BWC Board of Directors
Investment Committee
Thursday, August 26, 2010
Level 2, Room 2 (Mezzanine)
30 West Spring St.
Columbus, OH 43215

Members Present:	David Caldwell Alison Falls, Vice Chair Kenneth Haffey William Lhota, *ex officio* Larry Price Robert Smith, Chair
Other Directors Present:	Charles Bryan, James Harris, James Hummel, Thomas Pitts
Counsel Present:	John Williams, Assistant Attorney General James Barnes, General Counsel and Chief Ethics Officer
Staff Present	Bruce Dunn, Chief Investment Officer
Consultant Present	Guy Cooper, Partner, Mercer Consulting
Scribe	Mike Sourek, Staff Counsel

CALL TO ORDER
Mr. Smith called the meeting to order at 9:51 AM and the roll call was taken. All members were present.

APPROVAL OF MINUTES OF JULY 28, 2010
Mr. Smith preferred the lists of priorities be included in the minutes, although the minutes noted that presentations were incorporated by reference. With no changes proposed, Ms. Falls moved to have the minutes of July 28, 2010 be approved, seconded by Mr. Haffey. The motion passed with a 6-0 unanimous roll call vote.

REVIEW AND APPROVAL OF AGENDA
With no changes proposed, Mr. Haffey moved to have the agenda approved, and the motion was seconded by Ms. Falls. The motion passed with a 6-0 unanimous roll call vote.

NEW BUSINESS/ACTION ITEMS
DISCUSSION ITEMS
1. **Portfolio Performance/Mercer Quarterly Report/Second Quarter 2010**

Ms. Jordan Nault, Principal, and Mr. Guy Cooper, Partner, of Mercer Consulting, (Mercer), presented Mercer’s Investment Performance Summary for 2nd Quarter 2010. The presentation is incorporated by reference into the minutes and was provided to the Investment Committee in advance of the meeting.

For the quarter, Ms. Nault reported the Disabled Workers' Relief Fund (DWRF) had returned 3.0%. However the fund was underperforming its policy benchmark because the Long Duration Government/Credit Index portfolio managed by State Street Global Advisors (SSGA) was lagging 20 basis points (bp) in performance to the benchmark index for the quarter and 80 bp for the full fiscal year. Some of the reason was due to pricing differences between the custodian and the manager; however, there were some security selection missteps according to Ms. Nault. Likewise, the Coal Workers' Pneumoconiosis Fund, or Black Lung Fund, had a smaller tracking error of 60 bp for the full fiscal year for its Long Duration Government/Credit Index portfolio managed by SSGA. The Self Insured Guaranty Fund was totally invested in cash, and the return there has been flat.

Mr. Haffey inquired about "security selection missteps." Ms. Nault reported SSGA did not fully replicate an index but develops a representative sample of the index. Mr. Haffey asked to the timing of notification. Ms. Nault replied quarterly and verified with customer statements. Mr. Bruce Dunn, Chief Investments Officer, added SSGA received certain allocation for new bonds under the index, and the bonds were substantially oversubscribed. SSGA may have been underweighted in a particular bond and paid higher prices on the open market to replicate the index. SSGA has received good allocations of the bonds, but taxable municipal bonds are a growing part of the index and new issues have been substantially oversubscribed by investors. Ms. Falls asked how much of a discrepancy was pricing issues versus security selection missteps. Ms. Nault noted less than 50% of the error was due to security selection missteps. Mr. Smith asked for Mr. Dunn's opinion on the appetite of bond issues with rates so low. Mr. Dunn replied the yield curve was very positive from 1-2 years to 30 years; given the current economic environment he was not surprised by demand for higher yielding paper. Some BBB rated and A rated issues are paying 200 bp over Treasuries. Ms. Nault said, with low rates, fixed income rate of return expectations have been lowered by Mercer by 20-30 bp. Mr. Cooper said if more than 60 bp tracking error exists, more questions are asked; however, this situation was an anomaly. Ms. Falls believed the efficiency in the market has not returned when there are pricing issues well after 2009; the markets were not as liquid or efficient.

