regular basis that they attest to these requirements.

The second proposed revision was to Section 5.1B.i. Code of Ethics and Personal Investment Activities; Gifts, Benefits or Favors. This revision stated that certain books, pamphlets, articles or other such materials given to staff to be used in performing official ERS duties provided must be less than $50 in value. Ms. Kassam also noted that this is already the current practice and this is merely a clarification for the policy.

The Investment Advisory Committee then took the following action:

> **MOTION** made by Mr. Vernon Torgerson, seconded by Mr. Ken Mindell and carried unanimously by the members present that the Investment Advisory Committee approve the proposed revisions to the ERS Investment Policy as presented in this agenda item.

The Board of Trustees then took the following action:

> **MOTION** made by Mr. Doug Danzeiser, seconded by Ms. Ilesa Daniels, and carried unanimously by the members present that the Board of Trustees approve the proposed revisions to the ERS Investment Policy as presented in this agenda item.

VIII. REVIEW, DISCUSSION AND CONSIDERATION OF THE FIXED INCOME PROGRAM:

a. Market Update and Program Overview - Mr. Leighton Shantz, Director of Fixed Income, Ms. Leticia Davila, Rates Portfolio Manager and Mr. Peter Ehret, Director of Internal Credit, presented the review, discussion and consideration of the Fixed Income program.

Fixed Income as an asset class is an extremely diverse group of assets, all of which have contractually fixed cash flows. The ERS' fixed income program, is comprised of two separate and distinct mandates, Rates and Credit. The Rates Portfolio is comprised primarily of securities issued by the U.S. Treasury which are currently viewed as having no credit risk.

The Credit Portfolio is comprised primarily of below investment grade bonds whose value is derived from their perceived credit worthiness and liquidity. It may also include securities issues from other government-backed agencies and some legacy transition assets. This portfolio is the primary component of the risk reducing portion of the asset allocation as well as the principal source of liquidity for the Trust. Its current AUM is $4 billion and is entirely internally managed.

Mr. Shantz introduced the Fixed Income team and new member Mr. Andrew Okun. Mr. Shantz and Mr. Ehret discussed the experience of the team and emphasized the difficulty to the Board and IAC of hiring high caliber investment professionals to the public sector.

Mr. Shantz presented the performance of the fixed income mandates. As of March 2016, the Rates portfolio has generated about 705 bps in return versus 651 bps for the benchmark. And Credit outperformed its benchmark with a performance of 749 bps versus 586 bps. Mr. Shantz further discussed the performance of the Rates portfolio. It is not a return-seeking mandate, but rather is utilized to provide liquidity for the Trust.

The internally managed portfolio has a 50 bps tracking error budget and has produced a rolling average 1-year return 12 bps greater than the benchmark (2.36% vs. 2.14%). To date its highest 1-year return was 24 bps greater than the benchmark's highest (3.63% vs. 3.39%) and 15 bps higher for its lowest 1-year period (1.25% vs. 1.10%). Effectively, higher average, higher highs, and higher lows. As of the end of March, its year-to-date performance was 228 bps compared to the benchmark of 224 bps.

Rates excess return decline is partially the result of relatively lower returns in government agency mortgage backed securities (MBS) than Treasuries during January 2016. MBS are pools of home mortgages guaranteed by government sponsored entities. In that month underlying interest rates fell dramatically, creating strong performance in U.S. Treasuries and relatively lower performance in MBS. Staff believed this made MBS relatively attractive and expects them to more than regain the performance differential via additional yield and price moves. MBS generally out-perform in flat or modestly rising interest rates environments, and under-perform in strongly declining ones like January. Subsequently the portfolio is up an additional 54 bps, and has been outperforming on a cumulative basis. ERS had approximately 15% of the Rates portfolio invested in government agency MBS as of the end of March 2016.

Mr. Shantz presented a chart that showed the performance for the two fixed income mandates to emphasize how Rates and Credit are each unique asset classes, even though they both are fixed income portfolios. Rates' 1-year returns have had an approximate 200 bps range, whereas credit has a range of approximately 2,000 bps.

Mr. Hester inquired about the amount of risk in investing in credit in a down market cycle. Mr. Shantz replied that staff believes it is late in the cycle, but the team considered the current spreads attractive relative to the risks. Mr. Ehret concurred and stated that the team is cautious about the risks they take late in this market cycle.

Mr. Shantz discussed the external Credit mandates. The external mandates make up 15% of the Credit portfolio and equal to approximately $250 million. All four of the current external strategies are limited partnership structures: two are private equity type draw structures with finite investment periods (one already completed), one is a collateralized loan obligation (CLO) based strategy, and one is a long/short special situations strategy. The last two each have an evergreen investment period.

