

**MONTANA BOARD OF INVESTMENTS  
DEPARTMENT OF COMMERCE  
2401 Colonial Drive, 3<sup>rd</sup> Floor  
Helena, Montana**

**MINUTES OF THE MEETING  
November 15-16, 2011**

**BOARD MEMBERS PRESENT:**

Gary Buchanan, Chairman  
David Aageson  
Karl Englund  
Patrick McKittrick  
Mark Noennig  
Quinton Nyman  
Jack Prothero  
Jon Satre  
Jim Turcotte  
Senator Joe Balyeat  
Representative Franke Wilmer

**STAFF PRESENT:**

Polly Boutin, Accountant	Chris Phillips-DeFranco, CFA, Investment Staff
Jason Brent, CFA, Alternatives Investment Analyst	Jon Putnam, CFA, FRM, Fixed Income Investment Analyst
Candy Burch, Administrative Assistant	Nancy Rivera, Credit Analyst
Geri Burton, Deputy Director	John Romasko, CFA, CPA, Fixed Income Investment Analyst
Richard Cooley, CFA, Portfolio Manager, Fixed Income/STIP	Nathan Sax, CFA, Portfolio Manager, Fixed Income
Tim House, Investment Operations Chief	Clifford A. Sheets, CFA, Chief Investment Officer
Ethan Hurley, Portfolio Manager, Alternative Investments	Carroll South, Executive Director
Ed Kelly, Alternative Investment Analyst	Steve Strong, Equity Investment Analyst
April Madden, Accountant	Ali Sturm, Accountant
Gayle Moon, Fiscal Accounting Manager	Louise Welsh, Bond Program Officer
Rande Muffick, CFA, Portfolio Manager, Public Equities	Dan Zarling, CFA, Director of Research

**GUESTS:**

David Ewer, State Budget Director  
Mike Heale, CEM Benchmarking  
Gordon Hoven, Piper Jaffray  
Jim Voytko, RV Kuhns and Associates  
Kris Wilkinson, Legislative Fiscal Division

**CALL TO ORDER**

Chairman Gary Buchanan called the regular meeting of the Board of Investments (Board) to order at 12:30 p.m. in the Board Room on the third floor at 2401 Colonial Drive, Helena, Montana. As noted above, a quorum of Board Members was present. Senator Joe Balyeat arrived at 12:45 p.m. and Representative Franke Wilmer arrived at 2:45 p.m.

Chairman Buchanan asked Ms. Gayle Moon, Accounting Fiscal Manager, to introduce Ms. Ali Sturm, the newest staff member to the Board of Investments' accounting team. Chairman Buchanan welcomed Ms. Sturm and then asked for introductions from Board Members, staff and guests.

Board Member Jack Prothero made a Motion to approve the Minutes of the August 16 -17, 2011 Board Meeting; Member Karl Englund seconded the Motion. The Motion was carried 9-0.

### **ADMINISTRATIVE BUSINESS**

#### **Audit Committee Report**

Audit Committee Chair Jim Turcotte reported that the Audit Committee met Wednesday, August 17, upon adjournment of the full Board Meeting. The Board's internal controls auditor, Galusha, Higgins & Galusha, presented a draft of the fiscal year 2011 internal controls report and staff's response.

There were seven recommendations in the draft report. The majority of the recommendations dealt with reflecting verification of reconciliations (i.e. dating and initialing the reconciliations that staff had prepared).

Audit Committee Chair Turcotte reported that the Committee accepted the draft fiscal year 2011 report and staff's response and directed the internal control auditor to finalize the report and directed staff to update the Internal Control Policy based on the recommendations.

A copy of the final Fiscal Year 2011 Internal Controls Report was handed out to the full Board.

Audit Committee Chair Jim Turcotte made a Motion to approve the Fiscal Year 2011 Internal Controls Report; Board Member Jon Satre seconded the motion. The Motion was carried 9-0.

