MINUTES OF JUNE 13, 2013 RETIREMENT BOARD
CITY OF ALEXANDRIA
SUPPLEMENTAL RETIRMENT PLAN
ANNUAL BOARD RETREAT

PRESENT

Members	Others
Shane Cochran, Secretary (General Schedule)	James Bland, Intern
Brenda D'Sylva, (General Schedule)	Steven Bland, Retirement Administrator
Bill Eger, (General Schedule, Alternate)	Barry Bryant, Dahab Associates
Tom Gates, Chairman (Management)	Bryan Capelli, Retirement Specialist
Bob Gilmore, (Deputy Sheriff, Alternate)	Kadira Coley, Retirement Specialist
Nancy McFadden, (Medic)	Michael Cross (Fire & Police Board)
Jean Niebauer (Management, Alternate)	Patrick Evans (Fire & Police Board)
Marietta Robinson, (General Schedule, Alternate)	Gary Failla, Comerica
Morgan Routt (Management)	Mark Jinks (Management)
Nelsie Smith, (Management)	Chris Kempton, Credit Suisse
Laura Triggs (Management)	Arthur Lynch, Retirement Specialist
	Shirl Mammarella (Fire & Police Board)
	Ed Milner (Fire & Police Board)
	Theresa Nugent, Communications Specialist
	Felecia Ryan, Comerica
	Eric Sabol, PRISA
	Al Tierney (Fire & Police Board)

Absent:
Jarrod Overstreet (Deputy Sheriff)

Note: This meeting was a joint meeting of the Boards for the Supplemental Retirement Plan and the Firefighters and Police Officers Pension Plan. The discussions reported in these minutes include comments from members of both Boards. All discussions are of value to each Board, even if the following motion did not apply to one Board. However, the motions noted in these minutes only relate to the Supplemental Retirement Board.

CALL TO ORDER

The meeting was called to order at 8:34 AM on June 13, 2013.

MEETING RECORD

There was a motion by Mr. Cochran to:

> Approve the May 9, 2013 minutes.

Ms. McFadden seconded the motion.

The motion was unanimously approved 8 – 0.

INTRODUCTIONS

Chairman Gates introduced Ms. Nelsie Smith, the newest member of the Supplemental Retirement Board, welcomed her, and everyone at the meeting introduced themselves.

Ms. Robinson arrived at 8:39 AM.

INVESTMENT VOCABULARY

Staff presented the vocabulary handout. It includes words, phrases, and acronyms related to pensions and investments. There are websites and books that serve as references. The websites & books are endorsed by staff. The books are about security selection, portfolio construction, performance measurement, economics, and people who have made a mark on the investment profession.

Ms. Niebauer arrived at 8:49 AM.

CHARACTERISTICS OF ASSET CLASSES

James Bland introduced the topic by saying that much of the board's work includes comparing or analyzing an investment manager and a benchmark, or index. As important as these indices are, the board might take a few moments to study them.

There is a significant amount of data but it was sliced and diced and sorted. Then it was averaged to facilitate comparison between groups.

Global, emerging, and domestic indices reflect large companies. Frontier market companies are smaller. Domestic companies have more technology companies. These companies have distinct characteristics which will impact the domestic indices' averages. High dividend yields may lead to lower growth because there is less for reinvestment. Alternatively, low growth prospects lead companies to pay out more in dividends.

Value and growth indices were compared. Market cap, Price/Book, Dividend yield, and Growth prospects were discussed.

Sector weightings showed that international indices and investing introduced diversification over economies and currencies, but sectors as well. Investing in frontier and Emerging markets provides more exposure to commodities, materials, and mining.

SECURITIES LENDING

COMERICA

Mr. Gary Failla and Ms. Felecia Ryans introduced themselves.

Staff distributed two booklets from Comerica, *Securities Lending* and *2011 – 2012 in Review*. Mr. Failla presented from *Securities Lending*.

Mr. Failla said that 39% of plans with over $100 million in assets use securities lending. 76% of municipal plans participate in securities lending.

Beginning with page three, Mr. Failla spoke of Comerica's program. It is compliant with federal standards and has operated for thirty years.