Ms. Nault reported U.S. Capital Markets and macroeconomic conditions were mixed. Markets are digesting sovereign debt issues and double dip recession fears with GDP growth. Interest rates remained very low with a flattening of the yield curve across the board, with U.S. unemployment rate remaining high at 9.5% and the participation rate and employment population rate converging at 65%. Domestic value equities have outperformed growth equities to date. Non-U.S. developed market equities lost 13.8% in the last quarter. Fixed income did well, with an 8.6% return for the Barclays Capital Long Government/Credit index for the second quarter of 2010 and a 10.2% return for the first half of 2010. The Bureau's State Insurance Fund (SIF) portfolio had a net return of 0.1% in the quarter and 11.8% for the full fiscal year 2010.

Ms. Nault reported the Bureau's funds totaled $19 billion, with the SIF portfolio accounting for 91.6% of assets and DWRF about 7%. The largest investments were in long duration credit bonds (28.3%) and domestic equities (19.2%). SSGA managed 45% of assets with BlackRock managing 35%. Diversification occurred by adding Mellon Capital as a manager with about 5% of assets. The SIF portfolio was valued at $17.4 billion on June 30, 2010 with some overweighting in asset allocation to long duration credit, TIPS, and cash. With the 12% return for the BWC total portfolio in fiscal 2010, this compared to a historical 3-year and 5-year return rate of 5%.

Mr. Smith requested several white papers listed by Mercer. Mr. Cooper agreed to provide a copy of all white papers for each director, and thanked the Board for the inquiry. Ms. Falls inquired if Bureau staff would be participating in Mercer's upcoming Investment Forum to be held in Toronto. Mr. Dunn replied in the negative. Very strong justification is needed to travel outside the U.S. on state business. If the forum were held in the U.S., Mr. Dunn stated he would have likely attended.

2. Monthly Portfolio Value Comparisons

Mr. Dunn presented the monthly portfolio comparison between June and July, 2010. July was a very strong month beginning FY 2011. Mr. Dunn reported net investment income of $557 million for a return of 2.9%. The positive return was driven by the equity markets showing a strong rebound from the correction in May and June, with one-half of unrealized loss in value incurred over these two months being regained in July. The equity portfolio returned 7.6%, which was a strong return but still lower than the ACWI ex-US index return of 9.0%. The Russell 3K returned 6.9%. For the bond portfolio, the total return was 1.2%. Long term credit bonds returned 2.3%, but long term government bonds and TIPS went virtually unchanged, at 0.2% and 0.0%, respectively. The US Aggregate portfolio returned 1.1% or almost midway between long term credit bonds and long term government bonds. There was an inching upwards in money market fund yields, with 7 day return at 0.08% on June 30th and 0.11% on July 31st.

3. Month-End Portfolio Asset Allocation Values

Mr. Dunn presented the month-end portfolio asset allocation values. Due to the very strong equity performance over the past month, the bond allocation decreased from 71.2% to 70.1% during July and the equity allocation increased to 28.3% from 27.1%. As of August 25, portfolio values increased for both bonds and equities for August to date. Mr. Dunn emphasized, due to the transitioning of the portfolio, values and returns for each of bonds and stocks for the specialty funds could not be separated. For the month of August to date, the portfolio has returned 0.9%, which includes all assets in the transition account. Mr. Dunn noted bond and stock market value changes do not add up to the total portfolio value change because bonds and stocks were not separated in the portfolio transition account for composite performance reporting purposes. Mr. Dunn reported all assets of the DWRF and Coal Workers' Pneumoconiosis Fund portfolios had been transitioned to target asset allocations in August. While the Bureau increased the equity position for the DWRF portfolio during this transition, equities overall had a negative return while in transition leading to a reduction in value of approximately $20 million for the approximate $1.5 billion of investment assets being transitioned, or a negative return just over 1% for the transition account. Mr. Smith asked if the fiscal year to date return ending July 31, 2010 was 2.9%, and Mr. Dunn responded in the affirmative. Mr. Smith appreciated the efforts of providing the month to date figures.

