Joint Meeting of the Board of Trustees and Investment Advisory Committee

May 19, 2015

ERS

Employees Retirement System of Texas

Presented for Review and Approval

August 18, 2015

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

May 19, 2015
ERS Auditorium
200 E. 18th Street
Austin, Texas 78701

COMMITTEE MEMBERS PRESENT
Lenore Sullivan, Chair
James Hille, Vice-Chair
Robert Alley, Member
Monty Jones, Member
Caroline Cooley, Member
Ken Mindell, Member
Vernon Torgerson, Member

COMMITTEE MEMBERS ABSENT
Laura Starks, Member

TRUSTEES PRESENT
Brian Ragland, Chair
Frederick E. (Shad) Rowe, Jr., Vice-Chair
Doug Danzeiser, Member
Cydney Donnell, Member
I. Craig Hester, Member
Yolanda M. Griego, Member

ERS STAFF PRESENT
Ann Bishop, Executive Director
Porter Wilson, Executive Director Designate
Larry Zeplin, Chief Operating Officer
Tom Tull, Chief Investment Officer
Paula Jones, General Counsel and Chief Compliance Officer
William Nail, Special Projects and Policy Advisor to the Executive Director
Tony Chavez, Director of Internal Audit
Robert Kukla, Director of Benefit Contracts
Marci Sundbeck, Manager of Enterprise Risk Management
Ralph Salinas, Director of Human Resource
Catherine Terrell, Director of Governmental Affairs
Michael Wheeler, Chief Financial Officer
Carolyn Anderson, Investments
Ben Bowman, Investments
Carlos Chujoy, Investments
Adam Cibik, Investments
Kelley Davenport, Executive Office
Pablo de la Sierra Perez, Investments
Peter Ehret, Investments
Leah Erard, Governmental Affairs
Andrew Hodson, Investments
Lauren Honza, Investments
Dana Jepson, Governmental Affairs

Jennifer Jones, Governmental Affairs
Sharmila Kassam, Investments
David Lacy, Legal Services
Robert Lee, Investments
Mark Lopez, Benefit Contracts
Betty Martin, Investments
Patti Maugham, Executive Office
Robert Meyers, Investments
Tim Reynolds, Investments
Tanna Ridgway, Investments
Tom Roberts, Investments
Cheryl Scott Ryan, Legal Services
Leighton Shantz, Investments
Robert Sessa, Investments
Michael Shoop, Investments
John Streun, Investments
Chris Tocci, Investments
Mary Jane Wardlow, Governmental Affairs
Karla West, Investments
Keith Yawn, Office of Management Support

ALSO PRESENT
Steve Voss, Hewitt EnnisKnupp
Julian Bostic, Neubuger Berman
Gary Chandler, Texas Department of Public Safety Officers Association
Kevin Deiters, NM Education Trust
Katy Fallon, Legislative Budget Board
Ryan Falls, Gabriel Roeder Smith
Tom Griebel, Retired State Employees Association
Shea Guinn, Game Warden Peace Officer Association
Bill Hamilton, Retired State Employees Association
Diana Hodges, Office of Texas Senator Joan Huffman
Jimmy Jackson, Texas Department of Public Safety Officers Association
Lisa Kaufman, Texas Public Employees Association
Emily Morgani, Legislative Budget Board
Joe Newton, Gabriel Roeder Smith
Mauro Powers, American Federation of State, County and Municipal Employees Texas Retirees
Paige Rabalais, Neuberger Berman
David Sinclair, Game Warden Peace Officer Association
Brad Young, Altius
Jay Yoder, Altius
Bryan Sweeney, Altius
Kristen Doyle, Aon Hewitt
Dan Krivinskas, RV Kuhns and Associates
Mark Bartman, RV Kuhns and Associates
Evan Kepil, LECM

Ms. Lenore Sullivan, Chair of the Investment Advisory Committee 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 10:21 am on Thursday, May 7, 2015 as required by Chapter 551, Texas Government Code, referred to as ‘The Open Meetings Law.’”

XIV. REVIEW AND APPROVAL OF THE MINUTES TO THE FEBRUARY 24, 2015 JOINT MEETING OF THE BOARD OF TRUSTEES AND INVESTMENT ADVISORY COMMITTEE

Ms. Lenore Sullivan opened the floor for a motion to approve the minutes of the February 24, 2015 Joint Meeting of the Board of Trustees and Investment Advisory Committee.

The Investment Advisory Committee then took the following action:

MOTION made by Mr. Bob Alley, seconded by Mr. Vernon Torgerson and carried unanimously by the members present that the Investment Advisory Committee approve the minutes of the February 24, 2015 Joint Meeting of the Board of Trustees and Investment Advisory Committee.

The Board of Trustees then took the following action:

MOTION made by Mr. Shad Rowe, seconded by Mr. Doug Danzeiser, and carried unanimously by the members present that the Board of Trustees approve the minutes of the February 24, 2015 Joint Meeting of the Board of Trustees and Investment Advisory Committee.

XV. REVIEW AND DISCUSSION OF INVESTMENT PERFORMANCE FOR FIRST CALENDAR QUARTER OF 2015

Mr. Tom Tull, ERS Chief Investment Officer, and Mr. Steve Voss and Ms. Kristen Doyle from Aon Hewitt presented the review and discussion of investment performance for the first calendar quarter of 2015.

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 began the global market update. For the second consecutive year, US economic activity was affected by bad winter weather. Fourth quarter GDP was reported to have grown by an annualized quarterly rate of 2.2%, which is less than half the rate of Q3's 5% or Q2's 4.6%. There were signs of continued strength in other areas, including the housing and labor markets. In terms of housing, existing home sales grew at an accelerated 4.7% year-on-year in February, but the standout was new home sales growth, which surged by over 24%. As for the labor market, the unemployment rate continued to fall compared to the first quarter to 5.5%, the lowest since May 2008.

European and Japanese equity markets and performances lead the way in Q1. The US equity market performed moderately in the first quarter of 2015. Several other regions outperformed the US in dollar terms, including Europe, with the MSCI Europe ex-UK index gaining 5.5% and the MSCI Japan index returning 10.2% in the first quarter. This was despite the ongoing strength of the dollar versus the other major and emerging markets alike.