Mr. Failla spoke of the required collateral. Borrowers must put up cash, not securities – cashing being the more conservative approach. The program does not impede the investment management of the trust fund.

Turning to pages six through fourteen Mr. Failla described the mechanics of the Securities Lending program. Page twelve illustrated the great spread in pricing securities for lending. Some securities generate much higher fees than others. Mr. Bryant asked about operational risk.

Ms. Niebauer asked about the program in 2008. The program was conservative in early 2008 and Comerica tightened it up even more. Since then it is even more conservative. Staff asked if the there was more than one collateral pool and if so could Alexandria pick the more conservative of the two. Collateral could be solely quality rated overnight securities. Comerica does not lend to hedge funds.

Securities lending might generate $46,000 annually for the combined plans of the City of Alexandria. Mr. Failla distributed a one page handout detailing the derivation of the $46,000 figure. However, that figure will change over time. Staff said the amount will change with the value of securities as markets go up and down and contributions net of expenses increase the plan assets. Also, lending is only available for the plans' separate accounts. It is not available for comingled funds. If investment managers are changed, then the amounts available to lend may also change.

Securities lending fees are split 70% for the pension plan and 30% for the custodian.

Mr. Jinks asked if Comerica loaned US securities or international. The lending is domestic only.

Staff said that without exception every pension plan he had previously worked with had participated in securities lending.

Staff recommended a motion:

- That the boards pursue securities lending for the plans,
- That the most conservative collateral be used,

- That staff, Comerica, and/or the investment consultant report to the board annually, and
- That the contract is subject to legal review by the City attorney.

The consensus was to place securities lending on a future agenda.

Ms. Ryan and Mr. Failla left the meeting.

The meeting recessed at 10:00 AM. The meeting resumed at 10:07 AM.

MANAGER ATTRIBUTES

Staff referenced *Manager Attributes*, handout # 6. The theme of the presentation was to develop an appreciation for the styles of each of the plans' managers and a sense for when their particular styles are expected to underperform or outperform.

Polen, Champlain, and Johnston all invest in securities with quality balance sheets. They are expected to underperform on the upside and outperform on the down side. In the almost two years we have been with these managers this has virtually always held true.

Herndon is somewhat similar to an equal weighted index.

NewSouth is eclectic manager. Their results are hard to forecast.

PIMCO stock plus has three sources of earnings. The first is exposure to the Russell 2000 through futures. The second is the opportunity to selectively purchase futures at advantageous prices. The third is to invest collateral more aggressively than in T-Bills which is what most do when valuing and buying or selling Russell 2000 futures. The three sources should be independent. A periodic loss in either of the last two should be partially or fully offset by a gain in the other.

Glovista thrives on volatility and recent markets have not been volatile. Their performance is best measured after a spike in volatility.

Research Affiliates is based on fundamental indices. They may under or outperform, but tracking error should be modest.

Brandes is a traditional emerging market manager. They have especially low turnover with a distinct value bias.

PIMCO's Total Return Fund is the largest fixed income fund in the country. It is a core plus fund. The "plus" will lead to periodic underperformance. They take more sector risk than duration risk.

Hamilton Lane's primary private equity fund of funds has many primary investments under its wing. The diversification should lead to "average" results, less fees. Extreme results are unlikely.

Hamilton Lane's Secondary Fund II and Landmark's Fund XIV were both launched around the bottom of the market in 2008. They should benefit somewhat from some fire sales. However, as low as prices were, few deals were closed at dramatically reduced prices.

Hancock's fund X is half domestic and half international. It is benchmarked to the NCREIF timber index, which is 100% domestic.

Funds have been committed to Molpus (timber) and UBS (farmland), but none have been called to date.

PRISA Real Estate is one of the largest in the country. They are a "core plus" manager. However, the non-core aspects are very small. It is very close to being a "core" manager.

COMMODITITES

Mr. Kempton referred to tab two of his handout, *Credit Suisse Asset Management Commodities.* He discussed the benefits of investing in commodities (page six). They provide diversification benefits, a hedge against inflation, and it can be a short term tactical investment. Page seven displays correlations and commodity returns in inflationary and non-inflationary environments. Page eight shows the different ways to gain exposure to commodities. Page nine displays correlations of various commodities and the CPI.

