



Teachers' Retirement System of the State of Illinois

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MINUTES

Meeting of the Investment Committee

August 22-23, 2012

A meeting of the Investment Committee of the Illinois Teachers' Retirement System was held on August 22-23, 2012 at the Springfield office of the Illinois Teachers' Retirement System 2815 West Washington Street. Cynthia O'Neill, Chair, called the meeting to order at 1:18 p.m. A quorum was present.

Roll Call attendance was taken with the following trustees present: Cynthia O'Neill (Chair), Marcia Campbell, Jan Cleveland, Cinda Klickna, Sharon Leggett, Bob Lyons, Janice Reedus, Molly Phalen, and Chris Koch.

Absent: Mike Busby (Vice Chair) and Sonia Walwyn.

Others present: Dick Ingram, Executive Director; Stan Rupnik, Chief Investment Officer; Greg Turk, Director of Investments; Deron Bertolo, Director of Investment Operations; Scottie Bevill, Sr. Investment Officer; Tim Hays, Sr. Investment Officer; Dakin Sanert, Sr. Investment Analyst; Bill Thomas, Investment Officer; Chuck Handy, Investment Officer; Kenyatta Matheny, Investment Officer; Jerry Quandt, Investment Officer; Tom Gray, General Counsel; Cynthia Fain, Sr. Assistant General Counsel; Jana Bergschneider, Director of Administration; Gina Larkin, Director of Human Resources; Sally Sherman, Director of Member Services; Stacy Smith, Director of Internal Audit; Tassi Maton, Sr. Internal Auditor; Christina Baker, Internal Auditor; Dave Urbanek, Director of Communications; Tammy Green, Asst. to Executive Director; Sue Billington, Executive Assistant; Jamie Shen and Avery Robinson, Callan Associates (Real Estate Consultant); Becky Gratsinger and Marcia Beard, RV Kuhns (Investment Consultant); Mike Krems and David Fann, TorreyCove (Private Equity Consultant); and John Long, Cavanagh & O'Hara (Fiduciary Counsel).

Visitors present: Rob Lauer, Barclays; Angela Myers, Loop Capital Markets; Dennis Murfin, IRTA Rep.; Don Davis, IRTA Rep.; Shirley Dodds, IRTA Rep.; Erika Lindley, ED-RED; Mark Bailey and Nick Scipione, IEA; Jim Baker, UNITE HERE; Barb Gilhaus, IEA-R; Dan Hankiewicz and Matt

Dragoo, COGFA; Andrew Perkins, Tom LaHood, and Kim Fowler, Senate GOP; Joe Sculley, House GOP; Jordan Fein, UNITE HERE; Maria Martinez and William Kingston, Hotel Palomar; Kristen Clark, Governor's office; and Sara Kaufman, IEA & IRTA.

APPROVAL OF MINUTES

A draft of the May 22-23, 2012 minutes of the Investment Committee meeting was sent to the committee for review. On a motion by Marcia Campbell, seconded by Cinda Klickna, the minutes were approved as printed by unanimous voice vote.

OLD BUSINESS

Investment Manager Chart

Stan Rupnik, Chief Investment Officer, provided an organizational chart of TRS's public markets investment managers as of June 30, 2012. Allocations are shown for the main TRS trust fund, the POB account and on a total TRS basis. Documentation is on file.

Cash Withdrawal

Mr. Rupnik discussed the recent cash withdrawals necessary to fund the System's cash requirements. Documentation is on file. Further withdrawals will be necessary to meet TRS's cash obligations. A motion was made by Janice Reedus, seconded by Sharon Leggett, that the committee recommend to the Board to withdraw up to 2.0 percent of the main TRS trust fund's total value, or \$619 million based on the May 31, 2012 ending market value. The motion passed by unanimous voice vote.

RFP Updates

Staff is planning due diligence meetings with search finalists for securities lending services and plans to have a final recommendation in October or December.

Staff is reviewing RFP responses for real estate co-investment advisor services, general investment consulting, and an investment performance reporting system. Recommendations are anticipated in December.

In May, the Board approved hiring Deloitte to perform real estate audit services. However, contract negotiations with Deloitte were not successful. Staff re-opened negotiations and recommended selecting KPMG to provide real estate audit services for a five-year contract period. A motion was made by Sharon Leggett, seconded by Jan Cleveland, that the committee recommend to the Board to hire KPMG to provide real estate audit services for five years. The motion passed by unanimous voice vote.

