

MEETING OF THE TRUSTEES
CITY OF CHATTANOOGA GENERAL PENSION PLAN

January 22, 2015

The called meeting of the City of Chattanooga General Pension Plan Board of Trustees was held on January 22, 2015 at 8:30 a.m. in the J. B. Collins Conference Room. Trustees present were Daisy Madison, Steve Perry, Erskine Oglesby, Katie Reinsmidt, and Travis McDonough (ex-officio for this meeting). Others attending the meeting were Valerie Malueg, City Attorney's Office; Teresa Laney, First Tennessee Bank; Robert Longfield and Scott Arnwine, Gavion, LLC; Todd Dockery, Madeline Green and Cheryl Powell, City Human Resources Department.

The meeting was called to order by Chairwoman Daisy Madison.

A quorum was present at the beginning of the meeting. Travis McDonough provided the document appointing him for this meeting.

Approval of Minutes

Steve Perry made a motion to approve the minutes of the November 20, 2014 meeting. Erskine Oglesby seconded the motion. The minutes of the meeting were unanimously approved.

Report from Counsel

This agenda item was moved ahead of the manager interviews at the meeting. The funding policy for the pension plan is the main item for discussion. A draft of the most recent version including all changes to date will be sent to the trustees and others on the distribution list prior to the next meeting.

Robert Longfield questioned the requirement that the actuarial return assumption be no more than 50 basis points above the assumption in the Tennessee Consolidated Retirement System (TCRS). He would like to know if this is a requirement in the law of the State of Tennessee. Daisy Madison said that she has sent an inquiry to the state about this clause.

Manager interviews for Private Real Estate – Gavion

Robert Longfield provided an short overview concerning private real estate and the recommended allocations for the two funds. The General Pension Fund will invest \$18 million and the OPEB Trust will invest \$3.5 million into this asset class. Value Add Real Estate is being added as an asset class to diversify the income generation in the portfolio and increase the probability of attaining the assumed actuarial return in the portfolio. The higher yield of the Value Add Real Estate combined with the lower yield of the fixed income class of assets will increase the probability of achieving the goal. He reminded everyone about the difference between an open-end and a closed-end real estate fund. There are three managers that will be interviewed.

The first presenter is American Realty Advisors – American Strategic Value Realty Fund. Scott Darling, President and Executive Managing Director, Portfolio Management and Todd Fowler, Director, Marketing and Client Service represented the company. Todd Fowler made opening remarks to describe the firm and state that its only business is Real Estate. Scott Darling presented more detail about the American Strategic Value Realty Fund where funds would be invested.

- The fund is an open end fund seeking to return 11-13% net of all fees. The fund targets properties in the large metropolitan areas. The advantage of the open end fund is that the firm can adapt its strategy depending upon how the market cycle develops. The returns will vary by investments and opportunities, the quality of the assets and the perception of tenants. The execution of the exit strategy for each investment is on the critical path to delivering the anticipated returns. The date of inception for performance measures is 12/30/2009.

- The firm co-invests its own capital. It is conservatively leveraged at approximately 40%. They hire third parties to manage the properties. Third party brokers are hired to sell the properties. The firm does enter joint ventures in construction and development deals.
- It takes approximately 12 months for a new investor to be fully invested; however, the investor starts to be invested immediately in the pool.
- The firm limits investments in construction activity to 25% and they do not participate in secondary or tertiary markets.
- The fee structure is outlined in the presentation with a progressive decrease on the net asset value of invested assets only beginning with 125bp on the first \$10 million. There is an acquisition fee of 60bp on each new investment.
- Target achievement of net 10% IRR over a three year period; managers may earn 20% of the fund return above the target measured over the three year period, subject to a clawback provision. A summary of the returns as of December 31, 2014 are provided in the handout presentation.
- Asset values are determined each quarter based upon independent appraisals conducted by the Altus Group on an annual basis.
- They currently have no problem assets.

The second presenter is Intercontinental Real Estate Corporation – US Real Estate Investment Fund. Headquarters is in Boston, MA. Devin Sullivan, Director, Institutional Services, Eugene Duffy, Senior Managing Director, Institutional Services, Atlanta, and Peter Palandjian, Chairman and Chief Executive Officer represented the company. Devin Sullivan provided introductions and Peter Palandjian presented the information about the US Real Estate Investment Fund (US REIF). About 80% of the funds invested have come from municipal governments, pension funds, and unions. The business began as construction and has a series of closed legacy funds. The US REIF is the active (and only) fund for investments. Peter Palandjian provided an overview of the personnel and how the acquisition of properties works.

