



# ADVISOR



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## Paper Assets & Real Assets

Editorial

The world of “high finance” has been rough sledding over the last two years. In the past, if there was a crisis in a specific investment area like stocks (paper assets) or real estate (real assets), the other investments would be fine because diversification protected the portfolio. Unfortunately, due to the severe recession, portfolio diversification (that had protected us against big losses), is now suffering in every investment category – just in different months!

Investment funds with outstanding past records are reeling from investment meltdowns across the board. Harvard University was down 27.3 percent, while Yale University recently reported being down 24.6 percent. The biggest drag on Yale’s performance is a 34 percent decline in real assets, which includes real estate. Fortunately, after an early meltdown in stocks, Yale’s assets have rallied 55-65 percent over their lows. Instead of taking months to recover, real assets will likely take years before they rebound.

Most real estate investments by pension funds, banks, and insurance companies use 70-80 percent leverage (borrowed funds) to fund the purchase of real assets, like office buildings, hotels and the like. Most, if not all, of the 20-30 percent equity in their properties is now gone as commercial real estate is down 41 percent at this time. The RSA has not used any leverage on its real estate. This was a good conservative move. The RSA’s only problem in this environment is with the current value of the real estate, which we have no need to sell. These values should increase in the next three to four years, similar to the value of your house that you have lived in for a decade. ■

## Overly Conservative Reaction Hurts Performance

By David G. Bronner

Over three decades ago, the TRS and ERS had \$500 million in total assets with retirement benefits only 25% funded. That meant the RSA only had one dollar for every four dollars needed to fund retirement benefits.

In 2008 the total TRS and ERS assets were \$26.4 billion, but declined to \$23.5 billion at fiscal year end on September 30, 2009. This decline is not because the calendar year of 2009 was a bad year for investments (for example, the S&P 500 was up 19.26%), but because October, November and December of 2008 were so bad that the S&P 500 performance for the 2009 fiscal year amounted to -6.58%. The TRS had a return of -7.94% for the 2009 fiscal year, while the ERS had a return of -10.03% for the 2009 fiscal year.

My mistake was being far too conservative during the worst recession in our lifetime. During the stock market rally, I decided that protection of the downside was the smart thing to do. Wrong, dumb move. The RSA used “collars” after the market rebound, meaning we were willing to give up an extreme upside for some downside protection in the stock market. For example, if we collared part of our equity exposure at say 15% upside, we no longer participated in an equity move above that level. However, we felt it prudent to put in some downside protection (13% on average) considering the side of the rally out of the March lows. Obviously, if the market rockets past 15%, I lose that big upside gain.

My second conservative move that badly hurt performance was the preferred stock in Raycom (television stations) and CNHI (newspapers). Preferred stock is safer than common stock, but preferred stock value drops if the company is in a cash crunch and does not pay a dividend. The good news is that this preferred stock should come back to its full value as the economy improves. ■

## New York Times Financing Cultural Change

By Dan Luzadder

MOBILE, Ala.—When David Bronner, the chief executive of the Retirement Systems of Alabama, the pension fund for public employees in the state, first discussed making a

major investment in this city, he had an ultimatum for local leaders: show that you’re willing to rebuild the city’s education system, and the money will flow.

Mr. Bronner, 64, who has steered the

fortunes of the retirement system for 36 years, already had what he thought was a good idea. He would help Mobile rebuild its deteriorated downtown and its self-

*Continued on page two*

## Financing Cultural Change *continued from page one*

image—starting with the renovation of the Battle House hotel, which had once been the heart of the city's downtown.

But, first, he wanted a commitment from Mobilians that they were willing to invest in themselves by raising taxes to pay for better education. "Without education, how can we attract business and industry?" Mr. Bronner said.

A bond issue for public school reform was approved in 2003, and two years later it began to rain money in Mobile—an investment by the retirement system of some \$650 million so far.

Today, the Battle House hotel, which had been closed for more than three decades, has been restored to its antebellum elegance. Its rooms and suites are as well appointed as any luxury hotel in the region, and its spa has become a draw for tourists.