#### **Human Resource Committee (HR) Report**

HR Committee Chair Karl Englund reported that the HR Committee reviewed and discussed the annual performance appraisals for exempt staff prepared by Executive Director Carroll South and Chief Investment Officer Cliff Sheets. Additionally, it was reported that the HR Committee decided not to consider pay raises in 2012.

#### **Loan Committee Report**

Loan Committee Chair Jack Prothero reported that the Committee reviewed and approved two INTERCAP loan requests; the Loan Committee authorized staff to proceed with processing and closing these loans using the Board's standard Bond Program office procedures.

Borrower:	Town of Philipsburg
Purpose:	Interim loan in anticipation of USDA Rural Development long term financing for a wastewater improvement project
LC Approval Date:	November 15, 2011
Board Loan Amount:	\$3,652,000
Other Funding Sources:	\$2,348,000
Total Project Cost:	\$6,000,000
Term:	2 years

Borrower:	Gallatin Gateway County Water & Sewer District
Purpose:	Interim loan in anticipation of USDA Rural Development long term financing for a wastewater improvement project
LC Approval Date:	November 15, 2011
Board Loan Amount:	\$1,650,000
Other Funding Sources:	\$2,665,000
Total Project Cost:	\$4,315,000
Term:	2 years

Loan Committee Chair Prothero also reported that the Committee approved a loan request from the Department of Commerce in the amount of \$2,625,000 to fund Treasure State Endowment Program grants for the 2011 biennium projects authorized by the Legislature. The loan will be funded from the Permanent Fund sub-fund of the Coal Tax Trust.

Public Comment

Chairman Buchanan called for public comment on Board issues. There was no public comment.

**EXECUTIVE DIRECTOR'S REPORT**

Montana Veterans' Home Mortgage Loan Program

Executive Director Mr. Carroll South reported on the Montana Veterans' Home Loan Mortgage Program. The 2011 Legislature allocated \$15 million from the Coal Tax Trust into a revolving loan fund for home loans to veterans. Mr. South stated that on November 1, 2011 the Montana Board of Housing (BOH) kicked off the new Program. The first mortgage loans will be administered and serviced by the BOH and purchased by the Montana Board of Investments.

Pension Cash Flow Status

Mr. Carroll South reviewed selective pages from a recent report on the pensions provided to the SAVA Committee which highlight the difference between return and income. It then examined the history of the difference between investment cash income and cash flow (contributions vs. benefits) for the two largest plans. Because cash flow turned negative several years ago for both PERS and TRS, cash income has been used to make up the difference. In the case of TRS, the negative cash flow has grown to a level above investment cash income, necessitating a small liquidation of assets to meet benefit needs. This problem is expected to grow in the future absent any action to increase contributions to the actuarial required level. In turn, this liquidity need will eventually have implications for the asset mix. To the extent assets are increasingly used to fund cash flow shortfalls, the ability to use less liquid assets with higher expected returns will be compromised which will make it more difficult to achieve the expected return.

Pension Investment Management Fees

Mr. Carroll South distributed a report on Pension Fund Investment Costs. Mr. South reviewed pension investment fee history and its composition by asset type. Investment fees include external investment management fees, Board of Investment fees, custodial bank fees and fees charged by the two pension boards. For fiscal year 2011 total investment fees were 57 basis points. He also discussed the impact of investment costs on return and then explained why the gross vs. net return is imprecise in measuring the actual cost impact due to the compounding effect.

#### Resolution No. 217 Update

Mr. Carroll South presented the annual Resolution No. 217 update to the Board, including broker/dealers and managers that have been added as well as those terminated. The update also reflected changes in Board staff authorized to conduct financial transactions with the broker/dealers and managers. Resolution No. 217 designates its Executive Director as agent of the Board to deal with investment firms in connection with Board accounts with such firms; and reflects that the investment firms are authorized to deal with the Executive Director or the Executive Director's designated staff as agents of the Board. No Board action was required.