Furthermore in the US market, the end of Quantitative Easing last year made the markets focus even more on the regular statements and speeches by members of the Federal Reserve's Rate Setting Committee for clues about the timing of future interest rate increases. In terms of the economic backdrop, the economy slowed in Q4 and Q1, but not enough to completely alter the picture of a recovering economy. The sharp drop in the oil price triggered a fall in headline inflation to zero.

The European Central Bank (ECB) finally introduces Quantitative Easing. The ECB announced it would finally begin to buy sovereign European bonds at a rate of €60 billion per month until September 2016. As a result, the euro fell to a 12-year low against the US dollar, and bond yields fell across the continent. The 5-year German bond yield dipped into negative territory, while the 10-year yield was 0.2% at the end of March.

The perceived delay in the start of interest rate increases, and the sharp drop in the price of oil, have had strongly positive impacts on US small cap stocks in the past six months. The Russell 2000 index outperformed large cap stocks in Q1 with a return of 4.3% following Q4's 9.7% rally. Elsewhere, growth stocks outperformed value stocks during the first quarter returning 4.1% and -0.5%, according to the Russell 3000 growth and value index.

Sharp falls in the price of oil and the strength of the US dollar weighed on emerging market returns in 2014. During the first quarter of 2015, the MSCI Emerging Markets index gained 2.2%, and outperformed the US market.

Ms. Doyle discussed the performance of the total fund and the asset classes. During the first quarter, the Total Fund outperformed the Total Fund Policy Benchmark by approximately 40 basis points (bps). For the quarter, the global equity and absolute return components contributed positive relative value. The remaining asset classes were flat or detracted from relative performance during the quarter. The Total Fund outperformed the Total Fund Policy Benchmark by 65 bps over the previous one year period and every single asset class added some value to the total Fund over the trailing one year period.

Ms. Doyle showed that the Fund paid out about $2 billion in total in benefit payments during the year and investment earnings were $1.5 billion.

She also noted that ERS is a little bit overweight to global equity and a little bit underweight to rates for the shorter-term transition to the policy target asset allocation, but actually that indicates that the rates component is actually ahead of schedule. In terms of asset allocation relative to the long-term policy targets, ERS is overweight global equity and a little bit overweight to rates while continuing to develop out the global credit, real assets and private equity components. Mr. Tull commented that we will continue the overweight to global public equity particularly as we see values internationally relative to the US. The portfolio remains with a significant commitment to the US but overall there is a modest underweight to the US of 100 bps.

During the quarter, the global equity component outperformed the MSCI ACWI benchmark by 52 bps. Over the trailing one year, the global equity component significantly outperformed the benchmark by 200 bps due to strong manager selection within the non-US equity component. The domestic public equity asset class that is mostly internally managed outperformed for the quarter by about 80 bps with all portfolios contributing, except the mid-cap core. The allocation effect over the one year detracted 23 bps due to the portfolio historically being overweight mid and small cap. Barrow Hanley was the number one driver of positive performance over the one-year period. The international public equity component has produced strong relative performance for all of the trailing one year, three year, five year and ten year periods.

The global credit performance for the quarter was under the benchmark by about 20 bps, but did outperform over the one-year period. The main drivers of the outperformance over the one-year period were mostly the internal portfolios and the exchange traded funds (ETFs) that the asset classes invested in. Some of the newer commitments, Sankaty, BlackRock, and Glendon slightly underperformed their benchmarks.

Public real estate was up almost 14% absolute performance on a global basis and the internal portfolio was up 15% for the one-year period. The private real estate component had strong absolute performance at 10.4% relative to its benchmark which was up about 8%, which is the NCRIEF ODCE Index.

Mr. Hester inquired about drivers in the real estate market. Mr. Bob Sessa, ERS Real Estate Director, commented that the market has been strong due to continuing and increasing fund flows and low interest rates. All property types have performed well, especially multifamily.

Private infrastructure had an internal rate of return of 9.7% from inception since March 31, 2015. Staff has executed an additional two deals this year, totaling capital committed of $105 million.

The risk reducing portion of the portfolio is the rates portfolio, which is made up of mostly US Treasury securities. This quarter it was close to the benchmark, but overall has an outperformance of 40 bps over the one-year period. The absolute return portfolio outperformed its benchmark, the 90-day T bill plus 4%, over all trailing time periods.

Ms. Caroline Cooley asked about asset allocation and strategy in the portfolios. Mr. Tull explained the investments staff is finding opportunities in the public equity markets for alpha beyond the large cap space and core by overweighting small and mid cap. The team strives to be tactical and look for new opportunities as we are now nearly at our target asset allocation. Underweights and overweights in asset allocation in the portfolio are deliberate and strategic depending on the market and opportunities and staff and AON will highlight those as we continue to report to the Board.

Mr. Voss commented that with large pools of money to invest, it is difficult to find alpha yet over the last 12 months, the investment team has added over 65 bps of alpha on a net of fee basis. Mr. Craig Hester commended the Investment team for their success in achieving that return.

Ms. Doyle then discussed the difference between passive and active investment management. ERS Investments has a combination of passive and active management. For comparison of ERS performance and a benchmark, Aon uses the Standard & Poor's (S&P) Indices Versus Active Funds (SPIVA) The SPIVA is a database of mutual funds, and they scrub data, including removing biases from fund of fund performance relative to the benchmark and other biases that would prevent a relevant comparison.

Ms. Doyle showed details of the percentage of active funds outperforming their benchmarks. Aon recommends that clients index a substantial portion of their U.S equity investments because active managers have not shown an ability to consistently outperform market averages over a long period of time.

She further commented that this recommendation is based upon high market efficiency; cost differentials between active and passive management; availability of market indices; and the difficulty of active managers in outperforming market averages. ERS currently has some passive management within the U.S equity allocation, S&P 500 Core Portfolio. However, ERS has an advantage regarding active management due to the ability to reduce fees by using internal management. Fees are a big hurdle to active management, which is why ERS has a competitive advantage with a large internally managed portfolio.