NEW BUSINESS

Walton Street Capital – Real Estate

Representatives of Walton Street Capital provided an investment opportunity in the firm's real estate fund, Walton Street Real Estate Fund VII, Limited Partnership. Their presentation booklet is on file. Staff provided an overview of the due diligence that was conducted. TRS currently has existing investments with Walton Street in Funds IV and VI. Discussion followed. A motion was made by Molly Phalen, seconded by Marcia Campbell, to table further discussion until the following day. The motion passed by unanimous voice vote.

STAFF/CONSULTANT PRESENTATIONS

Investment Performance Review – June 30, 2012

RVKuhns provided a summary of the public markets investment performance for the quarter ended June 30, 2012. Documentation is on file. Stan Rupnik, Chief Investment Officer, provided preliminary data of the investment performance for the fiscal year ended June 30, 2012.

RECESS

The meeting recessed at 3:32 p.m. and reconvened at 3:47 p.m.

Watch List

Greg Turk, Director of Investments, provided an update of the investment managers currently on the watch list for the quarter ended June 30, 2012. The existing managers remain on watch due to performance reasons: Brandes Investment Partners (international equity) and Turner Investment

Partners (domestic equity). The following managers were added to the watch list due to performance reasons: Boston Company SMIDV (domestic equity), Denali Advisors (domestic equity), Frontier Capital Management (domestic equity), Levin Capital Management (domestic equity), and Putnam Investments (international equity). Staff recommended removing Hartford Investment Management Company (fixed income) from the watch list and terminating Credo Capital Management's domestic equity mid cap growth portfolio from the TRS Emerging Manager Program due to performance. A motion was made by Bob Lyons, seconded by Sharon Leggett, that the committee recommend to the Board to accept the watch list as presented. The motion passed by a unanimous voice vote.

Credo Capital Management -- Termination

A motion was made by Bob Lyons, seconded by Marcia Campbell, that the committee recommend to the Board to terminate Credo's domestic equity mid cap growth portfolio from the TRS Emerging Manager Program. The Rhumblin S&P 500 index fund dedicated to the Emerging Manager Program will be reimbursed for Credo's \$25 million initial funding. The motion passed by a unanimous voice vote.

MBE/WBE Utilization Report

Stan Rupnik provided preliminary data on the participation of women/minority-owned brokers and investment managers within the TRS investment portfolio through June 30, 2012. Assets under management for WMBE-owned investments were \$5.26 billion, representing 13.18% of the total TRS portfolio. Documentation is on file.

Notification of State Street Enhanced Custody Model

TRS utilizes State Street's Enhanced Custody Model for prime brokerage services. Bill Thomas, Investment Officer, noted State Street began imposing a new administrative charge in May for any non-self-borrowed assets. The additional fee results in an immense increase in annual fees. Staff is disappointed in the fee assessment and poor communication surrounding its implementation. Staff has worked w/Boston Partners on an analysis and recommends staying with the enhanced custody model.

Private Equity Asset Class

Greg Turk, Director of Investments, provided an update on recent activity within the private equity asset class. Staff requested ratification of a co-investment opportunity with Apollo Global Management in the acquisition of EP Energy Corporation. TRS's commitment is up to \$30 million to EP Energy. This co-investment opportunity is a complimentary fit with the goals and objectives of the private equity co-investment allocation strategy. A motion was made by Janice Reedus, seconded by Cinda Klickna, that the committee recommend to the Board to ratify the co-investment opportunity offered by Apollo. The motion passed by a unanimous voice vote.

In addition, staff requested ratification of a co-investment opportunity with Providence Equity Partners in an equity capital raise for Grupo TorreSur (GTS). TRS's commitment is up to \$40 million to GTS to fund the development of wireless towers in Central and South America. A motion was made by Molly Phalen, seconded by Cinda Klickna, that the committee recommend to the Board to ratify the co-investment opportunity offered by Providence Equity Partners, with an initial \$10 million investment followed by additional investments of up to \$30 million. The motion passed by a unanimous voice vote.

Real Estate Tactical Plan

Callan Associates presented the FY 2013 real estate tactical plan and provided a summary of the current year initiatives along with accomplishments as a result of last year's tactical plan. TRS has a long-term allocation target of 14.0 percent to real estate. The plan includes a real estate market outlook, a portfolio pacing analysis, a review of the program's long-term guidelines and objectives, an evaluation of TRS's existing managers, exposures and performance. A motion was made by Jan Cleveland, seconded by Cinda Klickna, that the committee recommend to the Board to approve the FY 2013 real estate tactical plan as presented. The motion passed by a unanimous voice vote.