Page ten displays the volatility of various individual commodities. They are quite volatile. However, the Dow Jones UBS index is much less volatile than its components due to their modest correlations. Page Eleven discloses risks. Mr. Eger asked if volatility has changed over time. Mr. Kempton believes volatility has increased over the last decade. Inventories have dropped and that the supply & demand balance shifts more significantly. Mr. Jinks asked if futures were less volatile than the underlying commodity. Mr. Kempton said for a given commodity the future maturing first is more volatile than those with maturities father into the future. Ms. Niebauer asked Mr. Kempton to explain the volatility of Natural gas. That is due to the shale gas boom.

Mr. Kempton referred to tab three, choosing a commodities Product. This section distinguishes the more popular commodity indices. Page fourteen showed a history of annual performance. Staff noted the worst bear markets of the last forty two years and that commodities had typically performed very well in most of these periods. Thus, commodities are an excellent diversifier. Pages sixteen through eighteen discuss the relative performance of the various commodity benchmarks.

Page twenty through twenty two focused on how various managers use strategies to outperform the benchmarks. The most common strategy is Roll Yield, the process of selling a commodity future prior to its expiration and buying new contracts. Mr. Jinks asked if enhanced products were fully invested. Mr. Kempton said yes. Also, they are liquid investments. There is good liquidity, and partnerships stayed open in 2008.

Mr. Kempton left the meeting.

REVIEW of STAFF REPORTS

This was deferred to a future meeting.

SOCIAL INVESTING

The talk was motivated by the Mayor's receiving a request to participate in a divesture of securities of the world's top 200 energy producers.

Socially Responsible Investing (SRI) is defined as investing for both returns and a social good. Examples of SRI include:

Governance (to encourage a change in corporate boards)
Markets (to encourage companies to stop doing business in certain countries)
Products (to boycott goods such as alcohol, tobacco, and firearms)
Suppliers (to encourage a change in sweatshop conditions)

The case for SRI is to acknowledge and continue fiduciary duty and at the same time contribute to a social good. The case against SRI is first that SRI has not been proven to be effective in bringing about a change in corporate behavior. Second, the performance of SRI has produced mixed results with underperformance in the U.S. and out performance internationally.

Some possibilities to bring about social good without SRI include leveraging our relationships with vendors to encourage socially responsible behavior (such as reports with two sided copies), minority and women account representatives, employing emerging managers, and activist investing.

Beginning on page 87 of the packet there is a political cartoon and an editorial on SRI titled, *Misdirected Furor*.

PLAN SPECIFIC TOPICS was moved to maximize the number of trustees present for voting. See the Administrator's Report and Old Business below for voting record.

There was a break at 12:30 PM for lunch. The meeting resumed at 12:45 PM.

REAL ESTATE

Mr. Sabol introduced himself on behalf of his firm. He distributed a book, *PRISA SA, PRISA II, PRISA III*. Section I provides background on Prudential Real Estate. Page 14 shows diversification across sectors and geography. Page 16 provides a snapshot of the key characteristics of the three PRISA funds. Pages 21 – 24 provide key performance figures of PRISA. PRISA overweights New York, Washington D.C., Los Angeles, and San Francisco because of job growth and real estate transaction activity.

Page 29: non-core is 13% of the fund and expected to decline over time. Development is limited to 10% of the fund.

PRISA is always open, but there may be a queue. PRISA II opens periodically, and is expected to open again in 2014. PRISA II has $72 million being deployed, and then the Deposit queue will be down to $91.2 million.

Mr. Eger asked about the energy efficiency of PRISA buildings. The newer buildings are energy efficient and LEED certified (Leadership in Efficiency and Energy Design). Roughly 37% is LEED certified and that percentage will grow over time.

Property turnover is 10% - 14% annually.

Page 78 displays statistics on debt. Typically there is a larger proportion of floating debt. However, with fixed rates low, much debt was locked in.

