MINUTES OF SEPTEMBER 5, 2007, RETIREMENT BOARD
CITY OF ALEXANDRIA FIREFIGHTERS AND POLICE OFFICERS PENSION PLAN
DUE DILLIGENCE MEETING

PRESENT

Members	Others
Dana Lawhorne, Chair	Larry Agne, Participant
Michael Cross	Chuck Arrington, Trusco
Michele Evans	Carl Beveridge, Suntrust
Pat Evans (Alternate)	Steven Bland, Retirement Administrator
Henry Howard	Barry Bryant, Dahab Associates
Bruce Johnson	John Horvath, Participant
Chris Lockwood	Gerald McHugh. Participant
Shirl Mammarella (Alternate)	Dean Molinaro, Prudential
Laura Triggs	Theresa Nugent, Communications specialist
	Douglas Powell, Participant
	Lisa Powell, Prudential
	Michael Sahakian, Suntrust
	Kevin Smith, Prudential

CALL TO ORDER

The meeting was called to order at 8:35 A.M. on September 5, 2007.

MINUTES

There was a motion by Mr. Cross, seconded by Ms. Triggs to approve the July 10th, 2007 minutes. The motion was unanimously approved (7-0).

Ms. Evans arrived.

REPORT FROM DISABILITY COMMITTEE

Ms. Triggs recapped the mandate from the July 10th meeting. She reported the results of the actuarial study. The cost of providing step increases to disabled participants in the Disability Income Plan would be a .88% of salary increase in contribution rates. If the City funded this the first year cost would be roughly $280,000. If the employee funded this it would cost an employee earning $65,000 per year $22 per pay period.

REAL ESTATE

Kevin Smith from Prudential made presentation on real estate. A five-year history of returns was provided. Historically returns are dominated by rental income. However, over the last five years appreciation has exceeded rental income.

The PRISA fund is diversified by geographic and property type (commercial, apartment, hotel, industrial). They tend to buy and hold for 7seven to ten years. They have an income focus. The fund was created in 1970. The maximum leverage allowed is 30%. The current level is 24%. The PRISA process includes budgeting their buys, sales, and an extensive forecasting process to project future rental income. PRISA buys completed buildings and does not speculate on construction.

Recently Blackstone Group completed a leveraged buyout of Sam Zell's Equity Office Trust for over $36 billion. That distorted the supply and demand of office properties in the United States. The fund is repositioning itself to the next cycle in rental increases.

PRISA has no direct exposure to sub-prime loans. However, indirectly some tenants in some properties may have their business impacted by the sub-prime crisis.

Mr. Smith referred to page 11 of his handout and indicated he believed there would be a reversion to gains attributable to income rather than continued appreciation.

Mr. Smith referred to page 13 and indicated a rollover of less that 10% is desirable. Rollover is an ending of a lease.

Mr. Smith indicated 12% of the funds holdings are in the Baltimore, Washington D.C., Northern Virginia corridor. Another area of concentration is the Los Angeles to Long Beach industrial corridor.

In Tampa Florida Prudential purchased a failed apartment complex to condominium conversion project.

Mr. Jinks asked about re-pricing on the sale side. If capitalization rates go up would not prices go down? Staff distributed a reprint from the wall street journal. It included a graph showing capitalization rates had declined for about five years. Mr. Jinks suggested it was more likely that capitalization rates increase rather than decrease.

Mr. Smith mentioned the customer cue to make purchases of real estate. Staff asked about future commitments to the fund. Did $3 million have to be committed all at once or could installments be made? Mr. Smith indicated installments would be acceptable.

Mr. Lockwood asked Mr. Bryant what he would do? Mr. Bryant indicated real estate has had two down years in the last twenty. He attributed those to changes in tax laws. He argued it is very hard to call market turns, therefore since long-term real estate is appropriate for the portfolio we should purchase now.

Mr. Lockwood asked what is the average term for a lease? Mr. Smith said it was 10 to 15 years for office and retail space.

Mr. Seskey made a motion:

> At the next cue the board fund at least half of the remaining unallocated portion of the real estate target allocation.