Regarding the non-U.S market, Aon recommends allocation into passive management for developed markets. Those markets have become as efficient as US markets due to technological advances, better information flows and an increase in capital mobility. She also noted that emerging markets over the longer time periods have not shown to be as successful either for active management. ERS currently does not have any passive management in non-US markets, including both internal and externally managed portfolios. Mr. Voss noted that ERS international public equity portfolios have consistently outperformed the benchmark for all measured time periods.

Ms. Doyle explained for investors to select the best active managers it requires a good process around selection, monitoring and having a sell discipline. Aon has found that active managers that take more active risk have illustrated higher performance. These managers take bigger bets and tend to be dramatically over or underweight. She recommended investors take a high conviction approach to hiring managers. Mr. Tull responded that we are able to select good managers and be tactical with funding and defunding managers because of the Select Pool due diligence and monitoring processes.

Mr. Monty Jones inquired if benchmarks outside the US were as efficient and diversified. Mr. Tull stated that benchmarks all over the world are becoming more sophisticated. Ms. Doyle also concurred that international benchmarks have come a long way and coverage is about 99% of the global equity market with a small, mid and large cap structure per country in these international benchmarks. Aon recommends that investors are more market cap weighted in global markets with a higher international allocation versus the US.

Mr. Shad Rowe inquired why not invest domestically. Mr. Tull responded that we invest in the best companies both in the US and international markets to take advantage of all opportunities.

Mr. Tull concluded the agenda item that ERS staff continues to look for new ways to generate alpha and staff wants to hear from the Board and the IAC on their thoughts. We are increasing active share and working on a strategic mix of external and internal management. Other focuses for active management also include incorporating hedge funds as appropriate into other asset classes, the Best Ideas portfolio, building the internal high yield portfolio, listed equities options utilized as we do currently in fixed income, and leveraging a strong investment team to continue to explore new ideas.

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

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

a. Market Update And Program Overview – Mr. Bob Sessa, Director of Real Estate, Ms. Annie Xiao, Real Estate Portfolio Manager, Ms. Amy Cureton, Real Estate Senior Analyst, and Mr. Dan Krivinkas, Head of Real Estate at RVK presented the market update and program overview.

At the August 19, 2008 Joint Meeting of the Employees Retirement System of Texas (ERS) Board of Trustees (Board) and the Investment Advisory Committee (IAC), 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.

Mr. Bob Sessa began the presentation by outlining the asset allocation of the real estate program. As of March 31, 2015, the total portfolio was valued at $2.3 billion. The program is targeted at 10% of the Fund's assets, but is currently at 9%. Investments in REITs are approximately $820 million, while private real estate is valued at $1.5 billion.

Mr. Sessa presented the organization chart of the real estate team. The real estate staff consists of Mr. Sessa, Ms. Xiao, and Ms. Cureton, along with Mr. Ken McDowell, Portfolio Manager and Mr. Adam Cibik, Portfolio Manager. He also introduced Tony Cardona, the new Real Estate Analyst. Mr. Sessa also thanked the legal staff, investments operations and administrative staff for their support.

Ms. Annie Xiao began a discussion regarding the real estate listed securities as of March 31, 2015. At the end of last quarter the public real estate portfolio was valued at $890 million, representing 3.2% of the total fund. The real estate team internally manages 88% of the portfolio, and 12% is managed by external advisor, Brookfield-Wells Street Partners.

She presented the geographic exposure of the portfolio. Currently, the US accounts for 52% of the portfolio, Asia 28%, the United Kingdom and Continental Europe make up a total of 15%.

She showed a chart of the accumulated assets total return for the private real estate portfolio, which illustrated that the internally managed domestic REIT portfolio has been a primary driver for the excess return over time. The chart also illustrated the performance of the external advisors.

Ms. Xiao discussed the total return for the real estate market by major regions over the past five years. QE regions such as the US, Japan, UK and Continental Europe and non – QE regions, like emerging markets and Hong Kong, performances started to diverge about two or three years ago. In 2000, the universe market cap was about $410 billion US dollars; by the end of 2014, it will have grown to more than $1.8 trillion.

Ms. Xiao concluded her presentation by showing countries that had switched to the REIT structure. Currently 30 countries have adopted the REIT structure and 10 other countries are in the process of adopting it. Mr. Sessa commented that the securitization of real estate increases the transparencies of their respective markets and also the liquidity of the market and it's extremely helpful in terms of being just an investor in those markets that have listed securities.

Mr. Sessa discussed the overview of the private real estate program as of March 31, 2015. The private real estate portfolio currently sits at $1.5 billion; it was $1.2 billion last year at this time. Distributions since inception are $480 million, and last year at this time it was $243 million. 85% of the portfolio is in equity and 15% is in debt, in debt type investments in which ERS is the lender.

Mr. Sessa showed a detailed chart of the funds in the portfolio. It showed their geography and organized them by risk, as well as if the fund is core, opportunistic, or value-add strategy. Mr. Sessa mentioned that many funds are investing in ways that cannot be classified at just opportunistic or value-add, so he will ask the Board to change the strategies to core and non-core.

Ms. Cydney Donnell gave some insight about the real estate portfolio. The real estate portfolio is almost fully invested, so the real estate staff focus on monitoring will be expected to increase. Mr. Sessa indicated that staff is actively seeking ways to illustrate reporting and the risk reward spectrum to the Board and IAC. Mr. Sessa added that ERS is looking to peers to assist in finding the best reporting for the portfolio.

Ms. Ann Bishop explained how the investments in the real estate portfolio are made. The real estate portfolio is based on a 10% asset allocation. Based upon the policies and procedure and the tactical plan, investments are proposed to the Internal Investment Committee. If the investment is approved, it is funded, and then monitored and reported to the Board. Mr. Sessa clarified that there are rules regarding weighting and exposures in the portfolio that the staff uses as a guideline.