4. CIO Report – July 2010

Mr. Dunn presented his July, 2010 CIO Report. The report is incorporated into the minutes by reference and was provided to the Investment Committee in advance of the meeting. Mr. Dunn noted the report will grow every month as goals are achieved or updated.

Mr. Dunn noted one of the key goals accomplished in fiscal year 2010 was the new investment allocation for SIF. This goal took almost all of FY 2010 to complete, and the asset allocation objectives were met. Likewise, last December/January, a new investment allocation was approved for DWRF and the Coal Workers' Pneumconsis Fund. The investment policy statement was updated with new investment and transition managers appointed. The transition implementation carried over into FY 2011 and was executed this month and is essentially completed. The assets for these two specialty funds were in their respective transition accounts, but asset allocation targets were achieved with this transition. The funds will be transferred to the permanent accounts in the next few days.

Mr. Dunn indicated, as investment policies change by the Board of Directors, the Bureau's Investment Division would implement those changes in a planful manner. As far as new investment considerations, MWBE policy and real estate as an asset class are being discussed. There are also two new considerations. First, there is the exploration by the Bureau Investment Division to perform cash management functions, which the BWC Fiscal & Planning Division does currently. Investment Division consideration will be given to add more money market funds as well. Another option to be considered is a cash management overlay strategy. Without elaborating, the plan would carve out a certain percentage of operating cash for a certain period and employ the use of future contracts tracking existing target asset class benchmarks for a closer match to achieve target asset allocations. The cash target for SIF is 1% of fund assets, and the issue is how to better manage cash balances that frequently exceed this target. The use of futures would provide a better rate of return. Mr. Dunn indicated that several Ohio pension funds use a cash overlay strategy. The expected returns of cash overlay strategies are considerably higher than just putting excess cash into short term investments. Mr. Cooper noted that cash overlay strategies are commonly employed among public and private pension funds. Cash was earning less than 20 bp; hence any amount not needed immediately is preferred to be managed in this manner. Mr. Smith responded, while cash has a very low rate of return, this potential strategy is not an interim strategy. Mr. Dunn concurred. If the Bureau effectively manages its cash positions, there is less likelihood to rebalance the portfolios for that purpose. Any adopted program would be outsourced to managers with experience in cash management overlay. The anticipated improved investment income over the long term is impressive, according to Mr. Dunn. Mr. Smith inquired if guidelines and policies needed development, and Mr. Dunn replied in the affirmative. The program is a FY 2011 goal; and a presentation in the next several months is anticipated. Mr. Smith noted futures contracts always infer risk. Ms. Falls supported the concept now that the funds have gone through transition. Mr. Bryan wanted more discussion on the pros and cons of this approach.

Mr. Dunn said the second new consideration was the Deloitte study recommendation of consolidation of the Bureau's specialty funds. The recommendation of any combination would require Bureau initiated legislative change. This topic could be addressed in the springtime with the biennial budget. Mr. Haffey inquired if there was a significant burden. Mr. Dunn replied investment costs would be lower due to fewer accounts, but how this change impacted the liability side would have to be addressed. Management fees would be modestly reduced with fewer investment accounts, investment managers, and custodial fees. In terms of broad stock/bond asset allocation, the Black Lung Fund

and DWRF are comparable to SIF. Ideally, all assets would be in SIF, but commingling of the specialty funds are currently prohibited.
Finally, Mr. Dunn commented a third strategic goal is internal investment processes. A lot of documented progress has been made, and any new endeavor regarding active style management will require associated processes and procedures. Mr. Smith thanked Mr. Dunn for his presentation and the teamwork from the Investment Department.

5. Mercer Presentation on Investment Policy Decisions – Next Phases

Mr. Cooper presented a discussion on Investment Policy Decisions – Next Phases. A chart is incorporated into the minutes by reference and was provided to the Investment Committee in advance of the meeting. Mr. Smith noted Mr. Dunn would be preparing a memorandum dependent on the Investment Committee responses.

