

MINUTES
ARKANSAS TEACHER RETIREMENT SYSTEM
BOARD OF TRUSTEES MEETING

Dr. Richard Abernathy, Chair

Monday, August 6, 2012

1:00 p.m.

1400 West Third Street
Little Rock, AR 72201

Board Members Present

Dr. Richard Abernathy, Chair
Jeff Stubblefield, Vice Chair
Lloyd Black
David Cauldwell
Dr. Tom Kimbrell
Danny Knight
Bobby Lester
Donna Morey
Robin Nichols*
Janelle Riddle
Honorable Martha Shoffner

Board Members Absent

Hazel Coleman
Honorable Charlie Daniels
Candace Franks

Consultants Present

Michael Bacine, Franklin Park
Chae Hong, Hewitt EnnisKnupp

Reporters Present

Mike Wickline, Arkansas Democrat Gazette

Staff Present

George Hopkins, Director
Gail Bolden, Deputy Director
Will Crow, Litigation Attorney
Kay Daniel, Director's Assistant
Mitzi Ferguson, Chief Fiscal Officer
Laura Gilson, General Counsel
Amy Glavin, Administrative Assistant
Rod Graves, Ret. Investment Specialist
Wayne Greathouse, Dir. Public Markets
Linda Hodge, Accountant II
Manju, Dir. Data Processing
Jerry Meyer, Dir. Real Estate
Tammy Porter, Paralegal
Michael Ray, Dir. Member Service
Gaye Swaim, Operations Administrator
Leslie Ward, Dir. Private Equity
Brenda West, Internal Audit/Risk Mgmt

Guests Present

Adam Ault, Division of Legislative Audit
Sarah Ganahl, Bureau of Leg. Research
Erika Gee, Attorney General's Office

**via teleconference*

- I. **Call to Order/Roll Call.** Chair, Dr. Richard Abernathy, called the Board of Trustees meeting to order at 1:00 p.m. Roll call was taken. Ms. Hazel Coleman, Honorable Charlie Daniels, and Ms. Candace Franks were absent.
- II. **Motion to Excuse Absences.**

Ms. Shoffner moved to excuse Ms. Hazel Coleman, Honorable Charlie Daniels, and Ms. Candace Franks from the August 6, 2012, Board of Trustees meeting. Mr. Knight seconded the motion, and the Board unanimously approved the motion.

- III. **Adoption of Agenda.** Dr. Abernathy requested to add October 15, 2012, Board Meeting Discussion under Other Business.

Mr. Knight moved for adoption of the amended Agenda. Ms. Riddle seconded the motion the Board unanimously approved the motion.

- IV. **Election of Board Vice Chair.** Due to Ms. Beverly Leming's resignation, the Board of Trustees Vice Chair position is vacant. According to Board policy, the Board must elect a new Vice Chair.

Mr. Lester moved to nominate Jeff Stubblefield for Board Vice Chair. Ms. Riddle seconded the motion, and the Board unanimously approved the nomination.

- V. **Executive Summary.** The Executive Summary was provided for reference with no questions or expansions on the written summary.

- VI. **Approval of Minutes of June 6, 2012.**

Mr. Black moved for approval of the Minutes of the Board of Trustees meeting of June 6, 2012. Ms. Morey seconded the motion, and the Board unanimously approved the motion.

- VII. **Report of Member Interest Amount Waived Under A.C.A. Sec. 24-7-205.** Mr. Hopkins presented the member interest amount waived report. ATRS waives interest on members when there is a dispute between ATRS and the member as to whether ATRS made a mistake or otherwise did not do all that was required on the member's account. There were no waivers to report.

- VIII. **Report of Employer Interest and Penalties Waived Under A.C.A. Sec. 24-7-411.** Mr. Hopkins presented the employer interest and penalties waived report. ATRS may waive employer interest and penalties when reports/payments are late or have issues due to new bookkeeper, sickness, etc. ATRS has recently been converting from a paper report to an electronic report. ATRS staff is pleased to report that ATRS is in the process of converting most ATRS employers from a paper check contribution payment to an electronic funds transfer (EFT) payment. Subsequently, ATRS waived \$2,655.56 in interest and penalties due to employers converted to the EFT process.

