

FARMINGTON CITY COUNCIL  
SPECIAL MEETING  
September 22, 2009

A special meeting of the Farmington City Council was held on Tuesday, September 22, 2009 in Council Chambers, 23600 Liberty Street, Farmington, Michigan. Notice of the meeting was posted in compliance with Public Act 267-1976.

The meeting was called to order at 7:05 p.m. by Mayor Knol.

COUNCIL MEMBERS PRESENT: Knol, McShane, Wiggins, Wright, Buck.

COUNCIL MEMBERS ABSENT: None.

FARMINGTON CITY REPRESENTATIVES: City Clerk Halberstadt, Director Nebus (left at 10:40 p.m.), City Manager Pastue, Attorney Schultz.

**APPROVAL OF AGENDA**

**09-09-193** MOTION by Buck, seconded by Wright, to approve the agenda as submitted. MOTION CARRIED UNANIMOUSLY.

**MICHIGAN EMPLOYEES' RETIREMENT SYSTEM (MERS) PRESENTATION**

Present: John Waugh, Sue Feinberg, Bob Griffin

Pastue discussed the steps that were taken leading up to the City's recommendation to transfer administration of its retirement system to the Municipal Employees' Retirement System (MERS).

John Waugh, Benefit Plan Advisor, provided an overview on the background, growth, structure and governance of MERS. He identified MERS benefits including: flexibility, options, pooling, economies of scale, stable contributions, commitment to fiscal responsibility, ongoing education and information and cutting edge technology.

Bob Griffin, Investment Officer and Product Specialist, discussed the portfolio foundation for MERS Investments. He noted the investment philosophies of the City and MERS are very similar. He stated the only major differences are due to the size of MERS and the economies of scale. He stated the foundation of their portfolio is to optimize potential returns while minimizing risk.

Griffin discussed the composition of their portfolio which includes diversification, long-term investors, economies of scale, strategic asset allocation and tactical decision making. He stated the size of MERS allows them to pursue alternative investments. He pointed out those asset classes such as commodities, private real estate and private equity are typically cost prohibitive for smaller pension systems. He noted private

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equities are companies not traded on a public exchange. He advised the MERS Retirement Board performs a strategic asset allocation every 5 years and the next one is scheduled for 2010. He noted the Board establishes asset allocation guidelines.

Responding to a question from Wright, Griffin stated examples of private real estate investment would be the purchase of a shopping mall or apartment buildings, assets that generate income. He advised they may enter into partnerships for these purchases. He confirmed it is a small piece of their diversified portfolio. He discussed their target allocations and the tactical leeway the board allows.

Griffin spoke about MERS' policy benchmark by which they measure performance. He noted over the past 5 year downturn MERS consistently outperformed the Russell 3000 Equity Index. He discussed investment strategies including an increase in commodities providing downside protection.

Responding to a question from Wright, Griffin stated their managers' fees for 2008 were 37 basis points. He pointed out that based on the size of their investments, MERS is able to negotiate some pretty remarkable fees. He noted they have some of the most expensive asset classes that you can buy.

Griffin pointed out between June 30 and September 21, 2009, MERS added a half billion to its portfolio due to a tremendous run in equities.

Griffin discussed their due diligence process in hiring managers. He stated it takes about six months to hire a manager. He discussed investment guidelines, performance expectations, portfolio review and the probation process.

Responding to a question from Buck, Griffin confirmed MERS is on a calendar year basis.

Responding to a question from McShane, Griffin stated there are no other fees in addition to the investment manager and administration fees. He further confirmed there are no additional fees to the employee membership.

Responding to an additional question from McShane, Griffin advised MERS does not make any loans.

Noting one of the attractions of municipal bonds is the tax advantage, Buck asked why MERS would own municipal bonds since their returns are not taxable.

Griffin responded MERS owns municipal bonds because there is a taxable municipal market that typically results in higher yields. He advised when the market starts to heal itself those bonds can be sold at a significant profit.

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Buck pointed out in the MERS presentation document, the investment chart on page 15 representing MERS total market fund as measured against MERS policy benchmark does not reconcile with MERS historical average return data on page 21.