Mr. Cooper said since all the previously approved transitions were now completed a new "to-do" list needed to be developed. The chart incorporated all of the ideas the Board of Directors had discussed, except cash equitization or consolidation of funds. The Investment Committee was asked to determine what should be done next, and in what order. Ms. Falls asked if the Investment Committee should be focusing on projects currently listed as Phase I or II. Mr. Cooper noted Phase I projects corresponded to work in the next several months, which presently includes MWBE development, discussing active management of long duration credit bonds, and exploration of real estate as an asset class. Phase II programs included most active management programs which have been postponed until it is decided how the programs would be managed. Phase III programs would be final phase projects, such as active management of international stocks, continuing to evaluate other asset classes and strategies.

Mr. Smith noted there was no concern over the real estate issue, just what the Investment Committee's conviction was towards the asset class. He recommended not engaging in MWBE until active management was further developed. Mr. Dunn noted his concern was the marriage of MWBE with other active management. He concurred active management were primarily Phase I and Phase II considerations, and Mercer and other sources he has talked to doubted MWBE firms would have a strong presence to active long duration credit management. Mr. Dunn believed strongly in MWBE, but the long duration credit asset class represented 28% of the portfolio. Mr. Smith noted potential disconnect between policy and portfolio design. Ms. Falls added there was much work in asset allocation, and there were other policy issues at the margins just as important. MWBE deserved prioritization. Any asset allocation issue is also a major policy decision. There were many issues on the table, and three months was a conservative estimate to complete Phase I projects. If Phase II projects would not start for about a year, various pieces would come together. When more active management occurs, liquidity will become more important; hedge funds now buy Treasuries. Mr. Smith noted sometimes a developed policy implies immediate implementation. With MWBE, the policy development was important, but there was no drive necessarily to implement in light of the Bureau's current capabilities. Mr. Dunn appreciated the input.

6. Mercer Proposed Next Steps for Minority and Women Business Enterprise (MWBE) Investment Managers, first review

Mr. Dunn and Mr. Kweku Obed, Senior Associate with Mercer presented a review of the next steps for MWBE Investment Managers. Memoranda are incorporated into the minutes by reference and provided to the Investment Committee in advance of the meeting.

Mr. Dunn said MWBE discussions with the Investment Committee defined what the program was and its relationship to the Bureau. Mr. Dunn emphasized the issue was not timing but implementation. There were two implementation approaches: direct investment or manager of managers (MoM). The MoM approach is used when there is insufficient staff or resources to hire directly, and an organization is satisfied with outsourcing due diligence and performance management. Proper allocation size to MWBE would be a long term strategic goal, and the MoM approach is most appropriate for the Bureau. The benefit from the MoM approach is that any approved MoM would select well regarded managers and could potentially incubate/graduate some managers into managing directly into SIF in a 3-5 year horizon. Mr. Smith stated the dollar commitment to MWBE was an issue, and the discussions have been informative. He inquired if the MoM approach is how organizations similar to the Bureau have started. Mr. Obed replied one of the companies where Mr. Smith was Chairman of the Board had implemented MWBE with MoM.

Mr. Obed concurred with Mr. Dunn's comments. The Bureau was not well staffed to evaluate MWBE participants, but there were a handful of firms with the expertise to initiate the endeavor. Whichever firms are selected to be MoMs, the Bureau would learn much in the first few months of implementation. These firms will have a good perspective of dealing with implementation challenges. MoM experienced managers are usually strong in one to two asset classes. Some MoMs are more experienced in equities than fixed income. The asset class experience of a potential MoM was critical, especially with adequate experience in fixed income.