The hotel lobby connects to the 35-story RSA Battle House Tower, a sparkling 470,000-square-foot high-rise that is the first truly Class A office space in Mobile, offering tenants the highest-quality space and most advanced technology available in the city. At 745 feet, the tower is also the tallest building on the Gulf Coast east of Houston.

The Battle House Tower, which opened in 2007, is just one of a number of investments that Mr. Bronner has shepherded within Mobile.

His agency also built a new cruise port for \$16.1 million: the Alabama Cruise Terminal, a 302,000-square-foot docking area that has attracted cruise ships to the city, including some that used New Orleans as a port before Hurricane Katrina. It spent \$97.3 million to buy and restore the 534,000-square-foot Grand Hotel across the water on the eastern arm of the Bay of Mobile, after it was damaged by the wind from Katrina. And the fund most recently spent \$6.7 million to buy the 300,000-square-foot, 34-story former AmSouth Bank Building, built in 1965. It is under reconstruction for conversion into the city's second Class A office tower.

Donald Epley, a professor of real estate and the director of the Mitchell College of Business Center for Real Estate Studies at the University of South Alabama in Mobile, said the retirement system's investments here—and its even larger investments upstate in Alabama's state capital, Montgomery—reflected a bet not just on the individual projects but also on the state's economy.

"If you are going to talk about office

space, you have to talk about employment, because that is what drives office space," Mr. Epley said. "So the story is one also of economic development success here."

The pension fund's initiatives have inspired small local banks and other lenders to back business development here, Mr. Epley said.

While the fund's investments have unquestionably helped the city weather the recession a bit better than some metropolitan areas, there have certainly been casualties. A review compiled by the Center for Real Estate Studies in September showed vacancy rates of about 18 percent in the first and second quarter of this year, based on availability in 191 commercial properties of all classes. By contrast, the rate in the first quarter of 2008 was 12.7 percent.

Mr. Bronner's vision of investing in Alabama reflects an unusual approach for a state pension fund. Most, he said, are content to turn their money over to an investment manager, and most operate from a single goal of enhancing the value of the retirement funds by wise investments.

But Mr. Bronner has a reputation for taking a longer view, and has invested in real estate as a way to create cultural changes in the state. The approach has on occasion made him controversial, with critics suggesting that spending on economic development by building, owning and operating major hotels and office buildings isn't the purpose of a state pension fund.

Mr. Bronner credits the fund's investment in hotels and resorts associated with the Robert Trent Jones Golf Trail in Alabama for creating a multibillion-dollar tourist economy in the state. The agency spent more than \$213 million building 11 luxury golf courses designed by Robert Trent Jones, and hundreds of millions more to build hotels and residential developments that the agency owns and operates at the courses. That move is credited with helping to attract business, like the immense new ThyssenKrupp Steel USA plant being constructed on the banks of the Mobile River, 30 miles north of the port city.

The Retirement Systems of Alabama has a story of revival of its own. Badly underfunded in the 1970s, with only \$500 million in the kitty, it was limping along in the shadows of the State Capitol building in Montgomery when some civic leaders recruited Mr. Bronner, then a young financial visionary from Minnesota, to become its chief executive.

At the time, state office workers were housed in dozens of places around

Montgomery. One of his first steps, he said, was to devise a plan to consolidate the workers into several large office buildings—largely built by the retirement system.

Mr. Bronner cites other deals that he is proud of, like investing in US Airways when it was in bankruptcy earlier this decade, and buying the 3.8-million-square-foot 55 Water Street, the largest building by floor area in New York City, according to Emporis.com, a Web site with an extensive database on buildings.

From a \$500 million start, he has guided the agency into a \$28 billion financial juggernaut. Mr. Bronner is fond of dragging reporters to the balcony of the fund's well-appointed new office complex in Montgomery to gaze out at his symbolic signature—the green-trimmed rooftops of all the buildings that the fund has helped to build.

The fund's most recent annual report carries an aerial photograph of the city with all of the buildings it has financed taken out of the picture. "It makes a point," Mr. Bronner said with a grin. "This is what the city would look like without us."