IX. **Investment Committee Report.** Dr. Abernathy gave a report on the Investment Committee meeting. It was reported that Ms. Robin Nichols was now the Committee Chair and Mr. Danny Knight was now the Committee Vice Chair.

A. **Arkansas Real Estate Update.**

1. **Woodland Heights Update.** ATRS staff has been monitoring Rector Phillips Morse (RPM) Realty's management performance. At the beginning of the year, the occupancy was at 69%, with a high turnover due to deaths and deteriorating health. It is currently at 71%, and ATRS staff is expectant that RPM's current advertising strategy will be successful. Due to concerns about security and safety, ATRS has been installing security cameras for residents' protection. RPM is on a month to month contract, and ATRS staff can start the RFQ process if the Board decides to search for a different management company
2. **Farmland Update.** The ATRS Farmland Manager, Halderman, performed final due diligence on the purchase of an organic orange grove in Florida with approximately 436 acres. Due to an open line of credit of approximately \$500,000 on the orange grove, ATRS staff decided that this would not be a prudent investment.

An additional tract property is being evaluated to add to the existing Indiana "Wright Farm" in Pine Village, Indiana. It appears that this potential addition would be less than 100 acres, but should be available at a very attractive price. Overall, the farm manager is reviewing many opportunities and is choosing select deals that meet the return criteria established by ATRS and the consultant for appropriate investments. At this time, due to values seen in farmland, it is extremely difficult to find quality investments.

As to west-coast farmland, ATRS has had no success in finding cropland in California and nearby states. The cost of the land relative to meeting the annual yields and price appreciation does not meet the ATRS criteria for purchases. In the future, ATRS and its consultant may work with Halderman to adjust the regional allocation to increase allocations in other areas of the country.

3. **Victory Building Update.** ATRS owns a parking deck in association with the Victory Building. ATRS staff will make preparations for a bid to reseal the parking deck, maintain rubber friction pads, and make other repairs. At this time, the property manager and ATRS have had an engineer to determine the scope of the needed maintenance and prepare bid specifications to obtain bids from qualified contractors to

complete the needed maintenance. ATRS, through its property manager, Irwin Saviers Ballard, is moving forward to bid-out the maintenance of the parking deck. The cost of this maintenance should be paid by the regular cash flows from the building. ATRS will also place the parking deck on a regular maintenance schedule to stay ahead of the maintenance curve as the parking deck ages.

Occupancy continues to be strong in the Victory Building with no issue as to major tenants or other problems in the building. The occupancy level continues to be 98%.

4. **Other Arkansas Related Issues.**

- a. **Peabody Hotel Loan.** The owners of the Peabody Hotel are working with a potential buyer to remarket the hotel. At this time, ATRS continues to hold a loan of approximately \$24 million on the hotel. The loan has a "due on sale clause" with the Peabody Hotel Group, with the total of the loan to be repaid in full should the Peabody Hotel Group sell the hotel. ATRS staff is prepared to meet with any buyer to determine whether the buyer has any interest in borrowing. ATRS will continue to monitor this issue and keep the Board updated as a potential sale progresses.
- b. **Ross Dress For Less Store Opens in Hot Springs.** The Ross Dress for Less store is now open. ATRS staff, its property manager, and Ross have continued to work through minor issues that are typical with a major national retailer moving into rented space. ATRS staff expects that all issues with Ross will be resolved in a way that it is fair to ATRS and continues good quality tenant relations with Ross. ATRS is planning to spend approximately \$100,000 to groom the landscape and shopping area.

B. **General Investment Consultant Update – Hewitt EnnisKnupp.**

1. **Traditional Assets Risk Profile.** This is a report that HEK provides to the Board to look at the risk profile of ATRS in regard to benchmarks and other factors. This study helps determine if ATRS assets are properly allocated, not only as investment groups, but within those investment groups.

The total fund active risk is currently at 2.53%. This level of active risk indicates that the total fund's expected return should be within +/- 2.53% points of that benchmark in two out of three years. The majority of active risk comes from the U.S. equity asset class, followed closely by fixed income. This is due to high active risk fixed income strategies

in the portfolio, including Loomis Sayles, the two Western portfolios, and Putnam.