Mr. Price inquired if MWBE firms were used in the past by the Bureau, and Mr. Dunn responded in the affirmative. Mr. Price inquired to the previous MWBE structure, and Mr. Dunn indicated the program was direct investment. Mr. Price inquired if the intent was to grow and learn from the MoMs and then become a direct program. Mr. Dunn replied the goal was to allow an MWBE participant to work with a MoM for 3-5 years, and then the participant could possibly be placed directly under contract; however, this strategy was very preliminary and would need further discussion. Mr. Smith said he had learned the Bureau previously did not have the staff to capably manage 150 managers. A MoM approach is much easier in the Bureau's current structure than direct oversight. Mr. Price, while understanding the MoM approach, was concerned this method would lose sight of the goal of smaller firms being able to compete, grow, and become part of the Bureau family. Mr. Smith emphasized the MoM plan would accomplish that goal. Ms. Falls noted there were two decisions: how much money, such as $200 million, to devote to MWBE; and the execution of MWBE, whether by a direct or MoM approach. She agreed with the MoM approach, and strongly believed Mr. Price's concerns would be addressed in a fiduciary responsible manner. Administrator Ryan believed the issue, to some degree, was timing. MWBE would be more quickly implemented through a MoM approach. Mr. Harris believed MWBE was an important goal, but agreed the program had to be implemented in a thorough and deliberate manner. Mr. Obed remarked MoM enhances the Bureau's long term strategic goal of working with emerging firms. Good MoMs and oversight firms would be selected. Ms. Falls asked what additional information the Investment Committee needed for a vote. Mr. Smith suggested a policy recommendation be drafted for next month's meeting with action on the policy recommendation in two months.

7. **Mercer Presentation on Real Estate as an Asset Class, first discussion**

Ms. Allison Yager, Global Business and Investment Leader of Mercer's Real Estate Boutique, presented a first discussion on Real Estate as an Asset Class. The presentation is incorporated into the minutes by reference and provided to the Investment Committee in advance of the meeting. The presentation provides information on the types of investments, why an organization would invest in the asset class, and types of real estate investments recommended for the Bureau.

Mercer believes in a conservative investment approach, with heavy weighting in core assets. Core assets were the most conservative real estate investment, with about 80% weight in leased income assets with contractual agreements protecting the generation of income. Generally the income is from rental agreements. There were several risks in real estate: liquidity risk; capital market risk; property level risk; political risk; and investment manager risk. Investment manager selection is a very important risk. Most real estate is privately traded, and the manager and client need to understand the client's preferred returns and removal provisions. Real estate investment managers are active managers, not passive, and there is no benchmark index. Clients should not over allocate to one investment manager. To achieve diversification, a few managers are selected, but not an overly burdensome level.

Ms. Yager noted real estate has many common characteristics. There is a large investment universe, a private market of an estimated $235 billion and a publicly traded NAREIT index of $245 billion. The market was not large enough to recommend a 50% allocation, but large enough for some exposure. Ms. Falls inquired if the real estate investment market was about $500 billion, as opposed to trillion dollar investment markets in fixed income and equities. Mr. Cooper said he would have to research the answer. Ms. Yager said the NAREIT index were institutional owners who volunteer data. It does not include government owned assets.. Real estate is a great diversifier and risk reducer. Real estate has a low correlation with other asset classes and generates income yield which can be redeemed as cash. An average return was 7% per annum, or a level between bonds and equities. If leverage is removed, the return is lower, but most funds leverage. Leverage is debt used to buy more assets. Leverage of 20% means if a real estate buyer purchases a property for $100 million, $20 million of the investment is borrowed and the remaining 80% or $80 million in cash is applied to purchase the property. Mr. Smith inquired if Mercer would inform the Bureau of an investors leveraged position, and Ms. Yager replied in the affirmative; most of the Bureau recommendations will generate income from tenants with long lease contracts. Mr. Smith noted publicly traded Real Estate Investment Trusts (REITs) are priced clearly, and there was more quantifiable risk in private funds. He asked for Ms. Yager's opinion to reconcile the risk and return exposure. Ms. Yager replied most clients choose diversification, and most methods enhance total returns. Real estate investments were not correlated to equities as much as REITs. For that reason, a smaller allocation is recommended to REITs. Real estate also had moderate volatility.