### CONSULTANT REPORTS

#### CEM Benchmarking Report

Mr. Mike Heale presented an overview of CEM's investment cost analysis report for the Montana pension plans for the 2010 calendar year. The analysis examined Montana returns and costs vs. peers. It examined the concept of policy return and its composition in terms of mix and benchmarks. It looked at "value-added" which represents the difference between actual return and policy return. Mr. Heale reported that our 2010 total return of 13.5% was slightly below the U.S. median of 13.8%. He stated that our 2010 policy return of 13.7% was above the U.S. median of 12.5% and above the peer median of 12.4%. He noted the differences in policy returns are caused by differences in benchmarks and policy mix. Mr. Heale explained that our asset management costs in 2010 were \$47.7 million, or 68.7 basis points, which was slightly lower than our benchmark cost of 69.8 bp. Thus, our cost savings was 1.0 bp. In summary, the Board's costs were normal because we had a slightly lower cost implementation style and paid similar amounts to peers, but were placed in the negative net value added area of the cost effectiveness chart.

#### RV Kuhns & Associates

Mr. Jim Voytko presented an overview of the Investment Performance Analysis Report, Quarter Ended September 30, 2011. *(A complete copy of this report is kept on file with the documents of this meeting.)*

### PENSION BOARD REPORTS

#### Teachers' Retirement System Annual Report

Teachers' Retirement System (TRS) Director Dave Senn presented an overview of the TRS including information on TRS pension plan and long-term funding as of July 1, 2011 and beyond. Mr. Senn reported on the 2011 valuation and funding results and the projection of the System's unfunded accrued liability. He discussed the "Impact of Alternatives" and changes for current and new TRS members. In closing, Mr. Senn noted that changes to address the unfunded liability can be incremental and phased in over time; however, the sooner changes are made, the better the outcome will be for everyone – teachers, retirees, employers, and taxpayers.

#### Public Employees Retirement System Annual Report

Public Employees Retirement System (PERS) Executive Director Roxanne Minnehan reviewed performance of the retirement plans. Ms. Minnehan stated that four of the eight defined benefit plans are not actuarially sound. She stated that the normal cost rate for PERS members is 12.59% and 10.12% for new hires.

Ms. Minnehan stated that during the 2011 Legislative Session, the Public Employees Retirement Board proposed plan design changes to the PERS, Sheriffs' Retirement System and

the Game Wardens and Peace Officers' Retirement System, along with additional funding. The funding mechanisms were eliminated. The plan design changes were for new hires only. Ms. Minnehan stated that although this addresses long-term plan sustainability; the impact of changes for new hires will not significantly impact the plans for 15-20 years. The plans have not been receiving the actuarial required contribution for the past three years, compounding the funding issue.

Chairman Buchanan adjourned the meeting at 5:00 to break for dinner prior to the Executive Director Candidate interview.

### **INTERVIEW OF EXECUTIVE DIRECTOR CANDIDATE**

#### **Executive Director Candidate Finalist Interview**

Human Resource Committee Chair Karl Englund reviewed the process that was followed in the search for an Executive Director, including the following information regarding the search:

- the position was advertised statewide and nationwide;
- 67 resumes were received; 18 were from Montana applicants;
- 8 applicants were interviewed via telephone; and
- 4 applicants were interviewed in-person at the Board of Investments' office.

Mr. Englund concluded by introducing Mr. David Ewer, the finalist for the Executive Director position and recommended for interview by the HR Committee.

Mr. Ewer introduced himself to the Board and gave a brief overview of his background. Mr. Ewer then responded to questions asked by Board members.

At the conclusion of the interview, Chairman Buchanan announced that for reasons of privacy dealing with personal issues, the regular meeting of the Board would be closed to the public. This would allow the Board to meet in a closed session to discuss and to consider the interview of Mr. Ewer for the position of Executive Director.