KBS Realty Advisors Termination – Real Estate

Staff recommended ending the long-term relationship with KBS Realty Advisors due to underperformance and organizational concerns. To better align the portfolio, staff recommended transferring the KBS's portfolio to

Lincoln Property Company. A motion was made by Marcia Campbell, seconded by Janice Reedus, that the committee recommend to the Board to terminate KBS Realty Advisors from the TRS real estate portfolio. The motion passed by a unanimous voice vote.

RECESS

The meeting recessed at 5:45 p.m. and reconvened the following day at 8:04 a.m.

PUBLIC COMMENT

Jim Baker, UNITE HERE, provided the Investment Committee with a copy of a letter detailing issues regarding Walton Street properties. He expressed many concerns regarding TRS's relationship with Walton Street.

EXECUTIVE SESSION

A motion was made by Bob Lyons, seconded by Cinda Klickna, that the Investment Committee enter into executive session for the purpose of discussing real property acquisition and investments as permitted under the following exceptions set forth in the Open Meetings Act which authorizes the closing of the meeting to the public: 5 ILCS 120/2(c) (5) and 5 ILCS 120/2(c) (7). Roll call resulted in affirmative voice votes from Trustees Campbell, Cleveland, Klickna, Leggett, Lyons, O'Neill, Reedus, and Phalen. Motion CARRIED.

No action was taken during executive session. A motion was made by Molly Phalen, seconded by Jan Cleveland, that the Investment Committee come out of executive session. Roll call resulted in affirmative voice votes from Trustees Campbell, Cleveland, Klickna, Leggett, Lyons, O'Neill, Reedus, and Phalen. Motion CARRIED.

RECESS

The meeting recessed at 9:12 a.m. and reconvened at 9:20 a.m.

NEW BUSINESS

Walton Street – Real Estate

Jamie Shen of Callan Associates provided an overview of the due diligence process conducted for investing in Walton Street Real Estate Fund VII. A motion was made by Bob Lyons, seconded by Molly Phalen, that the committee recommend to the Board to commit \$100 million to Walton Street Real Estate Fund VII, L.P. for future investments in real estate, (\$75 million main fund, \$25 million POB account) subject to Walton Street Capital LLC confirming (in terms acceptable to the System) that it will remain neutral with respect to labor organization organizing activities. The motion passed by voice vote. Trustee Campbell abstained from voting.

STAFF PRESENTATIONS

Real Estate Appraisal Services RFP

The System's policies and procedures require that the System's direct real estate assets be externally appraised every three years based on the date of the investment. The current appraisal contracts with CB Richard Ellis Valuation & Advisory Services and US Realty Consultants expire the end of this year, however, these firms have been granted short-term extensions until the RFP process concludes. A motion was made by Bob Lyons, seconded by Janice Reedus, that the committee recommend to the Board to authorize an RFP for appraisal services. The motion passed by unanimous voice vote.

Absolute Return Targets

Greg Turk, Director of Investments, recommended revisions to the absolute return asset class structure targets relative to June 30, 2012 market values. Staff recommended lowering the Fund of Funds target closer to 50% by reflecting a 10 percent increase to Credit Funds, offset by a 10 percent decrease to Fund of Funds. A motion was made by Cinda Klickna, seconded by Jan Cleveland, that the committee recommend to the Board to approve staff's recommendation as presented. The motion passed by unanimous voice vote.

Transition Summary

Stan Rupnik reported on the following transition activities within the TRS portfolio:

- Denali large value reduction to Rhumbine S&P 500
- Rebalancing of the fixed income asset class to the international equity asset class
- Funding of Cortina from SSGM Russell 2500 Growth

Iran Divestment Update

In accordance with the Iran divestment, staff reported that the System has not received any responses from the identified companies regarding their business relationships within the Iran energy sector. Absent a detailed and justifiable response, a motion was made by Cinda Klickna, seconded by Marcia Campbell, that the committee recommend to the Board to add China National Petroleum Corporation, Gazprom (Russia), and Peronas (Malaysia) to TRS's list for possible divestment. The motion passed by a unanimous voice vote. No new companies were added to the TRS list. Since last year, ENI was removed from the source lists. Documentation is on file.

Quarterly Compliance Report

Staff reviews alerts triggered by the State Street compliance system to determine if there are any violations. Deron Bertolo, Director of Investment Operations, noted no issues were reported for the quarter ending June 30, 2012. Documentation is on file.