The retirement system has had an even greater impact in Montgomery than in Mobile—2.5 million square feet of commercial and state office space—where local commercial real estate developers like Jerry Kyser say investors are now eager to put money into new restaurants, offices and retailing in the city's downtown, including its new Alleyway project down the block from the retirement system's recently completed 395,000-square-foot Renaissance Hotel, which includes a 1,800-seat performing arts center and convention hall.

Back in Mobile, pedestrian traffic has returned to downtown day and night, said David Rasp, owner of Heroes, a longtime downtown watering hole, and of the new Royal Scam restaurant near the Battle House. New investors, he noted, are opening restaurants, pubs, boutiques and other ventures despite the current recession.

The Battle House, built in 1852 on the headquarters site for Andrew Jackson in the War of 1812, was a cultural icon for more than a century before it succumbed to age and neglect in the late 1970s. Now it has once again become the cultural heart of Mobile, a place for posh Mardi Gras parties.

It has all been, Mr. Rasp said, a "very, very good idea" for Mobile. ■

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**(Editor's Note:** RSA received a handwritten note of congratulations from Donald Trump after publication.)

## Are We Doing Our Share to Help Ourselves? TAX LOAD

Alabama gets less in state and local taxes per person than most states.

### Average state and local taxes collected per person:

1	Alaska	\$7,268
2	New York	\$6,898
3	Wyoming	\$6,205
4	Connecticut	\$6,044
5	New Jersey	\$5,944
<b>50-State Median</b>		<b>\$4,011</b>
46	South Carolina	\$3,134
47	South Dakota	\$3,009
48	Tennessee	\$3,005
49	Mississippi	\$2,989
50	<b>Alabama</b>	<b>\$2,909</b>

### Average state and local taxes collected per person as a percentage of personal income:

1	Alaska	18.01%
2	New York	14.56%
3	Wyoming	14.36%
4	Hawaii	13.10%
5	Vermont	12.85%
<b>50-State Median</b>		<b>10.65%</b>
46	Texas	9.25%
47	Tennessee	9.03%
48	<b>Alabama</b>	<b>8.98%</b>
49	South Dakota	8.87%
50	New Hampshire	8.71%

Note: Tax collections are for the 2007 fiscal year, which for most states ended June 30, 2007, and for Alabama ended Sept. 30, 2007. Twenty-five states had higher totals or percentages than the medians and 25 had lower. Sources: U.S. Census Bureau reports on FY 2007 tax collections; Census Bureau population estimates for July 1, 2007; Census Bureau and U. S. Bureau of Economic Analysis reports on average personal income in 2007.

## Editorial: *Mobile Press Register*

*DID SOMEONE in Montgomery say something about taxes?*

That word is politically taboo in Alabama, especially if it's combined in its singular form with the word "reform" or, heaven forbid, "increase." But now, after two straight years of proration—mandatory across-the-board budget cuts—in education, some prominent Alabamians are talking out loud about the inadequacies of the state's tax system.

Paul Hubbert, the head of the state teachers' union, said recently that he thinks "we've got to get a better tax base for funding our schools."

Let's give Mr. Hubbert a rousing "amen." Alabama's tax base isn't much of a base at all. It's made up primarily of the shifting sands of sales tax and property tax revenues. Those taxes are very sensitive to changes in the economy; even when the state is doing OK, they can suddenly decline, forcing cuts in education.

The current recession certainly has taken a toll on the state's economy and its tax base. But consider this: Alabama schools have been hit with proration 10 times since 1979. During that period, the nation endured just four recessions, and two of them were short and relatively mild.

It's clear that the economy alone doesn't account for the state's repeated school funding woes. As Mr. Hubbert suggested, the tax base isn't solid enough to provide consistent support for education.

Mr. Hubbert has a big megaphone,

but it's not surprising that the head of the teachers' union wants the Legislature to do something to improve the school funding system.

The schools need key elected officials to speak up on their behalf. Gov. Bob Riley did that in 2003 when he proposed a big tax reform package, only to see it shot down by voters in a statewide referendum.

