MINUTES OF NOVEMBER 8, 2012 RETIREMENT BOARD
CITY OF ALEXANDRIA FIREFIGHTERS AND POLICE OFFICERS PENSION PLAN
DUE DILLIGENCE MEETING

PRESENT

Members	Others
Michael Cross, Participant Representative [3, 5,6,7]	Steven Bland, Retirement Administrator
Pat Evans, Participant Representative Alternate [1,2]	Barry Bryant, Dahab Associates
Tom Gates, Deputy City Manager	Bryan Capelli, Retirement Specialist
Shirl Mammarella [3,4]	Kadira Coley, Retirement Specialist
Morgan Routt, Acting Director OMB [4,6]	Arthur Lynch, Retirement Specialist
Al Tierney, Participant Representative [5]	Theresa Nugent, Communications Specialist
Laura Triggs, CPA CFO, Director Finance [3, 4 ,5,6]	

Absent:
Michele Evans[1, 2, 8]
Ed Milner [1, 2, 6]
Jean Niebauer

[1] PLOP/DROP Committee
[2] Purchase of Service Credit Committee
[3] Technical Corrections Committee
[4] Training Opportunities Committee
[5] Vendor & Service Provider
[6] Adjustment Mechanism
[7] Chairman
[8] Secretary

CALL TO ORDER

The meeting was called to order at 8:40 AM.

APPROVAL OF MEETING MINUTES

There was a motion by Ms. Triggs to:

Approve the minutes of October 8, 2012.

Ms. Mammarella seconded the motion. The motion passed (6 – 0).

Mr. Evans arrived at 8:47 AM.

FINANCIAL REVIEW

Mr. Bryant provided the financial review. The current recession, which was caused by debt, has caused the economic recovery to be slow. The current trend is the economy is recovering in most sectors including jobs and housing, but it will continue to be slow.

The “Risk On/Risk Off” nature of the market still exists. The 3rd Quarter was a Risk-on environment due to stimulus from the Federal Government and the shoring up on ECB. Our portfolio performed ok in this environment but most managers lagged the benchmark. The market is affected by news from Europe and is continuing the trend from the past year of responding to all news about foreign and domestic economies and sovereign debt.

NewSouth, who we previously had concern about, had a great quarter, beat the benchmark, and is now in the 1st percentile and one of our top managers.

Some time was spent reviewing historical numbers for our managers. It was noted that the Plan was invested in Herndon and Polen for 3rd Quarter 2011 which was a down quarter. This explains why the since inception numbers for these two managers look deceptively worse than other mangers in the Plan’s portfolio. Mr. Tierney requested to see the historical returns for managers which were not provided in the quarterly investment report but are available.

Mr. Bryant noted that Champlain is a defensive manager that tends to outperform the benchmark in a down market and underperform the benchmark in an up market. Champlain tends to purchase high quality stocks which do not perform as well in bull markets.

Staff mentioned handout 2(a) and specifically highlighted that the both bond prices and equity prices increased this quarter. While this positive correlation has historically occurred recently the opposite has been true. In the past 4 years when equities were in trouble the government has interceded and increased bond prices.

Mr. Tierney asked if the type of debt has effect on the market recovery. Mr. Bryant noted that when debt is being repaid the economy slows because consumers are paying off debt rather than spending money. Staff noted that what debt is being used for is important. If debt is used for college education or for a company to improve its manufacturing capability it increases productivity and is helpful as opposed to acquiring new debt for a fancier car.

Mr. Bryant noted that the current DC platform performed well for the most part. He had no recommendation for a change based on the 3rd quarter returns and the upcoming review of the platform.

ACTIVE VERSUS PASSIVE MANAGEMENT

Staff handed out two articles, one of which highlights the advantage of active management while the other focused on the highlights of passive management. The Board was asked to read the two documents and come prepared to have a discussion about active versus passive management at a future board meeting.

Mr. Bryant noted that indexing and passive management forces attention on asset allocation. He recommended staying the course for now but would be open to considering passive management in the future.

Mr. Tierney noted that all of his research indicated that it hard to beat the market with active management.

