

MINUTES
ARKANSAS TEACHER RETIREMENT SYSTEM
BOARD OF TRUSTEES MEETING

Dr. Richard Abernathy, Chair

Tuesday, July 19, 2011

10:30 a.m.

1400 West Third Street
Little Rock, AR 72201

Board Members Present

Dr. Richard Abernathy, Chair
Hazel Coleman, Chair
Lloyd Black
David Cauldwell
Peggy Gram, designee for Honorable
Charlie Daniels
Danny Knight
Dr. Tom Kimbrell
Beverly Leming
Bobby Lester
Donna Morey*
Robin Nichols
Janelle Riddle*
Honorable Martha Shoffner
Jeff Stubblefield
**via teleconference*

Board Members Absent

Candace Franks

Consultants Present

Michael Bacine, Franklin Park
Heather Christopher, Hewitt EnnisKnupp
P.J. Kelly, Hewitt EnnisKnupp
Paul Zorn, Gabriel, Roeder, Smith & Co.

Staff Present

George Hopkins, Executive Director
Gail Bolden, Deputy Director
Brent Barrett, Senior Software Support
Bob Berry, Chief Fiscal Officer
Kay Daniel, Director's Assistant
Reed Edwards, Litigation Attorney
Laura Gilson, General Counsel
Amy Glavin, Administrative Assistant
Rod Graves, Ret. Investment Specialist
Wayne Greathouse, Dir. Public Markets
Manju, Dir. Data Processing
Jerry Meyer, Dir. Real Estate
Michael Ray, Dir. Member Services
Gaye Swaim, Operations Administrator
Leslie Ward, Dir. Private Equity
Brenda West, Internal Audit/Risk Mgmt.

Guests Present

Shane Benbrook, CPA
Chris Caldwell, Div. Legislative Audit
Dale Coy, CPA
Erika Gee, Attorney General's Office
Pam Hoover
Steve Singleton, ARTA

Reporters Present

Mike Wickline, Arkansas Democrat Gazette

- I. **Call to Order/Roll Call.** Chair, Dr. Richard Abernathy, called the Board of Trustees meeting to order at 10:42 a.m. Roll call was taken. Candace Franks was absent

- II. **Motion to Excuse Absences.**

Ms. Nichols *moved to excuse Candace Franks from the July 19, 2011, Board of Trustees meeting. Ms. Leming seconded the motion, and the Board unanimously approved the motion.*

III. Adoption of Agenda.

Ms. Nichols *moved for adoption of the Agenda. Ms. Coleman seconded the motion the Board unanimously approved the motion.*

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

V. Approval of Board of Trustees Minutes of June 6, 2011.

Ms. Leming *moved for approval of the Minutes of the Board of Trustees meeting of June 6, 2011. Ms. Nichols seconded the motion, and the Board unanimously approved the motion.*

VI. Election of Board Officers.

Ms. Nichols *nominated Dr. Richard Abernathy as Chair for the Board of Trustees.*

There were no further nominations for Chair of the Board of Trustees.

Ms. Gram *moved to accept Dr. Richard Abernathy as Chair for the Board of Trustees. Mr. Black seconded the motion, and the Board unanimously approved the motion.*

Ms. Nichols *nominated Beverly Leming as Vice Chair for the Board of Trustees.*

Ms. Coleman *nominated Hazel Coleman as Vice Chair for the Board of Trustees.*

There were no further nominations for the Vice Chair of the Board of Trustees. Votes were cast via paper ballot, with each Board member signing his or her name to their ballot. Ms. Morey abstained from the vote and Ms. Riddle cast a verbal vote.

By majority vote, Ms. Leming was appointed as Vice Chair for the Board of Trustees.

- VII. **Retirement Season Update.** Mr. Hopkins gave an update on the recent retirement season. With the legislative session and all of the changes in ATRS law, this retirement season may have been one of the busiest, if not the busiest, retirement season on record at ATRS.

Post 10-year T-DROP participants increased from 120 members in 2010 to 222 members in 2011. The post 10-year T-DROP balances increased from \$30 million in 2010 to \$54.3 million in 2011. Based upon the average monthly benefit for the 222 post 10-year T-DROP participants, ATRS saved approximately \$9.3 million in benefit payments.

The number of July 1, 2011, retirees appears to be approximately 1,500. The number of retirements will be down significantly from the expectations of actuarial assumptions. ATRS staff believes that a combination of the economic downturn and rising health care costs have played in part in the lower retirement numbers. There have been 632 new T-DROP applications, and 590 T-DROP participants have retired and left T-DROP.

ATRS has processed thousands of cost statements and purchase requests. ATRS staff estimate an excess of 500 new purchase accounts. The total commitments to purchase service are expected to exceed \$14 million.

- VIII. **GASB Update.** Mr. Zorn gave an update on the Governmental Accounting Standards Board (GASB) meeting. GASB met on July 8, 2011, and issued an Exposure Draft related to pension accounting and financial reporting, which would significantly change accounting and reporting for state and local governments. The proposals are not yet finalized. Current standards allow for six actuarial cost methods, discount rates that reflect expected long-term investment return, and actuarial gain/losses in unfunded actuarial accrued liability amortized over a maximum of 30 years.