The regular meeting of the Board was reconvened at 7:00 p.m.

#### **Approval of Executive Director Hiring – David Ewer**

HR Committee Chair Karl Englund Made a Motion to accept the following recommendation of the HR Committee:

- hire David Ewer as the Executive Director;
- hiring date would be effective December 1, 2011;
- annual base salary of \$160,000; and
- transfer approximately 400 hours of Mr. Ewer's exempt employee compensatory time to his new position as Executive Director.

Mr. Mark Noennig seconded the Motion. The Motion was carried 8-0. Member Quinton Nyman was not present as he had to leave the meeting early.

Board Member Mr. Jon Satre thanked Mr. Englund and the HR Committee for all of the hard work and many, many hours they spent in order to find the best possible person for the Executive Director position.

The meeting was adjourned for the evening at 7:15 p.m.

**CALL TO ORDER – Day 2**  
**November 16, 2011**

Chairman Gary Buchanan reconvened the meeting Wednesday, November 16, 2011 at 8:30 a.m. with eight members of the Board present. Mr. Quinton Nyman joined the Board Meeting at 8:45 a.m.

**ADMINISTRATIVE BUSINESS**

**2012 Board Meeting Dates – Tentative.**

Chairman Buchanan reviewed a draft schedule of the dates for next year's Board Meetings. The next Board Meeting is tentatively scheduled for February 21-22, 2012.

**Public Comment**

Chairman Buchanan called for public comment on Board issues. There was no public comment.

**INVESTMENT ACTIVITIES/REPORTS**

Mr. Clifford Sheets introduced Mr. Ethan Hurley to the Board. Mr. Hurley was hired as the new Portfolio Manager for Alternative Investments in October 2011.

**Retirement System Asset Allocation Report**

Mr. Sheets presented the Retirement Systems Asset Allocation Report for the quarter ending September 30, 2011. Mr. Sheets noted that total equity was down 3.8% from the previous quarter to 63.6%. The allocation to fixed income increased 2.8% to 27.4% and the allocation to real estate increased 1.3% to 7.8%. These changes in weighting were largely due to the significant decline in public equity returns for the quarter, with the domestic and international equity pools falling by approximately 15 percent and 21 percent respectively. Net new investments for the quarter were approximately \$17.4 million.

When asked about the near term investment outlook Mr. Sheets stated there are still serious concerns about Europe. The U.S. economy has done well in the third quarter and the prospect of falling into a double-dip recession has diminished recently. He noted that inflation is slowly coming down and there is a more positive outlook for risk assets now than a couple months ago.

**Comparison to State Street Public Fund Universe**

Mr. Sheets reviewed a comparison of the two large pension plans to the State Street public fund universe in terms of relative performance and asset allocation as a supplement to the RV Kuhns public fund universe return comparison.

**Private Asset Pool Reviews**

**Private Equity (MPEP)**

Mr. Ethan Hurley presented a comprehensive overview of the second quarter private equity portfolio: total exposure by strategy; market value exposure by industry; geography and investment vehicle exposure; and periodic return comparison. The report also included quarterly cash flow through September 30, 2011.

One new commitment was made since the August 2011 Board meeting:

<b>Fund Name</b>	<b>Vintage</b>	<b>Subclass</b>	<b>Sector</b>	<b>Amount</b>	<b>Date</b>
Siguler Guff Small Buyout Opportunities Fund II	2011	Buyout – Fund of Fund	Diverse	\$25M	08/31/11

Real Estate (MTRP)

Mr. Hurley presented a comprehensive overview of the following private edge reports for the second quarter: total exposure by strategy; market value exposure by property type; total exposure by geography; time weighted and internal rates of return; and the portfolio holdings by fund. The report also showed a graph of the quarterly cash flow for the portfolio through September 30, 2011.

No new commitments were made since the August 2011 Board Meeting.