Mr. Tierney referenced a study by the state of Maryland and its fees paid to the providers of actively managed funds. Mr. Gates found that article on line and forwarded a link. Staff will review that article and will be prepared to discuss that article with Board members.

The Board decided to have a more in-depth discussion about this topic at the 2013 Board Retreat. They also agreed to have the topic on the agenda for the February meeting to have a follow up discussion. Mr. Bland noted that he has done quite a bit of research on the topic and would have a 1-page handout to accompany the discussions in February.

ILLIQUIDITY

Staff referenced several handouts all with the theme of liquidity:

- 4(a) (iv) 1
- 4(a) (iv) 2
- 4(d) (iii)

Handout 4(a) (iv) 1 indicates Hamilton Lane Secondary fund has a remaining commitment of $800,000. Staff noted this calendar year's cash calls have been largely offset by distributions. Thus, to fulfill the commitment will likely require a lot less than $800,000 in cash. As the fund matures, this trend will continue. Handout 4(a) (iv) 2 provides analogous information for the Hamilton Lane primary funds. These funds are of a later vintage year than the secondary fund and primary funds call for their commitments slower than secondary funds. Therefore the primary fund will be at liquidity risk for a longer period of time. The Hamilton Lane domestic primary fund has a $1.8 million remaining commitment and the international a $900,000 remaining commitment.

Handout 4(d) (iii) – shows three scenarios illustrating a range of cash flows for the plan's liquidity needs. In the worst case scenario, each outstanding commitment was called immediately the plan would need to come up with $3.7 million. Distribution from timber and real estate would offset that total commitment. Other scenarios would place less demands on the plan's cash flows. The plan's expected cash flow from illiquid investments will be near $0 in 2013. All this is assuming no additional investments in farmland, etc.

Mr. Tierney asked what is the appropriate level of investment in illiquid assets, and what would happen in the case of a repeat of 2008 stock market? Staff referred to the cash flow report [4(a) (iii)] which shows the monthly receipts and disbursements. It was noted that the system is rather immature and that most of the current uniformed retirees went out under the old DC plan. Thus the Plan has a much higher portion of actives to retirees and less of an illiquidity issue due to disbursement than there will be 15 to 20 years from now. Staff noted that laddering can help with illiquidity concerns. Mr. Bryant noted that 15% of the portfolio is currently invested in illiquid and semi-illiquid assets (only 12.5% is currently committed). He also noted that the plans that historically have had issues have had over 50% committed to illiquid assets. He recommended the plan stay below 25% but would closely monitor the fund above 20%.

Staff presented the chart on IPO markets. The exit strategy from private equity market to IPO is driven by the strength of the IPO market. A weak IPO market would lead to liquidity concerns.

ADMINISTRATOR'S REPORT

REGULAR INVESTMENT REPORTS

Investment and Rebalancing Report
The pension portion was distributed with the advance packet. The disability portion of the report was handed out at the meeting to capture the rebalancing and distribution from the co-mingled fund on November 1st. Following the rebalancing we were able to take money out of midcap which is now more in line with the expected value. Despite the rebalancing fixed income still appears to be low because the monthly distributions on the 1st were taken from fixed income. The value of fixed income will continue to rise over the next couple of months as bi-weekly contributions come in and are paid directly to fixed income. There may be a small reallocation from small cap to fixed income in the future.

The Cash Flow report was covered under the Illiquidity report.

The Private Equity report was covered under the Illiquidity report.

Volatility is relatively low and lower than it has been for the past 5 years. Significant market declines rarely occur with volatility at current levels.

Real estate is above its target allocation. The PRISA fund is weighted to trophy properties (greater than the index) which have been the hottest part of the market in the past year or two. Staff suggested the Plan change its automatic reinvestment option with PRISA fund and take the distribution in cash to be invested in fixed income as this is a way to handle the needed rebalancing. Staff noted that this distribution be a gradual change and could take over a year to complete.

Mr. Tierney made a motion to:

Change the reinvestment option in the PRISA fund from reinvestment to taking cash.

Mr. Evans seconded the motion.

The motion passed (7-0).

COMMUNICATIONS/SEMINARS/CONFERENCES and TRAINING

Staff has a collection of books that are available to Board members interested in additional training materials. PIMCO puts together quarterly reports which are comprehensive and available through staff if interested.