Overall, the Credit portfolio is currently $1.7 billion, or 7% of total assets, scheduled to grow to 10% of the Trust over the next 18 months. It holds 63% of its assets, equal to $1.1 billion, in the internally managed high yield portfolio (IHY), another 22%, equal to $380 million, in credit-based Exchange Traded Products (ETPs), and the remaining 15%, the aforementioned external mandate.

The credit benchmark in March returned 4.44% and the external investments returned approximately -2.5% in February which the Agency recognized in March, creating a -700 bps relative performance deficit for them. That equates to approximately -105 bps of total credit under-performance for the month. Since inception, however, the Credit portfolio has produced 7.48% of total return compared to 5.86% for its benchmark.

The IHY portfolio, as noted earlier, is 63% of Credit's assets, and it continues to perform well. Its total return for the fiscal year through March was 0.00% vs. the benchmark's -1.37%. Over the last 12 months, IHY lost -1.04% while the benchmark fell -3.49%. From inception IHY has produced 13.90% of return compared to 5.86% for the benchmark.

Relative performance for both Rates and Credit has been positive for the past two years. Staff believes it will be able to continue to outperform its benchmarks over the long term.

There was no further discussion, and no action was required on this item.

b. Review of Securities Lending Program - Mr. Leighton Shantz, Director of Fixed Income, presented the review of the securities lending program.

In accordance with the ERS *Investment Policy*, Section 4.15, and Texas Government Code §815.303, on February 22, 2011, the Board of Trustees authorized staff to negotiate a contract with Deutsche Bank AG (DB) to act as its securities lending agent. ERS hired DB to implement an intrinsic value program that employs a strategy focused on lending only highly sought-after securities to a diversified group of borrowers. The resulting contract took effect on September 1, 2011 and DB initiated activity for ERS as an actively managed third-party lending-agent separate from ERS' custodian bank on September 6, 2011.

Mr. Shantz explained the suspension of the securities lending program in 2016 due to the market placing an increased risk of default of its lending agent. Early this year the team noticed that their CDS spread and implied default rate of its agent was rising quickly. Staff, in consultation with the Executive Director, believed revenues from the program were no longer sufficient for the risks implied by DB's credit spread level. ERS decided to enact contingency plans to reduce risks. Staff reduced the risk until late

April when the securities lending agent's CDS spread stabilized around 150 basis points, or about a 3% one-year implied default rate.

Mr. Shantz presented the credit default swap spread of ERS' securities lending agent from implementation to suspension of the program. He discussed the double indemnification obligation of the agent, which protects ERS against losses by both the counterparties that borrow from them as well as collateral investments. As a consequence of that double indemnification, the Trust's counterparty risk for lending narrows down to just its securities lending agent. Staff at no time, felt the counterparty was going to have immediate default issues.

Mr. Hester asked if a new lending vendor was needed. Mr. Shantz replied he did not believe so; and the decision to suspend activity was a result of the program revenue not being worth the risk at the time.

Mr. Shantz continued that the consequence to suspending the program is the decline in monthly revenue. ERS currently had $350 million in ETFs on loan and continues to monitor its agents' spreads. Staff intends to re-implement the program when it believes it is appropriate to do so.

There was no further discussion, and no action was required on this item.

IX. REVIEW, DISCUSSION AND CONSIDERATION OF THE REAL ESTATE PROGRAM

a. Market Update and Program Overview - Mr. Bob Sessa, Director of Real Estate, Ms. Amy Cureton, Real Estate Portfolio Manager, and Tony Cardona, Real Estate Analyst, and Mr. Dan Krivinskas, consultant at RVK, presented the market update and program overview.

Mr. Sessa gave an overview of the real estate portfolio. At the August 19, 2008 Joint Meeting of the Employees Retirement System of Texas Board of Trustees and the Investment Advisory Committee , an asset allocation was adopted that included investing 8% of the Trust's assets in real estate. At that time, approximately 2% of the Trust's assets were invested in real estate listed securities (Real Estate Investment Trusts or "REITs" and/or Real Estate Operating Companies or "REOCs") which were part of the public equity portfolio. With the approval of the asset allocation, Real Estate was deemed its own asset class. Consequently, the real estate listed securities portfolio was moved to the real estate asset class.

Subsequently, at the February 26, 2013 Joint Meeting of the Board and IAC, the Board approved an increase the real estate allocation from 8% to 10% of the Trust's assets.

As of March 31, 2016, the total portfolio was valued at $2.6 billion, or 10.4% of the Trust's assets compared to a target weight of 10%. Due to the illiquid nature of the investments along with the factors outside of staff's control which are mentioned above, the private real estate weighting will vary from quarter to quarter and year to year. As the private real estate portfolio is at its "steady state", it should be emphasized that maintaining a precise constant weight for private real estate is extremely challenging.