Mr. Shad Rowe asked how real estate was doing as the digital age and online shopping become more popular. Mr. Sessa said that online shopping has not had a big effect in the market as of yet and that people like to interact with others. Staff continually monitors trends and possible secular drivers of the market.

Ms. Amy Cureton was introduced and she began the overview of the private real estate portfolio. 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 portfolio has four industrial funds, two open ended core industrial funds, one focused on the US and the other is focused on Europe with two value added funds being focused on the US. Additionally, some exposure is gained through diversified commingled funds. The industrial property space should benefit from a US (and to a lesser extent European) manufacturing renaissance as cheap energy will support the sector in addition to multi-national companies rethinking their supply chain logistics away from Asia. E-commerce has a significant impact on industrial property space because it drives demand from both online retailers and traditional retailers establishing an online presence.

Mr. Rowe requested for clarification regarding the definition of core space. Mr. Sessa explained that core is a theoretically less risky investment. For example, with a highly leased building most of the returns would be from income. Ms. Cureton discussed the value-add strategy, which focuses on improving operational efficiencies of real estate. Staff favors managers who can balance current cash with capital appreciation potential within their portfolio, so current and potential income offsets the risk.

For the fiscal year through March 31, 2015, six deals have closed. Three of the deals were in the value add space for a total commitment of $131 million. Of those funds, two of the commitments were to successor funds of existing managers focused on the multifamily space in the US.

The other value-add deal was a self-storage investment. In the opportunistic space, two fund commitments were made totaling $175 million. One of these was to a Pan-Asian fund and another was a re-up to an existing manager focused on the US market. In the core space, one additional commitment was made to an existing Asian core fund for $25 million, bringing our total commitments for that fund to $35 million.

The target for fiscal year 2016 commitments is $200 million, with an upper range of $300 million. Through March 31, 2015, commitments made for fiscal year 2015 stand at six deals totaling $331 million. Capital called for the fiscal year through March 31, 2015 totals $250 million with distributions of close to $180 million. It is expected that another two to three deals totaling $50 to $150 million in commitments will be made before fiscal year end 2015.

Mr. Sessa concluded the ERS portion of the real estate overview by outlining accomplishments and initiatives. REITs continue to complement the private real estate portfolio and have provided beneficial exposure to the asset class. He discussed partnering with the ERS hedge fund group to underwrite a listed security portfolio, Brookfield-Wells Street program. Staff will continue to monitor hedge funds for listed securities.

One of the initiatives for fiscal year 2016 is to increase the portfolio's international and emerging market exposure. In the private real estate portfolio, staff will continue its strategy to focus on non-core (i.e., value added and opportunistic) investment strategies, as well as continue to explore separate accounts and co-investments.

The real estate staff and legal staff, along with RVK, continue to negotiate favorable economic terms for most of the private real estate investments saving the Trust an estimated $38 million over the life of the investments.

Mr. Krivinskas and Mr. Mark Bartman from RVK gave an overview of the real estate market. Last year, core real estate increased by 12.5%, which is approximately the same rate it increased the past three years. Core has been impacted by the currently low interest rates in the United States, but RVK predicts an eventual reversal in the market.

Mr. Krivinskas discussed the global real estate market. In the US, transaction volume has also returned to 2006 levels. Central and Eastern European markets are lagging and Greece continues to veer towards default. There are growing opportunities in Asia and Emerging Markets.

In the US markets, there have been positive core real estate returns. Multifamily has had a significant valuation rebound and most multifamily assets throughout the U.S. are trading above pre-credit crisis peaks. While core and multifamily have led the real estate recovery, other sectors including industrial, retail, and hospitality have gained momentum over the past year. The top cities in the US for real estate are New York, Los Angeles, San Francisco, Chicago, Boston and Washington, DC. Mr. Krinvinskas also showed that there was a dramatic rise in capital available for deals.

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

b. Proposed Revisions to the ERS Investment Policy Addendum II: Real Estate Policies and Procedures - Mr. Bob Sessa and Mr. Adam Cibik presented the proposed revisions to the ERS Investment policy. Section 2.3 of ERS' *Investment Policy* states that annually and as necessary, the ERS staff shall review and recommend changes to the Investment Policy.

Mr. Cibik explained the proposed changes and definitions of terms. The first proposed change is to combine the risk/return categories of value added and opportunistic into non-core category because most fund strategies do not fit neatly into one category. Value add is in the middle of the risk category and opportunistic has the most amount of risk, but has higher returns. If approved the core weight would remain at 30% and non-core weight will be the sum of value added at 25% plus opportunistic at 15%. The real estate team also proposed increasing the bands around the two categories from +/-10% to +/- 15%.

The second proposed change was to adjust portfolio leverage limitations from 60% to 65% to gain more control over leverage. Staff uses the amount of leverage utilized as a significant factor in reviewing the manager's track record.

If the non-core category is adopted, staff proposes a leverage limit of 70%. For a point of reference, the overall value added leverage limitation is 60% and the overall opportunistic leverage limitation is 75%. Staff also requested to totally remove the 50% overall leverage limitation for separate accounts.

The last proposed change is to change language regarding ownership requirements for a single fund and separate account. Currently, the policies and procedures allow ERS to invest up to 51% in a single fund and 97% of a separate account. ERS' specific share of an investment vehicle is important and as well as the amount of capital the GP has invested alongside the LPs, but other factors are more significant.

After discussion, the Board and IAC agreed to move the overall leverage limitation for separate accounts to 70%.

Ms. Lenore Sullivan opened the floor for a motion to approve the ERS real estate policies and procedures as presented in Exhibit A, except as revised for the proposed change number two, separate accounts have leverage limitations of up to 70 percent.

The Investment Advisory Committee then took the following action:

MOTION made by Mr. Vernon Torgerson, seconded by Ms. Caroline Cooley and carried unanimously by the members present that the Investment Advisory Committee approve the proposed revisions to the ERS Investment policy Addendum II: Real Estate Policies and Procedures as presented, except to revise that separate accounts have a leverage limitation of 70%.