Ms. Yager said real estate investments provide protection in both recessionary and inflationary periods. While real estate does not provide complete protection, lease contracts stabilize total returns. Unless a tenant becomes bankrupt, the lease contracts can be enforced. There are regional differences, and real estate lags in a recessionary period. In 2008, real estate held its value and did not decline until 2009. Since the U.S. is starting to recover from the recession, this is a good time to consider real estate. Mercer did not recommend abandoning real estate to clients in 2009; in January, 2010 the real estate market started to make an upturn, and Mercer is recommending core real estate investments. Mr. Smith inquired whether there would be any market calls. Ms. Yager replied real estate is viewed as a long term investment, and Mercer did not advise making market calls. Most leases have a "kicker" tied to the Consumer Price Index as an inflationary hedge.

Ms. Yager reported there were two most attractive investment choices: private real estate funds and publicly traded REITs. The investor can either hold equity or debt in real estate. For equity, an investor can own part of an asset, such as an apartment building or shopping center. For debt, the investor can be a lender to a developer and own the debt secured by the real estate. Mercer never recommended collateralized mortgage-backed bond securities (CMBS) funds.

Ms. Yager stated private real estate funds have several positive attributes. First, assets are owned directly by commingled funds structured as privately traded investment vehicles. Generally the funds are limited liability companies electing to be treated as REITs. The majority of investors are nontaxable like the Bureau, but some funds allow non-U.S. or taxable investors. The Bureau would join other investors similarly situated and buy units or shares. Mr. Haffey inquired if distributions, not dividends, would be paid. Ms. Yager replied in the affirmative, and the distributions can be reinvested or kept as cash. While the Bureau could hire an investment manager to buy real estate directly, this venture costs $600-$700 million to start up and adequately diversify. Second, private real estate funds provide access to numerous property types and locations. Third, the contractual nature of the underlying income stream contributes to stable earnings and accounts for a significant portion of overall return. Fourth, private real estate funds provide various risk/return levels ranging from high quality core to higher yielding but riskier value added and opportunistic. Finally, private real estate funds have comparatively low volatility and correlation to equities and bonds. Investment with a private real estate fund can be as low as $5 million or as high as $200 million and provide access to various diverse real estate markets.

Ms. Yager noted there were issues to consider with private real estate funds. First, the funds can be illiquid, even if the fund is open-ended. Real estate is generally an illiquid investment. Second, private real estate funds are privately traded with virtually no secondary market; there is a small unregulated secondary market with unfavorable pricing. Third, there are various strategies and legal structures available. Fourth, reporting is not standardized and varies between managers. Finally, the investment class requires very intensive management with a large staff. Mercer recommends the Bureau invest in open ended private real estate funds that allow for liquidation on a quarterly basis. In terms of cash flow, there have only been two time periods where withdrawal queues existed. The first period was the early 1990s where real estate led recession had withdrawal queues up to 12 months. The second period was in 2009 after the 2008 market correction. Most withdrawal requests have been satisfied 5 quarters later.

Ms. Yager noted there are three different real estate strategies described by Mercer: core; value added; and opportunistic. Core is an equity investment strategy in stabilized, well leased properties with typically 15-30% leverage, long term investment horizon of 5-7 years, generating a 7-9% annual return before fees of 90-120 bp, and moderate risk. Value added is an investment strategy where a manager buys an asset requiring an event to occur making the property valuable. Typically 30-60% leverage is used with an intermediate investment horizon of 3-5 years, more intense property management, generating 10-13% annual return before higher investment fees of 100-150 bp with a split between income and appreciation, and medium to high risk. Value added is recommended by Mercer for larger clients. Opportunistic is an investment strategy geared towards real estate related assets, distressed properties and loans, corporate and government dispositions, and entity level investing. This investment strategy is highly leveraged and high risk, seeking to capitalize on economic, financial and property market dislocation. Opportunistic may return 20% annually, but the investor must be willing to lose all capital. Opportunistic carries some bad publicity as the strategy may involve ground up development or buying a publicly traded REIT and taking private. Opportunistic is not a recommended strategy by Mercer for a new real estate investor such as the Bureau.