NEW BUSINESS

Advent International Corporation – Private Equity

Representatives of Advent International Corporation provided an investment opportunity in their private equity fund, Advent International GPE VII, Limited Partnership. Their presentation booklet is on file. Staff provided an overview of the firm and due diligence that was conducted. A motion was made by Jan Cleveland, seconded by Molly Phalen, that the committee recommend to the Board to commit up to \$150 million to Advent International GPE VII, L.P. split between main fund (85%) and POB

account (15%) for investments in companies in Europe and Latin America. The motion passed by a unanimous voice vote.

Oaktree Capital Management – Fixed Income

Representatives of Oaktree Capital Management presented an investment opportunity in the firm's Enhanced Income Fund within the fixed income special situations fund. Their presentation booklet is on file. Staff provided an overview of the due diligence that was conducted. A motion was made by Bob Lyons, seconded by Marcia Campbell, that the committee recommend to the Board to commit \$75 million to Oaktree Capital Management's Enhanced Income Fund within the fixed income special situations fund for investments in financial institution securities. The motion passed by a unanimous voice vote.

RECESS

The meeting recessed at 11:10 a.m. and reconvened at 11:20 a.m.

Clearlake Capital Group – Emerging Manager Program

The committee interviewed Clearlake Capital Group to fill an allocation within the System's Emerging Manager Program. Their presentation booklet is on file. Staff provided an overview of the firm and due diligence that was conducted. A motion was made by Marcia Campbell, seconded by Janice Reedus, that the committee recommend to the Board to commit \$50 million to Clearlake Capital Partners II, Limited Partnership for investments in distressed debt and special situation opportunities in small and medium sized companies. The motion passed by a unanimous voice vote.

Private Equity Education

TorreyCove provided an educational session on the topic of private equity secondary investing. Documentation is on file. Private equity secondary market is an initiative for the FY 2013 private equity tactical plan.

Private Equity RFP Request

Staff and TorreyCove recommended that the System execute a secondary private equity program to provide TRS with advice in the selection of private equity investments in the secondary market. A motion was made by

Cinda Klickna, seconded by Sharon Leggett, that the committee recommend to the Board to authorize an RFP for private equity secondary advisory services. The motion passed by unanimous voice vote. The RFP will be issued in September with a final recommendation in December.

RECESS

The meeting recessed at 12:35 p.m. and reconvened at 1:20 p.m.

Private Equity Tactical Plan

TorreyCove and staff presented the FY 2013 private equity tactical plan and the program initiatives. The plan includes a review of TRS's existing managers, exposures and performance, an updated portfolio pacing analysis, and a proposal to allow staff discretion on decisions regarding renewals or "re-ups" with existing private equity managers in good standing. A lengthy discussion was held regarding the commitment process for private equity "re-ups". It was consensus to table further discussion until the October meeting. A motion was made by Cinda Klickna, seconded by Marcia Campbell, that the committee recommend to the Board to approve the FY 2013 private equity tactical plan as presented. The motion passed by unanimous voice vote.

Investment Policy Revisions

Staff proposed the following revisions to the TRS Investment Policy.

- Section VI: Implementation – removes reference to Implementation Manual
- Section VII: Asset Allocation and Rebalancing Strategy – revisions to interim asset allocation
- Section VIII: Investment Manager Structure – reflects structure changes through fiscal year
- Section IX: Investment Manager Hiring Guidelines – revision to commitment process for private equity "re-ups"
- Section XIII: Performance Benchmarks – modifies TRS Policy Benchmark according to the interim asset allocation.
- Section XXII: addition of FY 12 minority goals

A motion was made by Cinda Klickna, seconded by Sharon Leggett, that the committee recommend to the Board to approve the revisions to the TRS Investment Policy, as amended. Section IX was deferred to October and Section XXII was added. The motion passed by unanimous voice vote.

Asset Allocation

To best reflect the portfolio's current positioning and ongoing implementation plan, staff proposed revisions to the System's policy benchmark for the beginning of FY 2013. Documentation is on file. A motion was made by Cinda Klickna, seconded by Marcia Campbell, that the committee recommend to the Board to adopt the revised interim asset allocation target and policy benchmark, as presented, effective July 1, 2012. The motion passed by unanimous voice vote.

ADJOURNMENT

There being no further business to come before the Investment Committee, a motion was made by Cinda Klickna, seconded by Sharon Leggett, to adjourn the meeting at 2:35 p.m.

Richard W. Ingram, Executive Director

Approved _____