Griffin responded the discrepancy is due to the difference between 20-year history and 10-year history. In addition, there is a mismatch between their benchmark in private equity and the benchmark in private real estate. He stated holdings are valued on a quarter lag and sometimes reported in a 2-quarter lag.

Griffin pointed out benchmarks are established on a daily basis. He noted MERS is six months behind the market, therefore they are experiencing losses that occurred last winter in those two asset classes. He advised the market has recovered nicely and those benchmarks may be up 4-5% whereas MERS is showing a 12% loss. He noted there is a gap of 16-17% in the last year alone.

Responding to a question from Wright, Griffin stated there is a lag because private equity and private real estate is difficult to value.

Discussion followed regarding the significant losses the market sustained over the past year. Griffin pointed out most equity indexes lost between 40-47% last year and most investors lost 10-year returns. He noted where MERS excelled is the ability to remain liquid with cash reserves on hand. He stated they were never in a position where they were forced to sell in order to raise cash.

Wright expressed concern relative to other municipalities participating in MERS that are underperforming and represent a potential risk to Farmington.

Sue Feinberg, Regional Manager, responded one of the requirements to participate in MERS is the municipality must come in at a minimum 50% funded.

Wright questioned whether the City could slow down its funding in order to reach a median with other participants. Waugh responded the City currently has a 20-year amortization with its plan, but could decide to move to a 25-year amortization to save money.

Waugh stated MERS would address a municipality that begins to dip below 50% funding. He advised they do not co-mingle assets. For example, if the City of Detroit wanted to participate, their retirement fund would be kept completely separate with a separate trust.

Griffin advised funds are pooled for investments purposes only. Farmington would own "X" amount of shares of the pool based on the dollars invested.

Responding to a question from Wright, Feinberg advised if a municipality does not meet its obligation, the State would take over and start collecting payments because it is a

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promised benefit. Waugh pointed out MERS would not satisfy the obligations of another city with the shares owned by Farmington.

Responding to a question from Wiggins, Griffin stated the timing has never been better to liquidate a portfolio.

Responding to a question from Buck, Griffin stated MERS had invested less than 2% in sub-prime mortgages.

Knol noted most of the cities with pension fund issues are not participants in MERS.

Discussion followed regarding travel and expenses related to pension board activities. Griffin discussed the restrictive limitations of MERS' travel and entertainment policy and accepting gifts from clients.

Responding to a question, Feinberg responded it would take a vote of the City's electorate to withdraw from MERS. Waugh advised there have been four communities that have withdrawn from MERS.

Responding to a question from Wright, Griffin stated MERS does not conduct business with any of its boardmembers, including members who are involved in the investment community.

Wright asked if these boardmembers could influence investments through their associates. Griffin stated it is highly unlikely that would occur especially given the extensive vetting process used by MERS.

Waugh advised the four communities that have withdrawn from MERS include: City of Fraser, Marine City, Stanton and Village of Elsie.

Discussion followed regarding how the City's plan would be administered under MERS. Waugh stated the City would continue to make decisions regarding its plan, however, he identified some of the safeguards MERS has in place. For example, MERS does not allow a City to make benefit changes to its plan without doing a supplemental evaluation to determine the affect on current and future costs. He advised there are parameters within which MERS will allow a City to make changes.

Pastue advised MERS's approach is in line with the City's conservative philosophy in terms of benefit changes and asset allocation. He discussed the significant amount of time dedicated to administering the City's pension system. He further discussed other related costs to administering the pension plan.

Pastue responded to a number of questions submitted to his office by Councilmember Wright concerning a move to MERS.

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Pastue advised Pension Plan Administrator Patsy Cantrell and Treasurer Chris Weber both support moving to MERS.

Pastue stated the City has not looked at other alternatives to the existing advisory team of MERS. He stated this would involve additional staff time and then a comparison to MERS administrative costs would need to be done. He advised due to the size of MERS it would be difficult to equal or beat their costs.

Pastue advised the City will not get the same volume of data from MERS as received by the City's current pension board. He stated the City would receive quarterly financial statements from MERS.