Staff has compiled a notebook of training opportunities including CAPPP series, e-learning classes, IFEBP, etc. Staff handed out a schedule of IFEBP classes and recommendations.

Staff announced that retirement seminars will be held on December 4th and the announcement with details will be going out to employees in the next few days and posted on the website.

FARMLAND INVESTMENTS

MACQUARIE

At 10:18 AM the Representatives from Macquarie arrived and introduced themselves:

- Bradley Wheaton, Agriculture Product Specialist
- Tim Hornibrook, Executive Director
- Jock Whittle

This is Macquarie's second agriculture fund. The first was for raising sheep and cattle. The fund's first closing was January 2011. They have purchased two properties and had one harvest on a property.

They target return of 11%-15%. The first distribution would be after three years. They employ 200 people, 80% are farmers or managing farmland assets.

Page 5: Mr. Hornibrook provided an overview of the fund focusing on Brazil and Australia.

Page 7: Mr. Hornibrook identified four areas for profit. Staff asked the contribution of each to returns. Mr. Hornibrook said the largest was operations.

Page 10: Mr. Hornibrook explained the thesis of focusing on grains and oilseeds. Agriculture is used for food for people as well as livestock. The latter is driving most growth as diets in emerging markets are now demanding more meat.

Page 11: Mr. Wheaton discussed the price of land as well as the price of land per unit of production. When production costs, along with transportation costs and political risks are considered, Brazil and Australia are most attractive.

Crop subsidies are priced into land prices. Farm subsidies in the United States are the highest in the world. Staff said that the present value of crop subsidies at the current rate is between one fourth and one third the value of the farmland. Farmland prices are dependent on the continuation of farmland subsidies.

Page 14: This page discussed the merits of farming in Brazil and Australia.

Page 15: Mr. Hornibrook discussed how the portfolio would be constructed by acquiring land in different climatic zones to diversify and reduce risk (political, weather, end market, etc.).

Page 17: Land would be improved by purchasing grain storage. Staff asked about the expense of grain storage and if it made sense to purchase improvements for leased land. Mr. Hornibrook said it would be purchased at a price with a three-year payback.

Page 18-19: Maps of Australia and Brazil showed climate and state boundaries. They would be clear of the Amazon. Their proposed properties would span a large area. The average property would be 7,500 acres. Farms would be aggregated regionally for administration.

Brazil may have two crops annually. This adds to productivity and diversifies.

The fund may hedge production

They have environmental audits.

Mr. Bryant asked about getting from farm to market. It might be by truck or rail. Brazilians have an advantage going to market in China as their ships do not have to pass through the Panama Canal. Many questions on transportation costs followed.

Mr. Wheaton targets an $800 million fund. They have raised $300 million so far. They have purchased 50,000 acres, half each in Brazil and Australia. Mr. Tierney sought clarification that there is ownership in Australia and all operational gains go to the partnership. In Brazil there is a crop sharing arrangement. There is no crop insurance in Australia. Mr. Tierney sought clarification that the activities in Brazil might range from 50% - 80% of the partnership and in Australia 20% to 50%. That is correct.

Mr. Tierney asked why Macquarie is limiting its interest to $20 million. Mr. Wheaton said the corporate structure is that of a bank which has reserve requirements that restrict this asset class.

The presenters from Macquarie left at 11:00 AM. The meeting recessed.

Ms. Mammarella left at 11:00 AM.

At 11:05 AM the meeting resumed. Presenters from Ceres Farms LLC arrived. The presenters introduced themselves:

- Brandon Zick, Senior portfolio manager
- Barbara Keady, Director of New Business Development

Ceres Farms LLC is an open ended partnership with direct ownership. It has $90 million in equity and $130 million in assets, leverage of about 45%.

They buy land and lease it to approximately 27 teams. Rate of return from inception has been 16.1%. Net asset value is $5,385 per acre. The last 20 properties they purchased average about

$4,000 per acre. They believe there is a very inefficient market and their strength lies in exploiting inefficiencies.

They own 106 farms and rent them for an average of $350/acre/year. They consider themselves in the real estate business, not the farming.

Page 3: Net returns are displayed.