The Board of Trustees then took the following action:

MOTION made by Mr. Craig Hester, seconded by Ms. Cydney Donnell, and opposed by Mr. Shad Rowe, and it was carried that the Board of Trustees approve the proposed revisions to the ERS Investment policy Addendum II: Real Estate Policies and Procedures as presented, except to revise that separate accounts have a leverage limitation of 70%.

c. Proposed Private Real Estate Annual Tactical Plan for Fiscal Year 2016 – Mr. Robert Sessa, Director of Real Estate, Mr. Ken McDowell, Real Estate Portfolio Manager, and Mr. Dan Krivinskas, Director of Real Estate from RV Kuhns and Associates, presented the proposed private real estate annual tactical plan for fiscal year 2016.

In accordance with the Employees Retirement System of Texas (ERS) Real Estate Policies and Procedures, Section III.B.1, staff is charged with preparing and presenting an Annual Tactical Plan (Plan) to the ERS Board of Trustees (Board) for its review and approval. The Plan reviews the current status of the real estate portfolio, recent historical and prospective market conditions and proposes the steps to be taken over the next fiscal year to implement the real estate program.

Mr. Sessa gave an overview of the program. The current value of private real estate is $1.5 billion and is projected to reach the 7% allocation target by 2016.

Mr. McDowell discussed the investments from fiscal year 2015. For fiscal year 2016, ERS Real Estate staff and RVK will target non-core real estate, similar to the strategy for the current fiscal year. Additionally, staff is focused on strategies and managers where the portion of return derived from income, as opposed to capital appreciation. Staff will continue to seek opportunities in separate accounts and co-investments, as well as niche type funds such as medical office, self-storage, and manufactured housing.

Expanding beyond domestic real estate will provide opportunities, as well as diversification benefits. In addition to Europe and Asia, Latin American investments will be given consideration in fiscal year 2016.

Staff will continue committing capital to private real estate and projects $200 million in commitments and two to fifteen deals for fiscal year 2016.

Ms. Lenore Sullivan opened the floor for a motion to approve the proposed Private Real Estate Portfolio Annual Tactical Plan for Fiscal Year 2016, proposed as Exhibit A. [Please note that since the value add and opportunistic descriptions were changed to non-core then Exhibit A was followed as it contained the core/non-core description]

The Investment Advisory Committee then took the following action:

> **MOTION** made by Mr. Bob Alley, seconded by Mr. Vernon Torgerson and carried unanimously by the members present that the Investment Advisory Committee approve the proposed Private Real Estate Portfolio Annual Tactical Plan for Fiscal Year 2016 that uses the newly adopted Private Real Estate Policies and Procedures sub-categorization (Core v. Non-Core Categories).

The Board of Trustees then took the following action:

> **MOTION** made by Ms. Cydney Donnell, seconded by Mr. Craig Hester, Mr. Shad Rowe was absent during this vote, and it was carried unanimously by the members present that the Board of Trustees approve the proposed Private Real Estate Portfolio Annual Tactical Plan for Fiscal Year 2016 that uses the newly adopted Private Real Estate Policies and Procedures sub-categorization (Core v. Non-Core Categories).

XVII. REVIEW, DISCUSSION AND CONSIDERATION OF THE PRIVATE INFRASTRUCTURE PROGRAM:

a. Market Update And Program Overview – Mr. Pablo de la Sierra Perez, ERS Infrastructure Portfolio Manager, and Mr. Jay Yoder and Mr. Bryan Sweeney from Altius Associates, presented the review, discussion and consideration of the private infrastructure program.

ERS has determined that, over the long term, inclusion of private infrastructure investments (herein after referred to collectively as “private infrastructure”) would enhance ERS’ expected portfolio investment characteristics. Specifically, infrastructure assets are known to provide stable inflation-protected cash flows with some capital appreciation.

The infrastructure portfolio will be comprised of privately held infrastructure assets. Publicly traded/listed infrastructure securities will be managed within the Global Equities team as part of the ERS’ Public Equities portfolio. Staff will continue to provide a review of ERS’ Private Infrastructure program at least annually.

Mr. de la Sierra began his presentation with the portfolio overview. Since inception through March 31, 2015, ERS has closed on two private infrastructure funds and four co-investments with commitments totaling $380 million. The private infrastructure portfolio net asset value (“NAV”) is $235.1 million. Additionally, as of March 31, 2015, private infrastructure investments have produced a Total Value to Paid In Capital (“TVPI”) of 1.19x, Distributed to Paid in Capital (“DPI”) of 0.01x, and an Internal Rate of Return (“IRR”) of 8.87% since inception versus a benchmark of CPI + 450.

Staff expects the private infrastructure portfolio commitments of $300 million +/- 25% in fiscal year 2015 and that it would meet its target allocation by the end of fiscal year 2020. Staff is on track to meet its target, but will explore additional mechanisms and tools, including ways to pool capital with other investors, that would benefit ERS in deploying the program. Also, staff continues to observe that co-investments and direct investments are at the forefront of the strategies for the majority of the institutional investors.

Mr. Sweeney provided an update of the infrastructure portfolio. He discussed the capital commitments and the growth of the portfolio. Currently, 54.4% of the infrastructure portfolio is in the developed markets and the remaining 45.6% is in emerging markets. The exposure of the portfolio is primarily in power (81.2%), and the remaining exposure is in transport and utilities.

Ms. Cydney Donnell inquired about geopolitical risk in investing in infrastructure in emerging markets. Mr. Sweeney stated that ERS invests in well-established managers and conducts thorough due diligence. The manager ERS has invested with invests in power in Asia, South America and Africa.

He continued to discuss the global infrastructure market. It is projected that approximately $53 trillion of global infrastructure investments are needed by 2030. In the US, the American Society of Civil Engineers estimate $3.6 trillion needed in the US by 2020 to maintain and improve the infrastructure. Due to these projections, more institutional investors are showing interest to this asset class.

Mr. Sweeney concluded with a discussion of the future of infrastructure and recommendations for fiscal year 2016. Direct and co-investments become more important for large investors as they increase allocation in infrastructure. Energy will remain a large and profitable subsector. In fiscal year 2016, infrastructure will move towards diversification targets by adding core and value-added exposure.