Staff asked about the amortization of principal. Mr. Sabol said the loans were interest only. No principal is being paid down.

Mr. Sabol left the meeting.

Mr. Routt left at 1:30 PM.

ACTIVE VS. PASSIVE INVESTING

Staff referenced handout 13. Discussions of active & passive investing often dwell on the fees and relative frequency of active managers beating a benchmark. The thesis of the presentation is that there is significantly more to the debate than these two points. The presentation is divided into four portions: 1) Performance, 2) Due Diligence, 3) Asset Allocation, and 4) Anomalies.

Performance related issues included: fees, turnover, style drift, tracking error, cash drag, economy of scale, capacity, securities lending, thinly traded securities, and the potential for outperformance.

Due Diligence related issues included: the time demands of manager review, marketing emphasis, change of managers, and the number of options/choices available.

Asset Allocation related issues included: tracking error, the validity of an asset allocation study based on index performance and applied to active managers, difficulty in statistically measuring managers' alpha and beta, and rebalancing.

Significant academic research suggests passive investing is the best way to go. Yet, there is also a significant body of research supporting a number of strategies that have beaten the market. These anomalies seemed to defy the research of the random walk. The anomalies were enumerated and then briefly discussed.

The consensus was to place active versus passive investing on a future agenda.

LIQUIDITY

Staff referred to handout 15. Exhibit 1 recapped the presentations of the last several months. The "Liquidity Premium" compensates investors for accepting illiquidity. The remainder of the page lists ways to adjust to or accommodate this reduced liquidity.

Exhibit 2 displays two schematics. The first shows a typical pension plan. The second highlights the differences between the Fire & Police Plan and the typical plan. Retiree liabilities that would otherwise be part of the pension plan are separated. Some of this is defined contribution plan assets, and some is retiree liability in the "Old" defined benefit plan that was closed in 1979.

Exhibit 3 shows results from a National Association of State Retirement Administrators' (NASRA) survey in 2011. The level of illiquid investments was 20.5%. Also, it has grown each year of the ten year survey.

Exhibit 4 is a reprint of a recent graph from Pension and Investments on line. It indicates that for each of four alternative assets – that are predominately offered in illiquid partnerships – more boards are considering increasing allocations than decreasing them. On average, the number planning to increase allocations is twice the number planning to decrease.

Exhibit 5 assimilates the information of the prior four exhibits. The plan with best practices is conservatively illustrated as having twenty percent illiquid assets. This is conservative because the statewide plans in the NASRA survey were at 20.5% illiquid and <u>increasing</u>. The components on the top right of the Fire & Police schematic illustrate a 0% allocation to illiquid investments for the defined contribution plan and the "old" defined benefit plan. For the total to average 20% the existing plan could have 27% allocated to illiquid investments. This would slowly decline over time as the active and retiree portion of the new plan grow and the others decline.

Exhibit 6 is a numerical derivation of the concepts illustrated graphically on exhibit 5. A comparable message is valid for the Supplemental Retirement Plan. In 1999 the retiree liability was accepted by Principal Financial Group. Assets for this liability were left with Principal. With the short tailed retiree liability carved out, the remaining long tailed active liability can accommodate an above average amount of illiquidity.

Exhibit 7 is a survey of our peer public plans in Virginia. A Fairfax County plan has had notable success without illiquid alternative investments. This has been through the use of risk parity programs which have involved the use of significant amounts of leverage.

Exhibit 8 is an excerpt from an article in P&I on line. It shows Maryland increasing its allocation to illiquid assets to at least 30%.

Exhibit 9 demonstrates the history of illiquid assets in the plans. The Supplemental plan is currently at 17%. This does not reflect a plan, design, or global intent. Instead, illiquid assets have been added one investment at a time. The current level happens to be 17%. There are many investments that have never been discussed by the board or considered for the asset allocation. When this is done, the 17% figure may rise further.

Mr. Tierney said he had no cares if the pension plan invested in bungee cords, as long as the bungee cords were liquid. Staff suggested investing in bungee cords was problematic.

There was a motion by Mr. Gilmore to:

Add the following language to the Investment Policy Statement.