Page 5: They distinguished themselves from international farmland managers. Water is one issue. In their area water is essentially free. About 40% of their land is irrigated.   They typically lease irrigated land for $450 - $500/acre and non-irrigated for $250.

Page 6: Crop subsidy is important. They do not require crop insurance. However, nearly 100% of farmers carry crop insurance because their banks almost universally require it.

Page 7: They appraise all land annually, staggered over the year. Their expectation is 6-7% for the rent, 6 ½% for land appreciation, and several more percent for purchasing properties below market values and having them marked to market.

Page 8: They seek tenants they treat as partners, trying to establish relationships with them and renting multiple properties to most tenants. Often the tenants will improve properties, such as cutting trees or clearing out ditches.

They may improve properties by adding grain storage.

Page 10: Ceres identifies tenants prior to acquiring land

Page 12: The returns displayed are net of fees.

Mr. Tierney asked how much can the Ceres Farm business model handle?   Mr. Zick said once assets reach about $400 - $500 million things will slow down.

Page 13: Ceres sees an advantage of their business model is an open ended one which helps maintain a long term focus.

The Ceres partnership may reinvest or take cash. There were discussions of a liquidity event, a significant number of redemptions occurring simultaneously. Trustees expressed some concern about this event.

Their current vacancy rate is zero. They take payment in full for the year in advance of the planting season, so there is no credit risk.

Leverage is over 40%. They may pool several farms and then lever them 50%. Fees are based on equity, not assets.

Ms. Keady and Mr. Zick left at noon.

CHAMPLAIN
The presenters from Champlain introduced themselves:

- Mary Michel, MBA, Client Service Partner
- Scott Brynam, CFA, Managing Partner

Page 4: Ms. Michele provided an organizational update on Champlain Investment Partners. Senior staff is unchanged. New analysts have been hired. They had vendor conduct a mock SEC compliance examination.

Page 5: Assets under management are now $4.6 billion, $3 billion small cap, and $1.6 billion mid cap. Mr. Brynam noted that some midcap companies show the growth potential of small cap but the survivorship of more mature larger companies.

Champlain tends to move opposite the crowd. They tend to sell when things are popular. Staff asked what metrics are used to determine value (undervalued to buy or overvalued to sell). Mr. Brynam said they look at metrics to compare to others in the industry, and discounted cash flows. However, the choice of assumptions is essential. They use cautious assumptions. When there are buyouts of securities they hold they tend to be at prices that validate their assumption sets.

Page 16: Mr. Brynam skipped forward to page 16. This page illustrates the relative performance of stocks with a high Return on Investment Capital (ROIC). Champlain tends to gravitate towards companies with high ROIC. Staff asked if this was indicative of froth in the market. Mr. Brynam said yes.

Page 17: This graph indicates the outperformance of Microcap vs. the Russell 2000. While this is not directly applicable to mid-cap, it does reflect extremes of enthusiasm and fear. Champlain has regularly outperformed in down markets and underperformed in up markets.

Returns year to date are 9.20% vs. the benchmark's 12.70%.

Page 11: Champlain does not own high beta stocks.

Page 13: Mr. Brynam discussed Superior Energy Services & Key Energy Services. He has a positive view on energy and energy services. He has added to other energy service providers. Demand will continue to grow in China and India. Supplies from places like Saudi Arabia are slowly winding down.

He has directed money out of the outperformers and towards the underperformers. He sold Illumina and then later rebought it after it went down.

Page 13: He believes baby boomers are moving out of their key spending years and are now saving more. He is deemphasizing consumer oriented companies.

He believes many property casualty companies and brokers are undervalued. Their investment portfolios are short duration. He believes rising interest rates will help them. Staff asked about sovereign debt. Mr. Brynam said most property casualty companies had very little sovereign debt.

Page 14: Software companies had been quite good, they have large operating margins. He particularly likes firms working on “the cloud.” He believes there are healthcare firms that will enhance productivity.

Mr. Brynam believes there is an industrial renaissance. Wage differentials with other countries are closing. He would overweight those making industrial machinery and underweight the industrials.

He sees food inflation in the long term.