The proposed framework would have an impact on ATRS. The employer's basic financial statement liability for pension benefits will be the net pension liability (NPL), or total pension liability minus the fair market value of plan assets at the end of the fiscal year. Pension expenses will include service cost, interest on total pension liability, changes in pension liability, differences between actual and projected investment earnings that are deferred and recognized over a five year period, and projected investment earnings.

The changes could cause a disconnect of accounting and reporting. The NPL will be included in the employer's basic financial statements. To the extent current and expected plan assets are not sufficient to pay future benefits, the discount rate will be adjusted to reflect tax-exempt, municipal bond yields. The changes in pension liabilities will be amortized over shorter periods,

increasing the pension expense's volatility. The pension expense will be significantly different from the actuarially determined contribution. Employers participating in ATRS will need to recognize a proportionate share of the plan's NPL and pension expense as their pension liability and expense.

The GASB will hold public hearings in October 2011 and the final statement will be June 2012. The plan will be effective June 15, 2012.

IX. **Audit Committee Report.** Mr. Coy gave a report on the Audit Committee meeting.

A. **Approval of Internal Audit Charter.** The Audit Committee approved the Internal Audit charter.

B. **2011-2012 Internal Audit Plan.** The Audit Committee approved the 2011-2012 Internal Audit plan.

X. **Investment Committee Report.** Ms. Leming gave a report on the Investment Committee meeting.

A. **Arkansas Holdings Update/Investment in Arkansas.**

1. **Victory Building Update.** ATRS has added a new tenant in the Victory Building. The tenant will be a health/fitness center in an area of the building that was previously difficult to rent. This addition brings the Victory Building to approximately 98% occupancy. ATRS staff is following up on the electrical usage issue discussed in previous Board meetings.

2. **Potential Boll Weevil Eradication Loan.** In the 2011 General Assembly, legislation was introduced concerning a potential loan to the boll weevil eradication program, but the bill was dismissed due to flaws after the retirement bill cut-off date. ATRS has since received correspondence from the attorney for the group and has also had input from legislators on the loan request. The proposed amount of the loan was \$16,379,595, at an interest rate of 4%. ATRS requested Hewitt EnnisKnupp's input on the matter since the law states that ATRS cannot recommend a loan to the Board without consultant input. Hewitt EnnisKnupp believes this loan is not highly collateralized. The backing for the loan is future cotton crops; however, should something happen to the crops, it would make the loan difficult to pay ATRS back. This could extend the loan for a very long time. Since the goal of ATRS is to make sound investments for member benefits, Hewitt EnnisKnupp would not recommend a loan to the Boll Weevil Eradication Board at 4%. The Committee does not believe the loan to

the Boll Weevil Eradication Board meets the Board's standards and makes no recommendations at this point.

3. **Insurance Department Building (Resolution 2011-26).** ATRS owns the building where the Arkansas Insurance Department is currently located. Due to a growing staff at the Arkansas Insurance Department, the Insurance Department has needed additional space in recent times. To date, the Insurance Department has leased adjacent space from another property owner. The Insurance Department has expressed an interest in greater ATRS involvement in any extra space needed by the Insurance Department. The Insurance Department strongly believes that ATRS can best meet the needs of the Insurance Department if ATRS purchases the adjoining building and lot. An ATRS property manager has submitted to the adjacent owner an offer of \$285,000, subject to Board approval, to purchase the building and lot in order to provide uniform property management and services to the Insurance Department. Purchasing the building would include renovations and a 1,000 square foot addition. ATRS investment staff has estimated future returns of 8% on the purchase. The Insurance Department building has been a profitable building for ATRS. Keeping the Insurance Department by meeting its space needs will be a significant part of maintaining the relationship with this important tenant. ATRS staff requests authority to negotiate and finalize this purchase as an add-on to the property. **Passed by motion, not resolution.**

Ms. Leming moved to authorize ATRS staff to negotiate and finalize the purchase of real estate property for the Insurance Department to lease. Ms. Nichols seconded the motion, and the Board unanimously approved the motion.

4. **Ross Dress for Less Lease.** A large majority of the remaining space from the old K-Mart property in the South Center Shopping Center in Hot Springs has been leased to Ross Dress for Less, a strong national retailer. This space has been vacant for over seven years. The lease will require some renovations to remove the automobile bays and garden areas, to improve the aesthetics of the building, and return it to "white box" condition. Remodeling is estimated to cost approximately \$215,000 for a new roof and other renovations. This tenant is financially strong and will make the property more valuable as an anchor tenant.
5. **Peabody Hotel Fixture Loan.** As reported at the previous Board Meeting, the Peabody Hotel has expressed an interest in an additional loan to improve and update the accommodations within the hotel.

ATRS staff and the Peabody Hotel Group have been in discussions about a potential loan to the Peabody Hotel Group of up to \$7 million. ATRS currently has a loan of approximately \$24 million to the Peabody Hotel, with 18 years remaining on the note.