Total fund risk is a result of manager active risk, misfit risk, and allocation risk. Active risk is the risk of underperforming a benchmark as a result of unsuccessful active management. Misfit risk is the risk that arises due to differences between manager's specific benchmark and the asset class benchmark. Allocation risk is the risk that arises due to deviations from policy targets. U.S. equity active risk is currently at 3.52%. Global equity active risk is currently at 2.38%. Fixed income active risk is currently at 3.44%. Since 2009 ATRS' level of active risk has not changed drastically. There has been a decrease in active risk since 2011, with the largest decrease occurring in the fixed income portfolio.

The analysis revealed several managers that contribute significantly to active risk. HEK suggests these managers be considered as a source of cash when withdrawals are required: ICC, Kennedy, Daruma, Wellington, UBS, Western, and Loomis Sayles. Reducing these managers' allocations somewhat will lessen the impact they can have on the total portfolio's performance. While this limits upside potential, it also serves as downside protection.

2. **Fixed Income Interest Rate Sensitivity Analysis.** This report is a follow-up on risk analysis in the fixed income space that is important for a large pension plan like ATRS. This risk analysis looked at unlikely occurrences to see how a major market disruption would affect ATRS and its fixed income investments. Most of the scenarios outlined in the report are not expected to happen and economics would dictate that they would be extremely rare occurrences.
3. **Manager Update.**
 - a. **Knight Vinke.** In the last meeting, the Board voted to terminate Knight Vinke and ATRS staff and Hewitt EnnisKnupp provided Knight Vinke with the appropriate notices. The discussions have been ongoing with Knight Vinke as to how best liquidate the ATRS portfolio. It is now expected that Knight Vinke will have totally liquidated the ATRS portfolio and provide ATRS with all the proceeds in the first few days of September.
4. **Research Topic: Public Funds Can Compete.** This study was presented to the Board several years ago on public funds and the ability of public funds to compete for returns in the markets with other institutional investors such as foundations. That study showed that

public funds were lagging other institutional investors in overall return. This study updates the research and shows that public funds have become more competitive and more innovative in obtaining investment returns that equal and often exceed returns of other institutional investors.

More recent data suggests that public funds can compete. Due to their cost advantage, emphasis of private equity and relative timing of their shift toward alternatives in the last few years, public funds have outperformed endowments. Allocations to alternative investments, the primary difference in investment strategy between public funds and endowment, performed well over the full period. HEK believes that successful integration of alternatives in public fund investment strategies will help ATRS stay competitive in the decades to come.

C. Real Estate Consultant Update – Hewitt EnnisKnupp.

1. **Real Estate Portfolio Performance Update for the Quarter Ended March 31, 2012.** Net IRR was at 6.5% for the quarter, 40 basis points higher than the last quarter. Net unfunded commitments decreased by approximately \$10 million during the quarter. Core fund performance continued its rebound at a slower pace during the quarter.
2. **Recommendation to Commit Up to \$30 Million to Almanac Realty Securities VI.** Almanac Realty Securities Fund VI (Almanac) is be a closed end, domestic, value added product targeting investments in both private and public real estate operating companies. Almanac will make both equity and debt investments with a target net IRR to investors of 12% and will pursue a relatively unique, but average risk strategy within the value added category. It is anticipated that roughly 50% of returns will be earned in the form of current income.

HEK is satisfied with the strategy of Almanac and its appropriateness for ATRS. HEK and ATRS staff recommended that ATRS invest \$30 million in the Almanac Realty Securities Fund VI to fulfill ATRS' remaining value added commitment.

a. Resolution 2012-26.

Mr. Knight *moved to adopt* Resolution 2012-26, approving the recommendation to commit up to \$30 million to Almanac Realty Securities VI. Dr. Kimbrell *seconded the motion*, and the Board *unanimously adopted the resolution*.