Staff referred to page 12 of Champlain’s book and page 5 of the Champlain section of Dahab’s book. Staff said the Champlain presentation was largely focused on where they are today. The Dahab book emphasized what they had done in the past. Staff argued they were completely consistent. Statistics such as the portfolio companies’ leverage and beta would lead to underperformance in up markets and outperformance in down markets. Indeed, Dahab’s book showed that had happened in five out of five quarters so far.

Mr. Brynam and Ms. Michele left the meeting. Ms. Mammarella returned at 1:00 PM.

Mr. Gates left at 1:02 PM.

FARMLAND DISCUSSIONS

Contract with Hancock Farmland was signed following February. Because of the number of deferrals on their closing date they have defaulted on their obligation which allows the Board the opportunity to get out of the current contract. We would need to send Hancock a letter to get out of the contractual obligation.

Hancock investment offers a lot of diversity. They would start with row crops. If the fund is large enough ($75 -- $125 million) they would incorporate permanent crops as well as start with domestic and extend to international.

Macquarie concerns/highlights/parameters

- International only
- Differential in transportation costs (U.S. vs. Brazil) not clearly communicated
- Political risks
- Some issue with property ownership
- Minimum of $10 million (probably flexible)
- Functions as both real estate owner and as a commodity producer

Ceres concerns/highlights/parameters

- Lacks crop diversity
- Lacks geographic diversity
- Higher level of leverage than other farmland managers
- Young, small company. Potential back office and key person issue

- Focus on buying undervalued properties – will this market continue to exist
- Presentation and numbers based on best case scenario – would want to investigate other scenarios including what happens when investors want to cash out
- Recent run up in domestic farmland prices
- Functions like real estate not a commodity producer
- Minimum of $1 million

Does adding this investment add diversity to the portfolio since they are more “real estate” market focused rather than commodity focused? Mr. Bryant noted that diversity has 2-sides asset classes (stocks, bonds, etc.) and operations (domestic, international, etc.)

Mr. Bryant focused on headline risk saying losing 35% in equities is better than losing 35% in farmland, even if equities have twenty times the weighting in the portfolio than farmland would have.

Domestic farmland carries crop insurance. In 2012 when crops were poor, farmers still received a payment from insurance so they did not incur losses. Mr. Bryant noted that he expects farm subsidies to continue.

Mr. Routt said he was not comfortable with either of the vendors. Mr. Cross said he would not want to give either vendor all of the farmland allocation.

Farmland companies seem to be having difficulty raising funds. This includes Hancock and Macquarie.

The current contract with Hancock commits the Plan to invest 3% of the Fund. Hancock has extended the closing date many times. They have contacted staff to inquire if the Plan would be ok with extending the closing date to June and extending the contract length to 10 years. It was noted that this was an inquiry rather than an official change but is probably indicative of the direction they will go.

There was a motion by Ms. Triggs to:

Remain with Hancock while waiting for them to close but to also continue exploring other farmland options.

Ms. Mammarella seconded the motion.

Ms. Mammarella left at 2:02 PM.

The motion passed (4 – 1).

Those in favor:

Mr. Cross
Mr. Routt
Ms. Triggs
Mr. Evans

Those opposed:
Mr. Tierney

If Hancock closes then the Board would have to adjust the investment policy statement asset allocation to indicate what fund the money would come from. It was requested that this be included on the January meeting agenda.

Ms. Mammarella returned at 2:07pm.

COMMITTEE REPORTS

Adjustment Mechanism Committee:
The committee reported that both Police and Firefighters have met with their department heads. The police officers have also met with labor leaders. Some additional questions were raised by labor leaders and staff is creating charts and handouts to address those questions. There is a need for coordination between police and fire labor leaders.

The next committee meeting is scheduled for Monday, November 12^{th} at 10:00am.

Mr. Evans left at 2:17pm

PLOP/DROP Committee:
This committee did not report.

Purchase of Service Credit:
This committee did not report.

Technical Corrections Committee:
This committee did not report.

Training Opportunities Committee:
This committee did not report.