Wright confirmed MERS would submit financial reports directly to Council and the City's pension board would no longer exist.

Feinberg noted employees can access their benefit statements directly online. Waugh advised they send out statements on an annual basis.

Wright confirmed an actuarial report would still be required by the City. Waugh advised MERS contracts with GRS for that report. Pastue state the actuarial report would be part of the annual report to Council.

In terms of seeking the opinions of other communities regarding MERS, Pastue stated he has pretty much relied on his own experience with the organization.

Pastue advised part of the impetus in going with MERS is the increasing complexity of the investment world and its challenges to the City's staff to stay abreast. He noted the City has benefited immensely from Patsy Cantrell's expertise, however, there is no guarantee that expertise will be available in the future.

Relative to moving to MERS at a lower funding percent, Pastue discussed required adherence to statutory guidelines.

Wright asked about the flexibility of the City's contribution to the retirement fund. He discussed the impact on the overall methodology on which the benefit is paid. In determining the contribution to the fund, he emphasized it is the City's liability, not MERS.

In addressing the flexibility of the City's contribution to the retirement fund, Waugh stated the City would contribute a monthly amount based on the normal cost, the unfunded liability and the determination of percentage of payroll for that year. He advised the City could contribute more than that amount, but not less.

Pastue emphasized the extensive research undertaken by City staff before arriving at the decision to recommend moving the City's pension plan to MERS.

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Buck asked about the timetable for moving to MERS. Pastue stated the City's goal is to have retirees receiving payments from MERS as of January 2010. He stated the Council still needs to adopt a resolution to initiate the process. He advised there have been discussions with staff regarding how the move to MERS will be communicated to retirees and active employees. He further advised the City's bargaining units are aware of and support this change. He stated there may still be some lingering issues going into next year.

Responding to a question from Buck, Pastue stated MERS is willing to take over the pension system's current investments. Griffin advised this is not part of MERS' normal procedures. Griffin further advised on the day the City's pension fund transfers to MERS it would be valued at current market rate in aggregate. He stated the City would get the most recent price data. He acknowledged 20% of the portfolio would be priced based on 3-month old data which may or may not work in the City's favor.

Buck expressed concern regarding potential losses in real estate holdings that as of yet are unrecognized, particularly in the commercial sector. Griffin confirmed there is a potential for losses, but the risk is only 3 ½% of the portfolio. He acknowledged there is an expectation there will be write downs on commercial real estate.

Discussion followed regarding the basis on which the City will make the FY 2010/11 contribution to the retirement fund.

Waugh advised if the City moved to MERS effective January 1, 2010 they would use the asset values as of 12/31/2008, apply smoothing asset valuation factor to those values, to determine the actuarial cost. He stated the investments will be transferred over at market value. He stated the actuarial value of assets will be the basis for contribution purposes and when the funds are transferred over the market value will be applied. He guessed the 12/31/08 asset totals will be lower than the actual market value when the transfer of funds occurs.

Council thanked the MERS representatives for their informative presentation.

**PUBLIC COMMENT**

No public comment was heard.

**CLOSED SESSION – LABOR NEGOTIATIONS**

**09-09-194** MOTION by Buck, seconded by Wright, to enter into closed session to discuss labor negotiations.

**ROLL CALL**

Ayes: Knol, McShane, Wiggins, Wright, Buck.

Nays: None.

Absent: None.

MOTION CARRIED UNANIMOUSLY.

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Council entered into closed session at 9:15 p.m.

**09-09-195** MOTION by McShane, seconded by Wiggins, to return to open session.  
MOTION CARRIED UNANIMOUSLY.

Council returned to open session at 10:35 p.m.

**OTHER BUSINESS**

Council discussed proposed changes to the City Manager's employment contract and concurred to delay taking action.

**ADJOURNMENT**

**09-09-196** MOTION by Wright, seconded by Buck, to adjourn the meeting. MOTION  
CARRIED UNANIMOUSLY.

The meeting was adjourned at 10:55 p.m.

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Valerie S. Knol, Mayor

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Susan K. Halberstadt, City Clerk

APPROVED: November 16, 2009