3. **Recommendation to Commit Up to \$50 Million to Westbrook Real Estate Fund IX.** Westbrook Real Estate Fund IX (Westbrook) is a closed end, opportunistic fund that employs an investment strategy focused on distressed debt, gateway cities, low leverage, minimal development activity, and complex transactions. On a relative basis, Westbrook intends to pursue a more conservative strategy within the Opportunistic style category. The Fund will target a 15% Net IRR.

HEK is satisfied with the strategy of Westbrook Real Estate Fund IX and its appropriateness for ATRS. HEK and ATRS staff recommended that ATRS invest \$40 million in Westbrook to fulfill ATRS' remaining Opportunistic commitment.

- a. **Resolution 2012-27.**

Mr. Cauldwell moved to adopt Resolution 2012-27, approving the recommendation to commit up to \$50 million to Westbrook Real Estate Fund IX. Mr. Black seconded the motion, and the Board unanimously adopted the resolution.

4. **Increase Halderman Farm Management/Real Estate Services from \$75 Million to \$100 Million.** Halderman's diligence has resulted in a portfolio that positions ATRS to benefit from positive movements in the farmland market going forward, while at the same time offering some protection against regional- or crop-specific distress.

Given Halderman's success deploying capital to date and proven ability to source deals consistent with ATRS' stated strategy, HEK and ATRS staff recommended that ATRS increase its allocation by \$25 million, for a total of \$100 million committed to the Halderman separate account.

- a. **Resolution 2012-28.**

Mr. Cauldwell moved to adopt Resolution 2012-28, approving the recommendation to increase Halderman Farm Management/Real Estate Services' allocation by \$25 million, for a total of \$100 million committed. Mr. Knight seconded the motion, and the Board unanimously adopted the resolution.

5. **Chess Ag Full Harvest Partners Due Diligence Ends.** In November 2010, ATRS met a number of candidates in HEK's office in Chicago, IL, as part of initial due diligence efforts to select one or more firms to manage a farmland separate account on behalf of ATRS. One of these managers was Chess Ag Full Harvest Partners (Chess Ag). Two

managers, including Chess Ag, were chosen as finalist candidates after this meeting, pending additional due diligence on both managers. ATRS discussed committing \$25 million to a separate account with Chess Ag contingent upon HEK's recommendation after completing additional due diligence.

As part of further due diligence efforts, HEK conducted numerous follow on calls with Chess Ag to gain additional understanding of the proposed strategy and processes in place for the potential ATRS separate account. After much consideration HEK does not believe the opportunity with Chess Ag is the best fit for ATRS' first foray into farmland investing. Chess Ag, though growing, is a small and relatively new organization and may be better suited for a more seasoned farmland investor with a larger, more broadly diversified portfolio of existing farmland holdings. HEK recommends ATRS not move forward with the \$25 million commitment to Chess Ag.

D. Private Equity Investment Consultant Update – Franklin Park.

1. **Private Equity Portfolio Review for the Quarter Ended March 31, 2012.** The net IRR for the aggregate portfolio since inception was 8.8%, with a committed capital of approximately \$2.7 billion dollars. The percent change in portfolio value for the quarter was 2.1%.
2. **Further Action Ends on Charterhouse Equity Partners V L.P.** On December 6, 2010, the ATRS Board approved a commitment of up to \$50 million to Charterhouse Equity Partners V, L.P. (Charterhouse), a small and lower middle market buyout fund that was being raised by Charterhouse Group (the General Partner). In order to ensure that the General Partner had sufficient capital to execute its strategy and that it was able to retain its team, Franklin Park required a minimum fund size of \$300 million before holding a first closing. The General Partner was unable to raise the minimum amount and consequently decided earlier in 2012 to cease fundraising for Charterhouse. Therefore, ATRS will not commit to the Fund and no further action is expected.
3. **Further Action Ends on Sycamore Partners, L.P.** On June 4, 2012, the ATRS Board approved a commitment of up to \$35 million to Sycamore Partners, L.P. (Sycamore), a private equity fund focused on acquiring underperforming retail and consumer businesses that was being raised by Sycamore Partners (the General Partner). This commitment was subject to satisfactory negotiation of final documentation. In the end, ATRS and the General Partner were unable to agree on certain terms. Therefore, ATRS will not commit to Sycamore and no further action is expected.