Mr. Sessa concluded this portion by introducing the real estate team. He discussed the importance of the legal team in closing deals and negotiating fees. He also noted the importance of the day-to-day functions of the investments operations team and investments administrative team.

Mr. Tony Cardona detailed the REIT Portfolio. The overall portfolio is comprised of two sub-portfolios: domestic and international. Risk controls include a tracking error limit of 300 bps to the FTSE EPRA/NAREIT Global Index. The real estate portfolio is comprised of publicly traded real estate securities (REITs/REOCs) and private real estate investments. Investments in REITs are approximately $730 million. 54% of the portfolio are U.S. REIT and the remaining 46% are in the international REIT portfolio. He described the international exposure to real estate as a percentage of the total portfolio, with Asia comprising 25% of the portfolio, Continental Europe at 12%, the UK at 5% and other at 4%.

Due to the build out of the private real estate program, the risk in the internal portfolio had been reduced. Historically, the global composite portfolio averaged over 150 bps of tracking error. A majority of the tracking error was taken in the domestic portfolio. The last several years, the global composite portfolio was tracking around 30 to 40 bps, but currently stands at close to 130 bps.

He also discussed the performance of the domestic portfolio. The performance has done well, especially due to stock selection in the domestic portfolio. One change pertains to Wells Street, a long/short hedge fund focused on global real estate securities. Unfortunately, the manager did not perform as expected and the strategy was defunded in two tranches with the last funds redeemed in early March 2016.

Mr. Cardona also presented for context the global adoption of the REIT structure. Most recently in 2015, Iran, Saudi Arabia and Vietnam have adopted this structure. The structure assists in transparency for international real estate investing and also sets a standard and reduces risk.

Mr. Sessa provided details about the private real estate portfolio. As of March 31, 2016, the net asset value of the private real estate program was $1.9 billion representing 45 investments, $2.9 billion worth of commitments and $770 million in uncalled commitments. Through March 31, 2016, commitments made for fiscal year 2016 stand at eight investments totaling $191 million. Capital called for the fiscal year through March 31 totals $325 million with distributions of close to $215 million. As has been discussed by staff in the past, liquidity in the portfolio is actively monitored.

The private real estate portfolio's net internal rate of return (IRR) was 12.74% since inception through March 31, 2016. This is unusual as typically a new portfolio will experience negative returns in the first few years due to the J-Curve effect. 85% of the portfolio is in equity type investments and 15% is in debt investment.

ERS has very little committed capital left to invest in the core space with the majority of future dollars invested devoted to the non-core strategies of value added and opportunistic. As a percent, core represents only 3% of total unfunded capital.

Mr. Mindell asked how the real estate staff decided the core/non-core allocation. Mr. Sessa replied that it is based on the ERS Investment Policy. Mr. Sessa also explained that there has been a decrease in attractive core opportunities so staff has decided to seek investments in niche strategies and non-core investments. As will be explained further in the tactical plan, which is a separate agenda item, RVK and ERS staff proposes no hard commitments for fiscal year 2017, but with the potential to commit up to $250 million.

Ms. Cureton began her portion of the presentation. She discussed metrics of the private real estate portfolio. She presented the total portfolio by risk and return, which is 32% core and 68% non-core. The portfolio was also detailed by region. The portfolio is 80% U.S. exposure and 20% international exposure. The current portfolio is overweight industrial, multifamily and hotels while underweight office and retail. The industrial overweight is a tactical decision to invest in a property type with secular drivers at an attractive entry point. The overweight will naturally diminish as future commitments are made to other property types and as the industrial investments are liquidated.

Ms. Cureton discussed amenity metric tracking. There has been a change in what certain tenants look for in the market. Leadership in Energy and Environmental Design (LEED) indicated sustainability features and considers improving operating cost through energy saving methods. 40% of the portfolio report LEED and 12% are LEED certified. Another metric is Walk score which indicates the walkability and convenience in the area to retail spaces. 45% of the portfolio scored above a 70 and 32% scored the highest score. Ms. Cureton further discussed that staff is not tracking these metrics for certain targets; however, this data is helpful in underwriting investments.

Mr. Sessa concluded the presentation with accomplishments of the real estate program. The real estate team, along with the ERS legal staff, negotiated an estimated $45 million in savings for the private real estate portfolio since inception and also improved terms regarding corporate governance. The team invested in two co-investments and closed on a co-investment separate account. In 2016, ERS successfully co-hosted the 3rd Bi-Annual Real Estate Emerging Manager (REEM) conference.

Additionally, Mr. Cardona and Ms. Annie Xiao assisted in increasing the tracking error for the domestic and international real estate portfolios, which resulted in increased relative performance.