On June 23, 2011, the Arkansas Supreme Court found that the new usury amendment was validly passed and is now effective. This means that interest rates in Arkansas can be charged on loans with a 17% cap on the rate. This ruling also provides ATRS the opportunity to consider whether it should occasionally reenter the role as a lender when returns and other circumstances warrant ATRS reentering the direct lending market. ATRS staff sees a benefit in moving forward with the Peabody loan review to assist the Peabody in maintaining its quality focus.

Ms. Leming *moved to approve authorization of ATRS staff to take all necessary steps to develop a loan proposal of up to \$7 million dollars to the Peabody Hotel, subject to an underwriter recommendation and Board approval. Ms. Shoffner *seconded the motion, and the Board *unanimously approved the motion.***

6. **Other Developments on Arkansas Investments.** As staff previously reported to the Board, ATRS was not successful in its tax lawsuits. The Arkansas Supreme Court found that the legislation granting ATRS local tax exemptions was unconstitutionally passed by the legislature and exceeded the legislature's authorities on granting such exemptions. ATRS is moving quickly to pay all taxes due and dismiss all the lawsuits. ATRS also plans to revisit Miller and Crittenden counties and ask for exemptions.

ATRS has been strongly encouraged by the Arkansas General Assembly and Legislative Council to focus on investing in Arkansas. ATRS has worked to follow up with known investment managers in Arkansas to discuss any investment strategies or investment opportunities that may exist. ATRS staff remains committed to always examine Arkansas opportunities and to place an emphasis on ensuring that minority firms, whether in Arkansas or other places, are given every fair consideration by both ATRS staff and the consultants in investment opportunities with ATRS. ATRS is currently reaching out to Arkansas-based managers for proposals.

B. General Investment Consultant Update – Hewitt EnnisKnupp.

1. **Portfolio Performance Update for the Month Ended May 31, 2011.**
Returns were slightly unfavorable for the month, with the total fund at -

1%, underperforming its benchmark of -0.8%. U.S. equity was at -1.5%, underperforming its benchmark of -1.1%, but is outperforming for the fiscal year to date. Global equity was at -2.2%, slightly underperforming its benchmark of -2.1%. Fixed income was at .7%, underperforming its benchmark of 1.2%, but is outperforming for the fiscal year to date

2. **Capital Guardian Transition Update.** The transition began on June 22, 2011, and ended on June 27, 2011. Opportunity costs were the largest expense during the transition, however Hewitt EnnisKnupp believes that the fee differential between Capital Guardian and BlackRock eliminates the disadvantage of the large opportunity costs

C. Real Estate Consultant Update – Hewitt EnnisKnupp.

1. **Portfolio Performance Update for the Quarter Ended March 31, 2011.** Real estate performance for the quarter was at 6.7%, which outperformed the NCREIF Property Index (NPI) at 3.4%. Net IRR improved by 90 basis points since the fourth quarter of 2010. Mid-term performance continues to be impacted by losses incurred during the market downturn. Net unfunded commitments increased by approximately \$20 million during the quarter. Core fund performance continued to rebound during the quarter.

ATRS committed an additional \$50 million to Prudential PRISA during the quarter, as well as an additional \$14.4 million to Torchlight DOF III and O'Connor capital calls. Pace of capital calls is expected to increase over 2011. Current pacing projections call for one to two value added commitments of \$70 million and one to two opportunistic commitments of \$50 million over the course of 2011.

D. Private Equity Investment Consultant Update – Franklin Park.

1. **Private Equity Portfolio Review for the Quarter Ended March 31, 2011.** The net IRR for the quarter ended March 31, 2011, was 8.5%, with committed capital at approximately \$2.4 billion. The percent change in portfolio value for the quarter was 6.2%.

XI. Staff Reports.

- A. **Medical Committee Report.** Mr. Ray gave the Medical Committee reports for June 2011 and July 2011. In June 2011, 21 applicants were considered, 19 were approved, and two were denied. In July 2011, 13 applicants were considered, 13 were approved, and three were denied.

Ms. Nichols moved to approve the June 2011 and July 2011 Medical Committee reports. Ms. Leming seconded the motion, and the Board unanimously approved the motion.

XII. Other Business.

- A. **IRS Determination Letter.** Mr. Hopkins reported on the IRS determination letter. ATRS has received a favorable recommendation from the IRS in regards to remaining a tax qualified public plan
- B. **NCTR Annual Conference.** Mr. Hopkins explained that NCTR Annual Conference information has been provided to the Board. ATRS staff will be looking for Board input as to Trustee interest in attending the NCTR Conference in order to facilitate any assistance needed by the Board in arranging travel and other attendance issues.

XIII. Adjourn.

Ms. Leming moved to adjourn the Board of Trustees Meeting. Mr. Lester seconded the motion, and the Board unanimously approved the motion.

Meeting adjourned at 11:45 a.m.

George Hopkins,
Executive Director

Dr. Richard Abernathy, Chair
Board of Trustees

Amy Glavin,
Recorder

Date Approved