Although ERS has observed abundant long-term opportunities in the U.S. and the global power generation sector, staff also anticipates legislative and regulatory developments in the transportation and utility market that may create investment opportunities in the near future. The US transportation sector is chronically underinvested and many state governments are considering implementing or have already implemented legislation that enables private sector participation in the design, construction, operation and financing of transportation projects. ERS will continue exploring ways to pool capital with similarly minded investors to increase the universe of suitable and appropriate co-investments and direct investments through Limited Liability Company (LLC) or Limited Partnership (LP) vehicles that ERS can prudently manage.

Additionally, ERS private infrastructure is considering an additional hire for fiscal year 2016.

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

b. Proposed Revisions to the ERS Investment Policy Addendum XIII: Infrastructure Policies and Procedures - Mr. Pablo de la Sierra Perez, ERS Infrastructure Portfolio Manager, presented the proposed revisions to the ERS Investment Policy Addendum XIII: Infrastructure policies and procedures.

Staff is charged with annually preparing and presenting to the Board for its review and approval the Private Infrastructure Policies and Procedures. Based upon the review of the policy and procedures, Staff recommended amending the infrastructure target allocations to increase private infrastructure to 4% of the Trust from the current allocation of 3% of the Trust. With the support of ERS' plan consultant, Aon Hewitt Investment Consulting, Inc., ERS is seeking to add a 1% commitment to private infrastructure to allow for more opportunities in co-investments and direct investments.

ERS' staff also recommended a revision regarding the delegation of authority of the Infrastructure Investment Committee's to approve in the case of co-investments and direct investments, from the lesser of $100 million or 0.375% of the Trust's assets up to the lesser of $150 million or 0.50% of the Trust's assets. There were proposed clarifying and non-material amendments to Partnership evaluation criteria in appendix B of the *Investment Policy* as well.

Ms. Lenore Sullivan opened the floor for a motion to approve the proposed revisions to section 2.2.B of the ERS *Investment Policy* as presented in Exhibit A.

The Investment Advisory Committee then took the following action:

MOTION made by Mr. Vernon Torgerson, seconded by Mr. Jim Hille and carried unanimously by the members present that the Investment Advisory Committee approve the proposed revisions to section 2.2.B of the ERS *Investment Policy* as presented in Exhibit A.

The Board of Trustees then took the following action:

MOTION made by Ms. Cydney Donnell, seconded by Mr. Doug Danzeiser, Mr. Shad Rowe was absent during this vote, and carried by the members present that the Board of Trustees approve the proposed revisions to section 2.2.B of the ERS *Investment Policy* as presented in Exhibit A.

Ms. Lenore Sullivan opened the floor for a motion to approve the proposed revisions to the ERS *Investment Policy,* Addendum XIII: Infrastructure Policies and Procedures, as presented in Exhibit B.

The Investment Advisory Committee then took the following action:

MOTION made by Mr. Ken Mindell, seconded by Mr. Jim Hille and carried unanimously by the members present that the Investment Advisory Committee approve the proposed revisions to the ERS *Investment Policy,* Addendum XIII: Infrastructure Policies and Procedures, as presented in Exhibit B.

The Board of Trustees then took the following action:

MOTION made by Mr. Doug Danzeiser, seconded by Ms. Yolanda Griego, Mr. Shad Rowe was absent during this vote, and carried by the members present that the Board of Trustees approve the proposed revisions to the ERS *Investment Policy,* Addendum XIII: Infrastructure Policies and Procedures, as presented in Exhibit B.

c. Proposed Private Infrastructure Annual Tactical Plan for Fiscal Year 2016 – Mr. Pablo de la Sierra, ERS Infrastructure Portfolio Manager, presented the proposed private infrastructure annual tactical plan for fiscal year 2016.

Staff reviews the current status of the private infrastructure portfolio, recent historical and prospective market conditions and proposes steps to be taken over the following 12-15 months to continue implementing the private infrastructure program.

The Board had approved the increase of the ERS Private Infrastructure target allocation to 4% of the Trust, so staff recommended that the Fiscal Year 2016 Private Infrastructure Annual Tactical Plan target a commitment of $300 million with a range of +/- 25% (or $225 million - $375 million).

In fiscal year 2016, staff will target two to four new investments across the risk spectrum and all geographies. ERS staff will also seek to enter into capital pooling arrangements with similarly minded investors with the objective of gaining scale and size to increase the System’s competitiveness when accessing opportunities. In general, ERS staff will continue to be in the search of proprietary opportunities, preferably not competitively bid, and will continue to form relationships with industry players. ERS staff is opportunistically approaching the infrastructure marketplace, rather than focusing on a predetermined subset of sectors or geographies.

Ms. Lenore Sullivan opened the floor for a motion to approve the ERS proposed private infrastructure annual tactical plan for fiscal year 2016 as presented in Exhibit A to the Appendix A of the ERS private infrastructure policies and procedures.

The Investment Advisory Committee then took the following action:

MOTION made by Mr. Bob Alley, seconded by Mr. Ken Mindell and carried unanimously by the members present that the Investment Advisory Committee approve the proposed private infrastructure annual tactical plan for fiscal year 2016 as presented in Exhibit A to the Appendix A of the ERS private infrastructure policies and procedures.

The Board of Trustees then took the following action:

MOTION made by Mr. Craig Hester, seconded by Ms. Cydney Donnell, Mr. Shad Rowe was absent during this vote and carried unanimously by the members present that the Board of Trustees approve the proposed private infrastructure annual tactical plan for fiscal year 2016 as presented in Exhibit A to the Appendix A of the ERS private infrastructure policies and procedures.

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

a. Market Update And Program Overview – Mr. Leighton Shantz, ERS Director of Fixed Income, Ms. Leticia Davila and Mr. Tom Roberts, ERS Rates Portfolio Managers, and Peter Ehret, Internal Credit Portfolio Manager, and Ben Bowman, Head of External Credit, presented the review, discussion and consideration of the Fixed Income Program.