Mr. Cross seconded the motion.

Discussion: Mr. Jinks indicated there was no information in advance. He requested annual returns by year to gage volatility.

The motion failed (3-5). (Aye: Mr. Cross, Mr. Lockwood, Mr. Seskey,
Nay: Chairman Lawhorne, Ms. Evans, Mr. Jinks, Mr. Howard, and Ms. Triggs)

Mr. Smith indicated he would forward more information.

FOURTH QUARTER INVESTMENT REVIEW - TRUSCO

Mr. Sahakian and Mr. Arrington presented for Trusco and Seix Advisors. Equities are overweighted and fixed income is under-weighted. In July fixed income beat the benchmark. In August they did not. They have overweighted quality.

Trusco's investment posture is governed by thesis sub-prime loans will take a while to work through the system; banks will have to raise capital, which takes time. Credit issues will be spread out, but the economy is strong enough to absorb it over time.

Mr. Sahakian distributed a handout with performance through July 31.

The fixed income portfolio is "A" or better with no direct sub-prime loans. On the equity side they see a cyclical shift and are inclined to emphasize growth over cyclical industries. They see this as time to cautiously commit to homebuilders.

Staff asked two questions: Equity position is nearly 3% overweighted which is typically bullish posture whereas the cash levels are nearly 5% and that is rather bearish. Mr. Arrington explained the cash reflected a point in time at month end. Typically cash levels are much lower, as they were now. Staff also asked about their historic value tilt versus their current "core" status. Mr. Arrington explained they would never chase earnings or momentum stocks. However, there was now more "value" to be found in growth stocks.

Mr. Jinks asked about Mortgage Backed Securities. Mr. Sahakian explained 20% were non-conforming (with Fannie Mae and Freddie Mae Standards) and 80% were conforming. The non-conforming were jumbo loans, loans over the $417,000 limit. They conformed in all other ways.

FOURTH QUARTER INVESTMENT REVIEW - DAHAB

Mr. Bryant's quarterly review began with the style box on page 1. Beginning in the second quarter of 2007 growth began to outperform value. On page six he discussed small cap equity. On page seven the focus was on underperformance of individuals due to over-allocation to guaranteed deposit accounts. Mr. Suggested staff has more educational seminars to address this issue. Staff reported they are working with Prudential to arrange a combination of seminars and one on one meetings with defined contribution plan participants.

Mr. Bryant directed attention to the Defined Benefit tab of the quarterly report. The plan had a value tilt for the last three years. Mid-Cap was also more sizable than is typical in pension plans. Bother served the plan well. Mr. Bryant recommended an evening of the Value and Growth weightings in both large cap and mid cap.

The small cap value manager, Munder, was discussed. Year to date through August 31 they were very close to the benchmark.

PIMCO had struggled through June 30, but performance was much better since July 1. They had shifted to a long duration too early. This hurt them in second quarter as rates rose, and aided them as rates dropped during the year's second sub-prime crisis. Also, PIMCO had international allocations to the Japanese Yen and English currency.

Mr. Bryant discussed indexing fixed income allocations as opposed to active managers.

Mr. Seskey asked about the market value June 30th and August 31st. Mr. Brant and Staff provided handouts for the two dates.

Mr. Jinks suggested the norm for pension plans is not to invest in Guaranteed Deposit Accounts or stable value funds but with active investment management and accept market value fluctuations.

PIMCO has 1% in high yield securities. The total portfolio is yielding 5.7%. Their volatility is due to active duration bets – meaning PIMCO'S investments do not mirror the benchmark. Mr. Bryant suggested we follow up on PIMCO in the third quarter review at the November board meeting.

Mr. Bryant suggested someone might make a motion to address the recommendation of evening out value and growth allocations. Mr. Cross said that Tactical Asset Allocation had been on the agenda for several meetings and had been deferred. If an Asset Allocation issue was placed before the board would it not be right to have that educational background prior to the motion and vote? Ms. Evans asked Mr. Bland what he thought of the idea. Mr. Bland said he thought the equaling out of the value and growth was a good idea as was the presentation on Asset Allocation.