But maybe—just maybe—after two rounds of deep budget cuts in education, the anti-tax climate in Alabama is changing. It's time for lawmakers from both parties to go out on a limb for a tax reform measure that would cut sales taxes, give the poor more relief from the income tax and raise the state's lowest-in-the-nation property taxes to offset the cuts.

It wouldn't be a bad idea to review the state's budget process, either. Rep. Greg Canfield, R-Vestavia Hills, offered a bill last year to replace the current revenue forecasting system with a "rolling reserve" that would cap budgets based on the previous 15 years' tax collections.

Perhaps the rolling reserve would protect the schools from repeated cuts, but the education budget would still be sitting on a precarious tax base. Tax reform was needed in Alabama in 2003; the sad state of the education budget today proves that reform is the only way to maintain adequate and stable funding for the schools. ■

## Survival Strategy

By Joseph B. Morton  
State Superintendent of Education

- K-12 education should receive at least 70 percent of the FY 2011 education budget and a constitutional amendment should be pursued to establish, by law, that all education dollars appropriated by the Legislature be based on student enrollment in K-12, the two-year college system and higher education, including graduate programs.
- The Legislature should freeze the FY 2011 state appropriation for educators' health insurance at the current level and require the Board of Control to make the difficult choices of adjusting rates and benefits to meet the funds available. The same is true for the retirement plan for educators. These programs must live within their means in order for them to be sustainable for future employees and retirees.
- The current law allowing people employed in education to retire with 25 years of experience and no minimum age requirement should be changed for new employees effective July 1, 2010, to a minimum of 30 years of experience and 55 years of age.
- The popular Deferred Retirement Option Plan (DROP) eligibility rule of 25 years of experience and 55 years of age should be changed for new employees effective July 1, 2010, to 30 years of service and 57 years of age.
- The current law requiring 5 percent of an educator's gross salary be deducted for retirement should be changed to 6 percent effective July 1, 2010, for all current and future employees. The law was changed from 4 percent to 5 percent in 1975, so a change every 34 or 35 years could not be considered dramatic when the retirement benefits are guaranteed by state law and not subject to economic peaks and valleys.

This plan is not intended to be punitive. It is intended to openly discuss some very emotionally charged topics and come to a resolution on how to get K-12 funding back on track so students in Alabama can have a fighting chance to receive the quality education they need to compete with students in Georgia, Florida, Massachusetts, Singapore, China, India, Germany, and elsewhere across our globe. It is also presented so the education insurance and retirement plans can be sustained to serve current and future members. ■

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• Feb. 4, 9–10, 21–24

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• Feb. 4, 9–10, 21–24

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• Feb. 1–9, 17–18, 21–25

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Call for Tee Times after booking package  
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• Feb. 1–9, 17–18, 21–25

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• Feb. 1, 7, 12–14, 28

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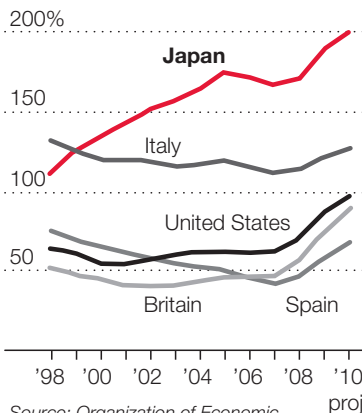
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## Rising Debt – U.S. at 98%

The Japanese government's debt levels are higher than other industrialized countries.

Gross government debt as a percentage of G.D. P.



Source: Organization of Economic Cooperation and Development

## Postretirement Earnings Limit for 2010

For calendar year 2010, the earnings limit for retirees who are employed on a part-time basis by a covered institution or agency participating in the RSA will remain the same as 2009 at \$22,000 per year.

## The RSA-1 (457) Deferral Limits for 2010

The 2010 calendar year deferral limitations for Section 457 deferred compensation plans (RSA-1) remain the same as 2009.

- Participants under age 50 \$ 16,500
- Participants age 50 and older \$ 22,000
- Normal Catch-up Deferrals \$ 33,000



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