Mr. Krinvinkas and Mr. Mark Bartmann presented an overview of the Real Estate Market and discussed domestic and international growth and trends.

There was no further discussion, and no action was required on this item.

b. Proposed Private Real Estate Annual Tactical Plan for Fiscal Year 2017- Mr. Robert Sessa, Director of Real Estate, and Adam Cibik, Real Estate Portfolio Manager, and Mr. Dan Krivinskas, Director of Real Estate, Principal, RVK presented the Private Real Estate Annual Tactical Plan for fiscal year 2017.

Mr. Sessa gave a further overview of the real estate portfolio. The proposed Plan will be incorporated into the ERS *Investment Policy* as Appendix A of Addendum II: ERS Private Real Estate Policies and Procedures. The tactical plan is meant as a guideline and does not overrule prudent real estate investment decision-making.

As of March 31, 2016, the current private real estate portfolio stands at 7.5% of the overall System's assets with an allocation target of 7% yet within an acceptable policy range. Currently, the value of the private portion of the Real Estate Portfolio is approximately $1.9 billion. Staff will continue committing capital to private real estate on a selective basis, but currently targets $0 to $250 million in commitments for fiscal year 2017.

Mr. Cibik discussed the tactical plan. He explained how the team strategically allocates assets based upon opportunities in core and non-core. For fiscal year 2017, ERS Real Estate staff and RVK believe that opportunities to target non-core real estate will be the most attractive area to focus on similar to the strategy for the current fiscal year.

Mr. Cibik discussed strategy and possible opportunities for fiscal year 2017. Staff is interested in special deals with a small group of like-minded investors, where these investors can really promote better governance and be impactful on key decisions. Niche-type funds such as medical office, self-storage and manufactured housing are also areas of interest to staff. Staff is still looking at co-investments and separate accounts. Additionally, select international investments may be vetted in fiscal year 2017.

The Investment Advisory Committee then took the following action:

> **MOTION** made by Mr. Bob Alley, seconded by Ms. Lenore Sullivan and carried unanimously by the members present that the Investment Advisory Committee approve the proposed ERS Private Real Estate Portfolio Annual Tactical Plan for Fiscal year 2017, as presented in Exhibit A.

The Board of Trustees then took the following action:

> **MOTION** made by Mr. Brian Ragland, seconded by Mr. Doug Danzeiser, and carried unanimously by the members present that the Board of Trustees approve the proposed ERS Private Real Estate Portfolio Annual Tactical Plan for Fiscal year 2017, as presented in Exhibit A.

X. RECOGNITION OF INVESTMENT ADVISORY COMMITTEE MEMBERS

Mr. Tom Tull, Chief Investment Officer, presented the recognition of Investment Advisory Committee (IAC) members.

Mr. Tull explained the background and purpose of the IAC. The IAC was established in Texas Administrative Code §63.17(b) at the discretion of the Board of Trustees (Board) and is composed of at least five and not more than nine members. The members are selected on the basis of experience in the management of a financial institution or other business in which investment decisions are made or as a prominent educator in the fields of economics, finance or other investment-related area. The IAC members serve at the pleasure of the Board.

The IAC reviews investment strategies and related policies of ERS to provide comments and recommendations to assist the Board in adopting prudent and appropriate investment policies. The IAC assists the Board in carrying out its fiduciary duties with regard to the investment of the assets of the system and related duties.

Mr. Tull discussed investment milestones attributed to the guidance of the IAC. The IAC was instrumental in adding additional asset classes and creating additional diversity in the Trust asset allocation. The IAC also contributed and encouraged an increase in internal management to approximately 60%, which resulted in decreases in management fees with internal assets currently being managed at less than ten basis points, a fraction of the cost of externally managed funds. These industry leaders, in addition to attending quarterly Board Meetings, are in regular communication with the CIO and ERS staff to provide their expertise and assistance to ERS.

Mr. Tull presented the tenure of the IAC members, which shows their commitment and loyalty to ERS. Special recognition was given to members Mr. Vernon Torgerson appointed in 1984, and Ms. Laura Stark appointed in 1990, for serving ERS for over 30 years and 25 years, respectively.

Mr. Hester also thanked the IAC for their commitment to ERS and its beneficiaries.

There were no questions or further discussion, and no action was required on this item.

XI. ADJOURNMENT OF THE JOINT MEETING OF THE BOARD OF TRUSTEES AND INVESTMENT ADVISORY COMMITTEE AND RECESS OF THE BOARD OF TRUSTEES

The May 17, 2016 Joint Meeting of the ERS Board of Trustees and Investment Advisory Committee adjourned at 10:49 pm CT.