Prior to committing to any illiquid investment staff and/or the investment consultant shall prepare and the Board shall discuss/review the investment's characteristics:

- The amount of the commitment,
- The expected duration of the investment lockup,
- The maximum duration of the investment lockup,
- The expected period that cash will be called,
- The expected period that distributions will be received,
- The length of the exit cue (if relevant), and
- The expected maximum cash call net of distributions received to that date.

Prior to committing to any illiquid investment staff and/or the investment consultant shall prepare and the Board shall discuss/review the plan's status:

- The cash flows to (contributions) and from (benefits & expenses) the plan,
- The cash flows from other illiquid investments,
- The plan's projected future cash flows,
- The investment's diversification and return benefits,
- The ability to sell other investments in anticipation of cash calls,
- The risks in not raising cash in advance,
- The availability of liquid alternatives to the illiquid investment under consideration,

Mr. Cochran seconded the motion.

DISCUSSION:
The Plan benefits from a coherent liquidity policy and a rubric for review of relevant information.

The motion passed (8–0).

ADMINISTRATOR'S REPORT

Staff discussed the administrator's report.

There was a motion by Ms. Niebauer to:

The Plan sells $1.5 million PIMCO Small Cap Stock Plus and purchase $850,000 RAFI Emerging Markets and $650,000 Johnston Asset Management EAFE.

Ms. Smith seconded the motion.

The motion passed (8–0).

There was a motion by Mr. Gilmore to:

Approve the recommended reimbursement of annual dues for CAIA and CFA Institute at a cost of $1,075 for Steven Bland using the annually determined allocation of 35% for the Supplemental Plan. The allocated cost is $376.

Mr. Cochran seconded the motion.

The motion passed (8–0).

The draft amendment to add a nominations section to the Policies and Procedures was discussed.

There was a motion by Mr. Cochran to:

Adopt the Policies and Procedures with changes as discussed

Mr. Gilmore seconded the motion.

The motion passed (8–0).

TIMBER
Staff provided a brief update on the Hancock wildfires that occurred in Australia earlier this year. In total Hancock's fund experienced a $50,000 loss. The City's portion was $600. The loss occurred to newly planted saplings that were less than one year old.

OLD BUSINES

There was no new business.

NEW BUSINESS

There was no new business.

NEXT MEETINGS

1. July Meeting is T.B.D
2. Wednesday – August 7th 8:20 AM, Sister Cities 1101, Interim Meeting
3. Thursday - September 12th 8:30 at AM, Sister Cities 1101, Due Diligence – joint meeting
4. Wednesday - October 2nd 8:30 at AM, Sister Cities 1101, Interim Meeting
5. Sunday – Monday, October 20 – 21, Association of Municipal Retirement Systems of Virginia (AMRS-VA).

ADJOURNMENT

The meeting adjourned at 3:00 PM.

HANDOUTS

Distributed to Board members in the Board Packet:

Agenda
Minutes of Prior Meeting(s) [2(a)]
Pension & Investment Vocabulary [3]
Equity Indices (Characteristics of Asset Classes) [4]
Securities Lending [5]
Manager Attributes [6]
How to Read Staff Reports [9]
Social Investing [10]
The Active vs. Passive Debate [13]
Liquidity [15]
Understanding the Investment Process [16]
Administrator's Report [17(a)]
Monthly Investment & Rebalancing Report [17(a)(i)]
Cash Flow Report [17(a)(iii)]
Private Equity Report Cash Flows [17(a)(iv)]
Administrator's Follow-Up Items Report [17(b)(ii)]
Recommended Motions [17(c)]
Nomination Process [20(a)(i)(1)]
Fun Fund Fact – Emerging Markets [20(b)(i)]
ICMA-RC email [20(b)(i)]

Distributed at the meeting:

1. Securities Lending - Comerica
2. City of Alexandria – Comerica
3. Securities Lending Portfolio Breakdown - Comerica
4. Credit Suisse Asset Management, Commodities – Credit Suisse
5. PRISA SA, PRISA II, PRISA III – Prudential Real Estate