Mr. Bryant distributed a handout on Tactical Asset Allocation. Mr. Cross asked if we had used Tactical Asset Allocation in establishing the current targets. Mr. Bryant said, “Yes.” Also, Trusco was doing the same in their recent tilt from Value to Core.

Mr. Cross asked if we are rebalancing the domestic equities should we also rebalance the foreign equities? MR. Bryant said, “Yes, rebalance.”

Ms. Mammarella asked what was the mechanism for rebalancing. Mr. Bryant explained the Investment Policy statement was written prior to the asset allocation. Therefore there was no rebalancing procedure written into the Investment Policy Statement.

Mr. Seskey recalled that in IFEBP training classes they were told to stay with the guidelines. Mr. Bryant pointed out that we were maintaining the 65%/30%/5% Equity/Fixed Income/Real Estate guideline. In fact, we were maintaining the 25% large cap/20% mid cap/ 10% small cap target. So, we were maintaining the larger guidelines and tweaking within those guidelines.

Mr. Seskey directed staff to distribute to the board minutes of the meeting (November 9, 2006) in which the first commitment to real estate was made.

Mr. Cross made a motion:

> The target allocations be changed as follows:
>
> | | |
> |---|---|
> | Large Capitalization Value | 12.5% |
> | Large Capitalization Growth | 12.5% |
> | Mid Capitalization Value | 10.0% |
> | Mid Capitalization Growth | 10.0% |
>
> Other targets are unchanged
>
> Staff will direct Prudential to rebalance the domestic and foreign equities to their target allocations. Following the rebalancing any residual funds will be deposited in the PIMCO account.

Mr. Jinks seconded the motion.

The motion passed (7-1). (Aye: Chairman Lawhorne, Mr. Cross, Ms. Evans, Mr. Jinks, Mr. Howard, Mr. Lockwood, and Ms. Triggs. Nay: Mr. Seskey)
Place on future agenda – PRISA
Mr. Jinks objected to making a decision based on information being distributed at eth meeting and not in advance.

Ms. Mammarella suggested we eliminate confusion by specifying procedures in the Investment Policy Statement. Staff indicated it was working with Mr. Bryant on the issue and it was still a work in progress.

FOURTH QUARTER INVESTMENT REVIEW - PRUDENTIAL

Mr. Molinaro represented Prudential's investment operations. Prudential discussed its "DDA" metric. This is a quantitative and qualitative score for determining a watch list. Oppenheimer was placed on a watch list for reason of a manager change, not performance.

Munder's recent performance problems (since July 1, 2007) were due to exposure to REITS. In 2006 the problems stemmed from homebuilders.

The Guaranteed deposit allows withdrawals of 16%/year without incurring a market value adjustment. Through July 31 we had just about that amount.

Mr. Lockwood asked how long it was following a fund earns a DDA score of 4 before they are placed on the watch list. Mr. Molinaro said it was typically one or two quarters.

Julius Baer, the international manager is allowed to allocate up to 20% in emerging markets. It is now at that level. This may raise a question on the benchmark.

Mr. Johnson asked about pages eight through ten of Prudential's quarterly report.

Mr. Jinks asked if High Yield performed badly in the second quarter. It did okay in the second quarter but poorly in the quarter to date.

Mr. Jinks asked about withdrawals from the GDA. Mr. Molinaro said the market value adjustment would be about 7%.

Mr. Johnson asked if we should have more than one fixed income manager. Mr. Molinaro referred to page 43 and suggested Bear Stearns Asset Management (BSAM) and the Core Index might be viable compliments to PIMCO.

Ms. Evans made a motion:

> Mr. Bryant works with staff to develop a recommendation for fixed income allocation.

Mr. Cross seconded the motion.

The motion passed (8-0).

T. Rowe Price is a large cap growth manager. They are on the watch list in the Defined Contribution Plan. Ms. Evans requested staff contact impacted members as well as post a notice on the website and on quarterly statements.