Mr. Lhota inquired if any recommendation has the Bureau investing in single family residential properties. Ms. Yager replied not single family residences, but perhaps a position in an apartment complex. Most core investment strategy involves investment in office buildings in central locations, high rise or garden style apartments, warehouses where not much tenant improvement is needed, and regional shopping centers that are grocery or large retail store anchored. Some core investment funds invest in self storage or hotels. Mr. Lhota, from conversations with acquaintances in the industry, said there has been pressure by tenants to change terms in rental agreements and a market power shift. Ms. Yager commented tenant market power is dictated by the local market; tenants have been asking for lower rent rates and more improvement dollars in retail spaces. Mercer has seen improvement dollars come back to previous levels, but not rental rates. Job growth would have to be demonstrated before rental rates would increase. Supply was not overdone in real estate except in the industrial sector. Mr. Cooper reiterated the Bureau would not be purchasing land, single family residential units, or doing any development.

Ms. Yager discussed the attributes of publicly traded REITs. Positives included: public markets and daily pricing providing liquidity; underlying physical assets with contractual rent streams providing a degree of capital protection and strong cash yields; a current average REIT yield of 6.1%; opportunity to invest a small amount of capital in large real estate holdings and to diversify by property type and location; and the FTSE NAREIT US Equity Index which currently comprises 98 real estate companies with a weighted average market cap of approximately $4.6 billion. Negatives included greater volatility than private real estate investments and higher correlation to other asset classes.

Ms. Yager discussed Global Real Estate Securities (GRES) Mercer believed in global diversification for clients by investing outside the U.S. The U.S. accounts for only 40% of the global investable institutional property market, thereby providing increased opportunity. Further diversification is achieved as real estate is highly localized with prices heavily dependent on supply and demand in the local market. Real estate cycles do not necessarily move together across the globe, and there has been lack of correlation between regions. REITs provide access to global property markets for investors at lower transaction costs than direct real estate and provide liquidity to investors no other property investment provides.

Ms. Yager said there were issues to consider with GRES. First, newer strategies with limited track records and experience of portfolio management teams exist. While firms have been in existence since the 1970s, REITs did not become popular until the 1980s. Most track records are based on 10 years, not 25-30 years; however, there has been tremendous growth of the investment product. Mr. Smith inquired if real estate is measured on future value. Ms. Yager replied this occurred frequently 5-7 years ago but not presently. Core investments have third party appraisals with a 10 year horizon and are present valued back. Core investments were generating positive returns in 2008, but there was a 30% market correction in 2009. CMBS created a huge debt market that collapsed and will never return to previous levels. Core investments were able to withstand correction until 2009 because of lease contracts; however, changes in the discount rate and a slight decrease in occupancy did cause a market correction. Mr. Cooper added in January, 2010, he expected core real estate investments to return between 0-1% return this year. Since then, the core investment market has increased to a potential 10% return for the year. Mr. Smith asked for historical data on asset allocation to real estate. Mr. Cooper replied there was no fixed trend except the allocation has increased over the past 10-20 years. A 5% allocation for large public funds used to be sizable, but now the level is up to 15%. Ms. Yager did not expect incremental growth until 2012 in this market and believed real estate was a standalone asset class for institutional investors. Mercer is watching for market changes; appraisal values had decreased so much owners did not want to sell off lease covered exposures, and very few transactions occurred the past year. At the end of the 4th quarter, 2009, there were significant withdrawal queues; after 2nd quarter, 2010, most real estate funds indicate no new money will be accepted until 2011.

A new real estate allocation typically takes 3-5 years to execute, and Ms. Yager recommended the Bureau invest mainly in core investments with some exposure to both value added investments and publicly traded REITs. Public REITs were recommended for liquidity and ease in rebalancing. If there was an overweight in real estate, the REITs could be sold off. While rebalancing could be done with core investments or value added investments, execution is difficult. Mr. Smith asked, as the Bureau grows into its real estate allocation, how would Mercer benchmark. Mr. Cooper replied the benchmarking would be consistent with the level of investment of the Bureau at the time, as had been done in other initiatives. The overall recommendation was 60% core investments, 25% value added investments, and 15% public REITs with a 16.89% risk and expected return of 7.74%. The conservative model was 70% core investments, 20% value added investments, and 10% public REITs with only minimal change in 16.60% risk and expected return of 7.68%. Mr. Smith asked if this allocation was comparable to last year, and Mr. Cooper replied in the affirmative. Ms. Yager indicated an aggressive approach was not recommended, and core investments and public REITs would be the first two real estate investments. Over time, value added investments would be added.