Partnership Focus List

There were no changes to the MPEP and MTRP Partnership Focus List (PFL) since the August 2011 Board meeting.

Public Asset Pool Reviews

Domestic Equity (MDEP)

Mr. Rande Muffick reported on the Montana Domestic Equity Pool as of September 30, 2011, including a summary of recent market trends.

International Equity (MTIP)

Mr. Muffick presented the Montana International Equity Pool Report for the period ending September 30, 2011 and reviewed market trends during the quarter.

Public Equity External Managers Watch List

Mr. Muffick reported that Analytic Investors was removed from the Watch List during the quarter. No managers were added to the list and there were no manager terminations. The current Watch List is shown below:

<b>Manager</b>	<b>Style Bucket</b>	<b>Reason</b>	<b>\$ Invested (mil)</b>	<b>Inclusion Date</b>
Western Asset	Domestic - LC Enhanced	Performance, Tracking Error	\$136	March 2008
Martin Currie	International – LC Growth	Performance, Risk Controls	\$85	February 2009
Artio Global	International – LC Core	Performance, Philosophy	\$93	November 2010
Columbus Circle	Domestic – LC Growth	Performance, Process	\$126	May 2011
TimesSquare	Domestic – MC Growth	Performance	\$87	August 2011

Fixed Income

Mr. Nathan Sax presented the Fixed Income overview and strategy for the Retirement and Trust Fund Bond Pools. Mr. Sax noted that interest rates fell significantly in the third quarter. Slow growth in the United States and continued fears of a sovereign debt crisis in the Euro zone drove Treasury prices higher.

Mr. Sax presented the Non-Investment Grade Holdings Report.

Mr. Richard Cooley reported on the Short Term Investment Pool, State Fund Insurance and Treasurer's Fund portfolios.

**MONTANA LOAN PROGRAMS**

Commercial and Residential Portfolios Report

Ms. Nancy Rivera reported that as of October 31, 2011 the commercial loan portfolio totaled \$149,422,370; reservations totaled \$5,510,492 and commitments totaled \$11,298,259. Past due loans totaled \$7,101,121 or 4.75% of the total portfolio. A payment was received on one of the past due loans which accounted for \$4,432,588 of the past due total. If that payment would have been received prior to the last day of the month, the past due percentage would have been a more respectful 1.79%.

Ms. Rivera also reported that the residential loan portfolio had an outstanding balance of \$25,411,018 as of September 30, 2011. Four loans were past due greater than 90 days; one of the loans was paid in October.

**BOND PROGRAM**

Activity Report

Ms. Louise Welsh presented the INTERCAP report for the period July 1, 2011 through September 30, 2011. Year to date commitments totaled \$9,510,393 with \$7,141,474 funded. Total loans outstanding are \$75,794,992; bonds outstanding are \$95,530,000.

Staff Approved Loans Report

The Board reviewed this report for the period of July 1, 2011 through September 30, 2011.

Borrower:	Custer School District #15
Purpose:	Roof repairs
Staff Approval Date:	July 5, 2011
Board Loan Amount:	\$41,556
Other Funding Sources:	\$0
Total Project Cost:	\$41,556
Term:	5 years

Borrower:	Valley County
Purpose:	Emergency road & bridge repairs
Staff Approval Date:	July 8, 2011
Board Loan Amount:	\$1,000,000
Other Funding Sources:	\$0
Total Project Cost:	\$1,000,000
Term:	10 years

Borrower:	Pondera County
Purpose:	Senior Center remodel
Staff Approval Date:	July 13, 2011
Board Loan Amount:	\$ 150,000
Other Funding Sources:	\$1,043,598
Total Project Cost:	\$1,193,598
Term:	15 years

Borrower:	City of Lewistown
Purpose:	Extend water & sewer services at the city/county airport
Staff Approval Date:	July 14, 2011
Board Loan Amount:	\$90,000
Other Funding Sources:	\$0
Total Project Cost:	\$90,000
Term:	10 years