Mr. Cross said this was one more reason to have more participant education. Staff indicated it was working with Prudential to schedule seminars in November or early 2008.

It was suggested participants receive information on asset allocation. Staff distributed such information in August to fire and police employees as well as Deputy Sheriffs, Medics, and Fire Marshals. Staff will send this information to terminated vested, retired, or disabled participants.

Meeting recessed at 11:50 AM

The meeting resumed at 12:15 AM.

Mr. Bryant announced the Dahab client conference October 2nd and 3rd. He distributed a handout.

CONFERENCES/SEMINARS

Board members were invited to the Middle Atlantic Public Employee Retirement Systems Forum September 17-18 at the Washington Dulles Hotel. Staff offered to arrange carpools.

Staff pointed out the November 7th meeting is the same day as the IFEBP conference in Anaheim CA. A straw poll suggests there will be a quorum.

Mr. Seskey made a motion:

> To approve the funding of board members attending the IFEBP November conference in Anaheim CA with funding come from the pension fund.

Mr. Cross seconded the motion.

The motion passed (8-0).

Ms. Triggs will endeavor to find a budget code to facilitate the reimbursement process.

REPORT OF THE VALUATION AND TECHNICAL CORRECTION COMMITTEE

Mr. Cross provided a review of the Valuation and Technical Corrections Committee's work beginning with the proposed seventh plan amendment. One aspect of the proposal is a uniform amortization of all components of the unfunded liability. All components would be amortized as a level percentage of pay.

Correspondence from Ken Hoffman and Eli Greenblum were discussed.

The contribution rates would be shifted in a way to maintain the tax-favored status of distributions of non-service partial disability benefits. The participant's after tax contribution to the Disability Income Plan would increase by .10% and decrease by an equal and offsetting contribution rate decrease in the retirement plan. The City's contributions would change in the exact opposite direction, decreasing by .10% in the Disability Income Plan and increasing by that amount in the Retirement Plan. In the future rates could be changed as long as the employee contribution rates totaled 8.0%.

The Valuation and Technical Corrections Committee recommends the full board approve the proposed the seventh plan amendment.

Mr. Cross made a motion:

> The board approves the proposed seventh plan amendment and recommends the City Council adopt the proposed amendment.

Ms. Triggs seconded the motion.

Discussion: Mr. Seskey asked if there were comments from Eli Greenblum on the Unfunded Liability. Mr. Cross said there would be no change to the unfunded liability.

The motion passed (8-0).

Mr. Cross discussed the eighth plan amendment which would provide the board with flexibility in administering elections and the clarify resignation process. He suggested three possible directions:

1. To give the committee authority to complete the task and send the amendment to City Council
2. To direct the committee to complete its work and bring it to a special board meeting
3. To defer the topic

The board elected to defer the topic.

Mr. Cross reported on the effort to increase the transmission of employer and employee contributions to the trust funds from monthly to bi-weekly.

Mr. Cross made a motion:

> Change the frequency of contributions to the trust fund from monthly to per pay period.

.

Mr. Lockwood seconded the motion.

The motion passed (8-0).

Staff reported this should begin in October.

Mr. Cross indicated the time lags between valuations and adoption by the City Council and implementation. Research into this continues.

Mr. Cross reported on the issue of a retiree from the Fire and Police Plan taking a position as a general employee not covered by their former plan. A separation of service is required of at least 30 days.

The actuary uses a 4% salary increase assumption in the valuation for purposes of amortizing the unfunded liability over future salaries. Some had questioned the validity of that assumption. The committee anticipates receiving data from OMB on salary history.

The committee's work on the Fair Labor Standards act is in progress.

UPDATE/FOLLOW UP ON OLD BUSINESS

Staff distributed several informational items that did not call for action from the board.

NEXT MEETING OCTOBER 3rd 8:30 AM

ADJOURNEMENT

Mr. Cross made a motion to adjourn. Ms. Triggs seconded the motion. The motion carried (7-0). The meeting adjourned at 1:03 PM.