OLD BUSINESS

UPDATE: Removal of section 5.6 from the Plan Document

The Board requested that the proposed amendment change be sent to the City Attorney. Mr. Spera reviewed the proposed change and recommended we have our outside council review the proposed change. Mr. Ken Hoffman reviewed the proposed change and concluded that it should be ok to remove the section of the document without any impact to the Plan. However, Mr. Hoffman recommended the Board wait to remove this section and update this section in conjunction with any other proposed disability changes.

Mr. Tierney inquired what the process actually entails to get the section removed from the document. Staff noted that the first step would be for the Technical Corrections Committee to review the change. That committee would then work with Mr. Hoffman to draft a proposed amendment to plan document. The amendment would then go the process of approval through the City's Pension Committee and ultimately be approved by City Council.

There was a motion by Mr. Tierney to:

Send the proposed change to the Technical Corrections Committee

Mr. Tierney withdrew his motion.

There was a motion by Mr. Tierney to:

Accelerate the process of removing Article 5.6 from the plan document.

Ms. Triggs seconded the motion.

Discussion:

Staff requested Mr. Tierney define "Accelerate."

Mr. Cross said the workload of committee members was high at present.

Staff proposed an understanding that the Technical Corrections Committee meet two to three weeks following the completion of the Adjustment Mechanism. Mr. Cross and Mr. Tierney agreed that was acceptable.

The motion passed (5-0).

Ms. Triggs left at 2:39 PM. The meeting continued without a quorum. Reports were received, but no votes were taken.

ADDITIONAL DISCUSSIONS

SUPPLEMENTAL RETIREMENT BOARD

The formation of the Supplemental Retirement Board is on the docket for December 7th. Once they are officially formed as a Board Staff is hoping to host combined meeting. The logistics of the joint meetings will need to be finalized.

Mr. Tierney expressed concern that the new Board will take time to get up to speed. Staff addressed this concern by sharing that the new board members have undergone an exhaustive training process which has spanned over 4 months.

CHEIRON ACTUARIAL VALUATION

Staff noted that we received printed copies of the actuarial valuation report. A formal presentation of the results was done earlier in the year. Chairman Cross asked for the actuary's annual certification of non-service connected disability contribution being in compliance with IRS standards for tax free benefits. Staff will follow up.

NEXT MEETINGS

There is a meeting planned for December 13th. Unless there is business that needs to be discussed regarding the Adjustment Mechanism this meeting will be cancelled. A final decision will be made in early December.

There will be an interim meeting January 10, 2013 at 8:30 AM.

ADJOURNMENT

The meeting adjourned at 3:28 PM.

Handouts distributed in advance

The materials included in this mailing are:

- Agenda
- Minutes of October 11, 2012 [1]
- Investment Performance Review [2(c)]
- Investment & Rebalancing Report [4(a)(i)]
- Cash Flow Report [4(a)(iii)]
- Private Equity Cash Flow Report – Hamilton Lane Secondary [4(a)(iv) (1)]
- Private Equity Cash Flow Report – Hamilton Lane Primary [4(a)(iv) (2)]
- Volatility Report [4(a)(vi)]
- Administrator's Follow-Up Items Report [4(d)]
- Illiquidity Report [4(d)(iii)]
- Farmland Overview [6(a)]
- Investment Policy – Asset allocation [6(f)]
- Prudential Investment Third Quarter 2012
- Cheiron Actuarial Valuation Report July 1, 2011

Handouts distributed during the meeting

1. Agenda (Revised)

2. Investment Performance Review (Revised) – 2(a)
3. Monthly Investment & Rebalancing Report – Disability Component – 4(a)(i)(2)
4. Private Equity Cash Flow Report – Hamilton Lane Primary (Revised) - 4(a)(iv) (2)
5. Illiquidity Cash Flows Report (Revised) – 4(d)(iii)
6. Selecting a Farmland Manager – 6(a)(1)
7. Active versus Passive Management Reports
    a. Bogle – "The Relentless Rules of Humble Arithmetic"
    b. Jones & Wermers – "Active Management in Mostly Efficient Markets"
8. Farmland Manager Search – Organizational Information (provided by Dahab)
9. Macquarie Group – Farmland Presentation
10. Ceres Partners – Farmland Presentation
11. Champlain Investment Partners – 3rd Quarter 2012 Report
12. Dahab Performance Review September 30, 2012
13. IFEBP training schedule