X. **Operations Committee Report.** Mr. Lester gave a report on the Operations Committee meeting.

A. **Final Approval of Rules after Review by Legislative Rules and Regulations Committee.** Both policies have previously been adopted and require a final adoption after a favorable review from the Legislative Council.

1. **Resolution 2012-29.**

Mr. Stubblefield *moved to adopt* Resolution 2012-29, a final approval by consent agenda of Policy 1-18, Audit Committee Charter, and Policy 6-1 Membership. Ms. Riddle *seconded the motion*, and the Board *unanimously adopted the resolution*.

2. **Policy 1-18 Audit Committee Charter.** The current wording of Policy 1-18 provides that the Committee Chair or Executive Director may call the meetings and set the agendas for the Audit Committee. As internal audit processes have developed at ATRS, it has been determined that it is best for the Internal Auditor and the Audit Committee Chair to work together to establish agendas and activities of this independent committee's processes. ATRS executive staff recommended removing references to the Executive Director as making decisions and replacing those references with the ATRS Internal Auditor for these functions. In addition, the ATRS internal auditor reworked the rules for the Audit Committee to more clearly state the process and function of the ATRS Audit Committee.

3. **Policy 6-1 Membership.** The current rule denies any new employees of certain specialized employers from establishing membership with ATRS unless the new member had prior service in ATRS with another employer. The law has changed since this policy was created in 2006. The proposed rule allows new employees of these employers to become ATRS members if ATRS staff determines that the employer is an eligible employer.

B. **Potential Rule Changes.**

1. **Policy 11-1 Survivor Benefits.** A review of Policy 11-1 Survivor Benefits revealed a policy error where the term "dependent child" does not reflect the legal definition. This provides opportunities for anti-selection and is a loophole that should be closed.

In the ATRS law definitions, "child of a member" means either a natural child of the member or a child who has been made a child of the member by applicable court action before the death of the member. However, ATRS policy allows for less defined requirements. ATRS staff recommends that the policy should more closely follow the definition in the law.

Mr. Knight *moved to approve* the revision to Policy 11-1 Survivor Benefits in order to eliminate conflict between ATRS rules and regulations and ATRS law. Mr. Stubblefield *seconded the motion*, and the Board *unanimously approved the motion*

C. Potential 2013 Legislation.

1. **Opportunity For Committee Members to Request Staff to Investigate Potential Rule or Law Changes.** ATRS staff is prepared to address any rule or law change brought up by ATRS Board members. This will become a permanent Operations Committee agenda item in order to give Board members adequate opportunity to introduce and discuss rule changes, law changes, actuarial studies, and other issues pertaining to ATRS.
2. **Six Month Separation for All Retirees to Become Effective July 1, 2014.** ATRS currently has a three tier separation period system for retirees. Vested members eligible for retirement that are under the age of 65 must go through a six month separation period before returning to work under an ATRS covered employer. Vested members eligible for retirement that are under the age of 65, but have over 38 years of service, must go through a one month separation period before returning to work under an ATRS covered employer. Vested members over the age of 65 do not have a separation period. This can be confusing for those with service in APERS, who require a six month separation for all retirees, regardless of age or service.

ATRS staff is continuously searching for cost savings to the System. While the cost savings on requiring a six month separation for all retirees is currently unknown, ATRS staff is confident that it would provide substantial cost savings over time. There is the potential that a six month separation period could delay retirement for members who plan continue working for their ATRS covered employer. This would mean less benefit payments paid out over time, which could potentially save ATRS millions of dollars.

Requiring member retirees to have the same separation period would also have the added benefit of making the administrative process more

efficient and uniform. It would also benefit those with service in APERS, and make the process less confusing. Because this item has the potential to be unpopular with members, ATRS staff is proposing an effective date of July 1, 2014, or later. This would prevent confusion among employers and members, as well as give ATRS staff the time needed to inform and counsel potential retirees.

Mr. Lester directed staff to gather information regarding the actual cost savings of this measure to present at the next Board meeting.