Borrower:	Bigfork Rural Fire District
Purpose:	Refinance Ladder Truck
Staff Approval Date:	July 26, 2011
Board Loan Amount:	\$673,045
Other Funding Sources:	\$0
Total Project Cost:	\$673,045
Term:	10 years

Borrower:	Roy Rural Fire District
Purpose:	Construct an Emergency Services Building
Staff Approval Date:	July 27, 2011
Board Loan Amount:	\$ 30,000
Other Funding Sources:	\$270,000
Total Project Cost:	\$300,000
Term:	15 years

Borrower:	City of Columbia Falls
Purpose:	Finish street improvement project
Staff Approval Date:	July 28, 2011
Board Loan Amount:	\$ 364,449
Other Funding Sources:	\$ 740,766
Total Project Cost:	\$1,105,215
Term:	10 years

Borrower:	Town of Superior
Purpose:	Interim loan in anticipation of USDA Rural Development Community Facilities Program long term loan - new fire hall
Staff Approval Date:	August 3, 2011

These minutes are Approved and Final. Full Board review and decision took place at the February 21 & 22, 2012 Regular Meeting of the Board.

Board Loan Amount:	\$498,000
Other Funding Sources:	\$458,500
Total Project Cost:	\$956,500
Term:	1 year

Borrower:	Bridger Canyon Rural Fire District
Purpose:	Refinance its fire station loan
Staff Approval Date:	August 22, 2011
Board Loan Amount:	\$125,000
Other Funding Sources:	\$0
Total Project Cost:	\$125,000
Term:	15 years

Borrower:	Culbertson Elementary School
Purpose:	Reroofing the school wings
Staff Approval Date:	August 23, 2011
Board Loan Amount:	\$125,000
Other Funding Sources:	\$0
Total Project Cost:	\$125,000
Term:	10 years

Borrower:	Culbertson High School
Purpose:	Reroofing the school wings
Staff Approval Date:	August 23, 2011
Board Loan Amount:	\$125,000
Other Funding Sources:	\$0
Total Project Cost:	\$125,000
Term:	10 years

Borrower:	Montana City School District
Purpose:	Energy retrofit project using energy performance contracting
Staff Approval Date:	August 25, 2011
Board Loan Amount:	\$134,343
Other Funding Sources:	\$163,600
Total Project Cost:	\$297,943
Term:	15 years

Borrower:	Ravalli County
Purpose:	Refinance Fair Trade Center
Staff Approval Date:	August 30, 2011
Board Loan Amount:	\$560,000
Other Funding Sources:	\$0
Total Project Cost:	\$560,000
Term:	15 years

These minutes are Approved and Final. Full Board review and decision took place at the February 21 & 22, 2012 Regular Meeting of the Board.

Borrower:	Town of Whitehall
Purpose:	Emergency backup generator for Division Street well
Staff Approval Date:	August 31, 2011
Board Loan Amount:	\$35,000
Other Funding Sources:	\$0
Total Project Cost:	\$35,000
Term:	10 years

Borrower:	Florence Rural Fire District
Purpose:	Purchase a new Type III Fire Truck
Staff Approval Date:	September 29, 2011
Board Loan Amount:	\$245,000
Other Funding Sources:	\$ 30,000
Total Project Cost:	\$275,000
Term:	10 years

### ADJOURNMENT

There being no further business, Chairman Buchanan adjourned the meeting at 11:20 a.m.

#### Next Meeting

The next regular meeting of the Board is tentatively set for February 21-22, 2012. in Helena, Montana.

*Complete copies of all reports presented to the Board are on file with the Board of Investments.*

#### **BOARD OF INVESTMENTS**

APPROVE: \_\_\_\_\_

Gary Buchanan, Chairman

ATTEST: \_\_\_\_\_

Geri Burton, Deputy Director

DATE: 4/3/12

MBOI:cb  
11/18/11