At the February 2013 Joint meeting the Board decided to allocate 15% of the 25% of the Trust allocation to all fixed income into a Rates portfolio. Its primary objective is to provide liquidity for the overall Trust, and to further maximize its risk-adjusted returns subject to this objective. It comprises the foundation of ERS' risk reducing allocation. An additional 10% of the Trust was allocated to a return seeking Credit portfolio. These two separate and distinct mandates, the Rates and Credit portfolios, comprise ERS' fixed income investments.

Mr. Shantz discussed the overall performance of fixed income. ERS has produced positive excess returns for the periods in which relevant data exists. From the fiscal year 2015 through March 31, 2015, Rates added +18 bps (+208 bps vs. +190 bps for its benchmark) and Credit added +34 bps (-29 bps vs. -63 bps for its benchmark). Excess returns for the trailing 1-year is +35 bps for Rates and +49 bps for Credit. While neither portfolio out-performed in every month, both have consistently out-performed since the inception of the new fixed income format noted above.

The Rates portfolio, excluding the Transition assets, decreased since last March by approximately $725 million (from $4.8 to $4.1 billion) and Credit grew $375 million ($1.0 to $1.4 billion). Both changes are primarily a result of respective withdrawals and contributions; not market movements. The $350 million reduction in Rates, not used to fund Credit, was either redeployed to either make benefit payments and/or to fund other asset classes. The Credit portfolio is on track to grow to its full 10% allocation by 2017.

The Rates portfolio is comprised primarily of U.S. Treasury securities, but may also include other government-backed issues as well as legacy transition assets.[1] Rates is intended to be a liquid risk mitigating allocation; not to generate high returns. The intention of the strategy is to assist in paying annuities to retirees without being forced to sell other assets.

Ms. Davila and Mr. Roberts discussed the rates portfolio investment process. She reiterated process is driven by the objectives of the Rates portfolio to primarily provide liquidity to the Trust, and secondarily to maximize returns. Staff combines a top-down macro approach with a bottom up security

[1] Legacy assets owned by ERS such as investment grade corporate bonds, CMBS, and ABS securities that are not suitable for Rates or Credit. These assets have shrunk from $2.4 billion to $541 million, and targeted liquidations have reduced risks to the point that there is no longer a relevant benchmark. At staff recommendation, the Board approved moving the remaining assets into the Rates portfolio for their continued orderly liquidation.

selection. The top-down process incorporates the overall assessment of economic growth and Fed policy vs. market valuations and risks to gauge the potential for outperformance. Staff then uses this top-down view to drive portfolio risk positioning and to influence the bottom-up security selection process.

Mr. Roberts explained the importance of interpreting the Fed, studying economic activity and technical trends. When implementing the strategy the primary areas of investigation are sectors selection, duration management, and yield curve position. Risk management is an integral part of the process, and staff actively monitors the portfolio's risk exposures. The portfolio management process is ongoing, and staff constantly monitors it and the market, with adjustments either to its outlook, portfolio or both.

Mr. Roberts discussed the outlook for interest rates. Staff believes monetary policy has been a primary driver for all market returns since the end of "the great recession." After a series of quantitative easing programs beginning in November 2008, the Federal Reserve recently ended its third round of (QE3) in October 2014, and has recently began hinting at raising short-term rates.

Mr. Ehret begins his discussion regarding the Internal High Yield ("IHY") portfolio and credit in general, reviewing the credit cycle in general, and its impact on asset prices. Staff believes it is in the mature part of the cycle. The economic recovery is now in its sixth year and credit spreads have fallen dramatically since the trough of the last cycle. Realized credit losses are low and the de-risking process seen earlier in the recovery has reversed. Leverage levels of new financings have steadily increased as the perception of risk has dissipated and investors seek excess returns.

The Credit portfolio is comprised primarily of below investment grade fixed income assets (high yield bonds, leveraged loans, and emerging market debt). It is a return seeking allocation benchmarked against the total return of the Barclay's U.S. Corporate High Yield 2% Issuer Capped Index (*LF89TRUU* on Bloomberg). Its current AUM is $1.4 billion, growing to $2.6 billion, or 10% of the Trust based on current valuations. As of the end of March, it is comprised of 65% ($920 million) in the IHY portfolio, 23% ($310 million) in credit-based ETPs, and the remaining 12% ($205 million) is externally managed in a series of satellite allocations.

The biggest contributor to the Credit portfolio returns has been the IHY mandate. Both the IHY and the overall Credit portfolio are relatively conservatively invested compared to their benchmark; with lower yields and credit spreads, as well as both having higher average credit ratings. The IHY portfolio's excess return has come from security selection and active trading.

Mr. Ehret described the current positioning of the portfolio in broad terms. It remains underweight in the higher credit risk area of the market (triple-C rated bonds) and yields less than its benchmark as a result. This reflects staff's view of the cycle and the lack of sufficient returns to justify the additional risk. It also reflects the depth of resources of the high yield team, which seeks to further develop and augment its capabilities to allow for greater analysis of riskier credits resources. Staff anticipates a time when the portfolio will hold a material overweight to these higher risk securities, which require enhanced rigor. This is possible with a larger team of experienced analysts.

The IHY portfolio is underweight cable/satellite based on staff's perception of increasing competition and overweight media/entertainment. Staff additionally has an overweight to the technology industry and an underweight to metals/mining. It is somewhat overweight energy, but not in energy services; the overweight is in exploration and production, refining and pipelines. Staff is underweight healthcare companies, mostly investing in some large hospital and pharmaceutical names.

Mr. Bowman began his presentation of the external Credit. The external Credit portfolio is currently made up exclusively of "satellite" strategies intended to complement the "core" High Yield allocation of the Credit mandate. By design, these are more volatile assets, with higher expected returns and lower correlations. The external portfolio effort is designed to give staff the ability to react quickly to market opportunities where no internal management capability or advantage exists, or where the opportunity is considered too transitory or resource dependent to warrant the development of in-house expertise. All four of the current strategies are limited partnership structures: three draw-structures with finite investment periods and one long/short special situations strategy with an evergreen investment period.