- 3. Discounted Buying of Benefit Rights.** ATRS staff continues to look for ways to address the liabilities on the ATRS balance sheet. Currently, over 4% of the ATRS liabilities are to members who are no longer on a career path or are no longer involved with Arkansas education. Many of these inactive members wish to cancel their service and obtain a refund, rather than receive a monthly benefit that may not occur for 20 or more years into the future.

Members with contributory service currently have the opportunity to receive a refund of their contributions, either as a rollover into an eligible retirement fund or as a lump sum amount. Noncontributory members are not eligible for refunds as they did not contribute to their account, so their payout cannot be immediate. By allowing inactive members to exchange their benefit for an immediate cash payment, ATRS has the opportunity to remove them as a liability.

ATRS has over 12,000 inactive vested members. The current liability to these current inactive vested members is a little over \$400 billion dollars that will grow to \$700 billion dollars over time as the reserve grows each year, and as the member gets closer to age 60. The average inactive vested member has a reserve account set up by ATRS worth about \$33,000. Each year as an inactive vested member reaches another year closer to age 60, their reserve balance increases. If ATRS can design a program to allow these members to take a set dollar amount now and surrender their right to a future benefit, it can be mutually beneficial to the inactive member and to ATRS.

Inactive members often want an opportunity to sever their relationship with ATRS in return for contributions that can be rolled into an IRA, or otherwise available for the inactive member to use. This can be beneficial to ATRS because these reserve accounts can be eliminated for significantly less than the current reserve value, and the reserve accounts value will not continue increasing annually as these members get closer to age 60. Over time, ATRS may be able to trade cash

payments to reduce hundreds of millions of dollars in liabilities. That reduction can assist ATRS in addressing its funding levels.

If this item were adopted, it would require legislation and then Board action from time-to-time to open a window for these discount liquidations. This would also be an entirely voluntary program; inactive members that wished to keep their benefit rights would have the opportunity to decline the immediate cash payoff.

Mr. Black moved to approve staff authorization to draft legislation regarding discounted buying of benefit rights. Mr. Knight seconded the motion, and the Board unanimously approved the motion.

- D. **CFO Report.** Ms. Mitzi Ferguson addressed issues observed so far in the Fiscal department and her department's goals for the future. She also presented a trending report on new retirees, T-DROP participants and pay-outs, and death benefits.

XI. **Staff Reports.**

- A. **Medical Committee Reports.** Mr. Ray presented the Medical Committee reports for June 2012 and July 2012. In June 2012, there were 28 applicants, 15 were approved and 13 were denied. In July 2012, there were 23 applicants, 22 were approved and one was denied.

Ms. Riddle moved to approve the June 2012 and July 2012 Medical Committee reports. Mr. Black seconded the motion, and the Board unanimously approved the motion.

- B. **Retiree Payroll Update.** Mr. Hopkins presented the retiree payroll update.

- XII. **Executive Session to Discuss Filling Vacant Board Position.** Chair, Dr. Abernathy, called the Executive Session of the Board of Trustees to order at 1:30 p.m.

Chair, Dr. Abernathy, reconvened the Board of Trustees meeting at 1:43 p.m.

- XIII. **Potential Appointment of Trustee to Fill Unexpired Term for Member Position #4.**

Mr. Knight moved to appoint Kathy Clayton to the vacant Congressional District #4 Member Trustee position. Ms. Morey seconded the motion, and the Board unanimously approved the appointment.

XIV. **Other Business.**

A. **October 15, 2012, Board Meeting Discussion.** The Board discussed the October 15, 2012, Board meeting date and, due to scheduling conflicts, decided to change the date to better accommodate Board members.

Mr. Lester *moved to change* the October 15, 2012, Board meeting date to November 13, 2012, due to scheduling conflicts. Mr. Knight *seconded the motion*, and the Board *unanimously approved the motion*.

XV. **Adjourn.**

Mr. Stubblefield *moved to adjourn* the Board of Trustees Meeting. Dr. Abernathy *seconded the motion*, and the Board *unanimously approved the motion*.

Meeting adjourned at 1:52 p.m.

George Hopkins,
Executive Director

Dr. Richard Abernathy, Chair
Board of Trustees

Amy Glavin,
Recorder

Date Approved