- The fund is an open end fund and it is possible to take cash out of the fund as frequently as quarterly, however this depends on the level of cash flow and the size of the queue. The NAV of the fund is the 'stock price' for transactions. The date of inception is 1/1/2008 for income and appreciation relative to the ODCE index.
- Third party appraisers are used to establish property values. All investments are appraised every 12 months with 25% of investments appraised each quarter. The valuation manager is Altus (formerly PricewaterhouseCoopers) and they hire the third party appraisers.
- Their investors are diverse, most are small investors, some with as little as \$5 m invested. There is no lockout period for investing and exiting.
- The target return is 10%, however managers earn an incentive after a preferred return of 8% is reached. The incentive is determined annually subject to a clawback provision.
- The fees structure is outlined in the presentation material with a progressive decrease on the investment value beginning with 110bp on the first \$25 million. The fees are assessed only on drawn capital. There are no acquisition or disposition fees. Rarely there may be a brokerage fee involved.
- All employees and members of the Advisory Board co-invest in the fund. The fund is leveraged at approximately 43%.
- They do rely on reports from third parties in certain aspects of research. Properties are managed by third parties, except for the few properties near Boston. They do not invest in construction projects; construction is outsourced. They do participate in joint ventures with managers in about one of every four deals, in particular development deals and operational properties.

Robert Longfield provided a recap of the first two presenters. As far as investment strategy, Intercontinental is better diversified (more properties) with a longer term fund. Intercontinental tends to have smaller investors in the fund as compared to American and this reduces risk for disruption due to potential early exits. For income over appreciation, Intercontinental has lower risk but American may perform better in the long run. Fees and performance incentives are different but the overall effect is similar among the two; however Intercontinental has no acquisition fees or disposition fees. Either company would be a good choice. The choice may depend upon how attractive TerraCap is.

The third presenter is TerraCap Management, LLC – TerraCap Partners III (Institutional) LP. James Lane, Director of Investor Relations, Stephen Hagenbuckle, Managing Partner and Robert Gray, Managing Partner represented the company. James Lane provided introductory comments. The company invests in deep value commercial real estate acquisitions. Investments are mainstream commercial properties and secondary markets in the Southeast, in particular the geographic areas of Florida, Atlanta, and Charleston for example. The area represents rapid growth with limited future supply and the upside potential of a price well below the cost of building. The acquisitions tend to be well below replacement costs providing some downside protection. They have had success capitalizing on distressed situations following the 2008 recession. The fund offered to the City of Chattanooga is the TerraCap Partners III.

- This is a closed end fund.
- There is no major construction included in the fund.
- The average hold of a property is about four (4) years including renovation, lease, and resale.
- The fund size is \$250 million and the term is 8 years. The hurdle return is a 9% compounding preferred return with a full return of capital to partners before the manager qualifies to receive the incentive of 20% carried interest. The management fee is 1.5% per year.
- There are no acquisition fees.
- TerraCap, as operators, manages the properties directly with some exceptions. The advantage is that disproportionate profits are not being paid away to someone else; instead these profits are passed directly to the limited partners. There are two joint ventures where the fund benefits from the disproportionate profits generated under the operator model.
- Capital calls are based on the acquisition activity and occurs whenever they need capital to close. Income distributions are made quarterly. At sale of the property, the capital and the hurdle return is distributed first and then the profit split. Reinvestment is only an option if a property is sold in the first year of ownership. Because they are subject to ordinary income rather than capital gains, properties tend to be held at least a year for tax purposes.
- Managers co-invest in the funds and match funds as they raise capital. Whenever it is possible, the funds are invested without debt. The leverage in the fund is historically low in the prior funds.

Robert Longfield made some additional remarks about this company. The risk-return model is different from the prior two presentation. It is unique since it is not like the large institutional type of investment, the properties are concentrated geographically and the properties are in close proximity to the managers. Gavion does have other clients who have included TerraCap in their portfolio.

Travis McDonough asked why we are looking at this kind of investment since returns depend on appreciation in values. Robert Longfield explained that at least for the short term, the extra yield from this asset class will help to offset the lower yields in the fixed income asset class so that the pension plan has a higher probability of achieving returns that meet the actuarial assumption. The non-core (value add) investments do provide some opportunity for appreciation in value and this asset class also produces income cash flows during the period they are invested. Since pension plans take a long term view, assets can be invested for short periods and then re-deployed in other less risky asset classes in the future.

After some discussion, the board decided that they preferred Intercontinental as the manager. Robert Longfield was asked to make a recommendation concerning the investment. He indicated that the board could choose to do one of the following:

1. Place \$18 million for the General Pension Plan and \$3.5 million for OPEB into the Intercontinental US Real Estate Investment Fund.
2. Place \$15 million for the General Pension Plan and \$3.5 million for OPEB into the Intercontinental US Real Estate Investment Fund and \$3 million in the TerraCap Partners III Fund.

His recommendation is the second one.

Erskine Oglesby made a motion to allocate funds as \$15 million for the General Pension Plan and \$3.5 million for OPEB into the Intercontinental US Real Estate Investment Fund and \$3 million in the TerraCap Partners III Fund. Katie Reinsmidt seconded the motion. There was no further discussion. The motion carried.

There being no other business, the meeting was adjourned by Daisy Madison.

APPROVED:


Chairman


Secretary