Mr. Smith opened the floor for any comments. The recommendation for real estate as an investment class was made one year ago, and he asked if there was any strong objection to now forming an appropriate policy to include real estate investment. Mr. Price said the presentation was good and pointed out all the positives, but he did not know all of the risks and requested more information. Mr. Smith said real estate is known as "patient capital" with an investment horizon of 5-20 years, compared to other investments monitored monthly, quarterly or yearly. Given the 30% downturn in the real estate market in 2009, there was a tangible benefit to investing in real estate, but the liquidity issue was real; firms were honoring 60 day notices in 13-14 months. Mr. Haffey commented New York approved a 60 story building near the Empire State Building, which signified there was clearly a demand for office space in midtown Manhattan. Mr. Harris asked if the Bureau ever invested in real estate previously. Mr. Cooper indicated the Bureau had invested in about everything else, but not real estate. Mr. Dunn concurred, noting the exception of the William Green Building. Mr. Caldwell admitted to an antiquated view of global investments, but when Castro took over Cuba, U.S. casino owners had a real investment risk realized. Investing globally made Mr. Caldwell nervous. Mr. Bryan was not opposed to a small investment in real estate; however, he wanted further research of funds similar to the Bureau. If those funds engaged in real estate, there would be no hesitation; however, if the Bureau was standing alone, the investment could create a significant criticism. Ms. Falls believed the decision was a policy decision as to whether to invest in this asset class, not an issue of active management. Mr. Price asked for Mr. Dunn's opinion. Mr. Dunn supported the proposal. He found Mercer's approach, especially with 60% real estate investment exposure in core assets, as protection in an inflationary environment. The income stream would generate higher returns than bonds, somewhat like TIPS, and provided appreciation potential. There were a handful of proven funds with the needed diversification, and the overall investment provided more inflation protection than other asset classes. Mr. Price asked if the Bureau would outsource management of the real estate investment. Mr. Dunn confirmed the entire investment management would be outsourced. Equity managers with experience in REITs would manage those investments, and others would manage core investments. Yields were greater than 6%, which is higher upfront income than most credit bonds. He was comfortable with the good income stream with top managers maintaining a high lease rate. An economic downturn could decrease value, but given core investments are not highly correlated to the equity market, the risk-reward was reasonable and a good midpoint investment. There would not be a long gestation period for the investment's return. Ms. Yager said the market downturn had occupancy rates only drop from the mid 90% to the low 90% range. Most assets of institutional quality real estate funds were not in Ohio, but in larger coastal cities with more economic drivers for office space. Mr. Smith asked for Mr. Cooper's opinion. Mr. Cooper indicated all institutional investors should have some real estate exposure, and current market conditions were providing an opportunity. Mr. Haffey inquired about expected fees, and Ms. Yager estimated about 80-90 bp per annum. Mr. Haffey supported investment in real estate. Notwithstanding previous reservations, Mr. Caldwell was ready to move forward.

8. Committee Calendar

Mr. Smith suggested the Committee Calendar be updated for next month to reflect Mr. Dunn would be presenting the CIO's recommendations on investment policy decisions. Mr. Dunn concurred. Mr. Dunn indicated he would be presenting his CIO Report with an update on the status of the international equity commingled fund managed by BlackRock. The report will provide an update on its assets under management and what the Bureau owns. The Bureau seeded this fund with approximately $1.5 billion. In October, the

Investment Committee will receive various annual reports, including the Investment Class Performance/Value Annual Report, which is provided to the Legislature.

ADJOURNMENT

Mr. Haffey moved to adjourn the meeting at 12:17 PM, seconded by Ms. Falls. The meeting adjourned with a unanimous 6-0 roll call vote.