As of March 31, 2015, the External Credit portfolio has committed $275 million across the four funds. Approximately $209 million of that commitment has been drawn, leaving $66 million undrawn. A summary of the investment characteristics of each fund was provided.

Mr. Bowman stated that the first of these external mandates was the $75 million commitment to a $400 million fund that invests in the lower portions of Collateralized Loan Obligation (CLO) capital structures. This transaction closed at the end of 2013 and to date has drawn approximately $71.3 million or 95% of the original commitment.

The second investment occurred in late December 2014. ERS invested $100 million in an anchor share class of a special situations credit hedge fund. Additionally, at the end of December 2014, ERS made a $50 million commitment to a $1 billion distressed credit fund. As of March 31, 2015, $25 million or 50% of the original commitment has been drawn.

Lastly, in January 2015, ERS closed on an asset liquidation strategy, committing a total of $90 million, $50 million of which was funded by the Credit portfolio (the remaining $40 million coming from the Absolute Return portfolio). The fund has total commitments of $260 million and is the second in what is expected to be a series of such draw structure funds by the manager. Staff expects continued participation in subsequent funds, which will eventually transform this strategy from a satellite to a core allocation. As of March 31, 2015, 40% of the original commitment has been drawn. The strategy involves purchasing the claims on assets of firms in the later stages of liquidation. The discount for these claims can be significant given uncertainties associated with the timing of the monetizations, the impact of pending litigation and the valuation of underlying assets.

Mr. Shantz concluded the presentation with the initiatives and goals of the program. Staff plans to initiate an RFP process to identify and select a long-only High Yield Bond manager to replace Fountain Capital Management (FCM). Recall from the February 2015 Joint Meeting of the Board and IAC that FCM closed their doors in February 2015, and staff liquidated the portions of the portfolio it did not wish to integrate into the IHY portfolio. Ideally, an external manager would be more focused one, with fewer assets under management. Staff is hopeful that this is an opportunity for an emerging manager.

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

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

ERS continues to implement an intrinsic value format in the securities lending program to maximize the program's risk adjusted returns. Securities lending is inherently a low-return strategy, so staff focuses on mitigating the risks and has implemented changes focused upon that objective.

Currently, ERS only lends securities with rebates at or below zero and invests its collateral in overnight government repos. Borrowers must post greater than 100% of the value of the loan and maintain a margin of at least 100%. ERS places strict diversification requirements on its borrower concentration and monitors the credit spreads of its agent's approved counterparties. The Trust is lastly protected by a double indemnification from its securities lending agent, Deutsche Bank, or "DB," against losses resulting from the failure of a borrower to return securities, and/or from any losses resulting from the investment of the collateral in government repo.

In the last fiscal year, the Credit ETPs held by the Trust generated 62% of its total lending revenue. In the current fiscal year to date, these assets were still generating a disproportionately large share of total revenue (48%), but were earning materially less, only earning $1.1 million in the first half of the fiscal year vs. $5.6 million in fiscal 2014.

The Federal Reserve has given strong indications that it will begin to raise short-term interest rates and that is expected to increase market volatility, which creates more borrowing demand on the margin. ERS will continue to monitor the market and adjust the program to ensure that it maximizes risk adjusted returns while maintaining the current conservative approach to this program.

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

c. Annual Analysis of Portfolio Liquidity as of March 31, 2015 – Mr. Leighton Shantz, ERS Director of Fixed Income and Mr. Ben Bowman, Head of External Credit presented the annual analysis of portfolio liquidity.

At the December 2014 Joint Meeting of the Board and IAC, staff presented the state liquidity report and showed how the establishment of a 15% allocation to the Rates portfolio simplifies the process of evaluating liquidity. The $4.6 billion Rates portfolio is comprised of the most historically liquid and least volatile assets, intermediate U.S. Treasuries and Agency MBS.

The most appropriate measure of available liquidity is the absolute size of the Rates portfolio compared to undrawn commitments. There is an opportunity cost of maintaining a highly-liquid, low-yielding portfolio, but its existence allows portfolio managers to seek out higher yielding assets where the compensation for “selling liquidity” can generate significant returns that exceed the foregone yield from the Rates allocation. Thus, the proper sizing of the Rates portfolio is an important consideration.

To calculate the coverage ratio, staff examined the historical private markets program to find the largest quarterly call as a percentage of uncalled capital. The largest call was $204 million in the fourth quarter of 2011 or 11.3% of the $1.8 billion uncalled balance. Applying this percentage to the current uncalled commitment of $3.9 billion gives $433 million, which represents the largest quarterly call that would be expected, given the current size of the private markets program. As of March 31, 2015, the $4.6 billion Rates portfolio would cover this call by 10.7 times. ERS’ U.S. Treasury holdings (a subset of the Rates portfolio) would cover the call by 7.7 times.

Given the 10.7 times coverage multiple, staff believes the Trust has sufficient liquidity to fund maximum capital calls from private markets in addition to meeting its obligations for annuity payments and other costs. Additionally, staff believes it to be appropriately sized at 18% of the Trust as of March 31, 2015, with a final policy target of 15% based on the asset allocation adopted by the ERS Board of Trustees.

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

XIX. SET DATE FOR THE NEXT JOINT MEETING OF THE ERS BOARD OF TRUSTEES AND INVESTMENT ADVISORY COMMITTEE, AND THE NEXT MEETING OF THE BOARD OF TRUSTEES AND THE NEXT MEETING OF THE AUDIT COMMITTEE

The dates for the 2015 meetings Joint Meeting of the ERS Board of Trustees and Investment Advisory Committee, the Meeting of the Board of Trustees and the Meeting of the Audit Committee were as follows:

Joint Meeting Dates:
Tuesday, February 24, 2015
Tuesday, May 19, 2015
Tuesday, August 18, 2015

2-Day Workshop:
Thursday - Friday, December 3 & 4, 2015

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

The May 19, 2015 Joint Meeting of the ERS Board of Trustees and Investment Advisory Committee adjourned at 4:58 pm.