MINUTES OF NOVEMBER 10, 2011 RETIREMENT BOARD
CITY OF ALEXANDRIA FIREFIGHTERS AND POLICE OFFICERS PENSION PLAN
DUE DILLIGENCE MEETING

PRESENT

Members	Others
Michele Evans [1, 2]	Steven Bland, Retirement Administrator
Patrick Evans [1, 2]	Barry Bryant, Dahab Associates
Tom Gates	Bruce Johnson, Acting City Manager
Shirl Mammarella [3,4]	Stephen Kenney, Hancock
Ed, Milner [1, 2]	Arthur Lynch, Retirement Specialist
Cheryl Orr [1, 3, 5]	Dean Molinaro, Prudential
Morgan Routt [4]	Theresa Nugent, Communications Specialist
Laura Triggs [3, 4 ,5]	Wayne Wallace, UBS/Agrivest
Michael Wimer	Oliver S. Williams, CFA, Hancock

Absent:
Michael Cross [3, 5]
Al Tierney [5]

[1] PLOP/DROP Committee
[2] Purchase of Service Credit Committee
[3] Technical Corrections Committee
[4] Training Opportunities Committee
[5] Vendor & Service Provider

CALL TO ORDER

The meeting was called to order at 8:37 AM.

APPROVAL OF OCTOBER 13 MINUTES

There was a motion by Ms. Mammarella to:

> Approve the October 13, 2011, Board meeting minutes.

Mr. Routt seconded the motion. The motion was unanimously approved (7-0).

Ms. Orr arrived at 8:39 AM and served as Chair in the absence of Mr. Cross.

FINANCIAL REVIEW

Mr. Bryant discussed inflation and the economy.

Investment markets have been driven by events in Europe.

Mr. Bryant discussed the often used terms “Risk on” and Risk off.” The former being an asset that responds to the stock market and the later not being responsive. The terms are relative to other assets, such as a single A rated bond is a risk on asset compared to treasury bonds and a risk off asset compared to junk bonds. Risk on has done well since 2008.

Mr. Bryant distributed and discussed a one page two sided correction to the quarterly performance report. The two parts were the manager Performance Summary and the Executive Summary. Staff mentioned the NewSouth universe should be small cap core. They beat their benchmark by 5% in the quarter.

Mr. Johnson arrived at 8:42 AM.

Mr. Bryant said active managers should provide downside protection. Ms. Mammarella made a reference to the volatility report. Mr. Bryant views volatility as a report card on confidence in the fiscal order.

Mr. Milner arrived at 8:55 AM.

Mr. Johnson spoke about fixed income, alternatives to PIMCO’s total return fund, and their relative performance.

Mr. Bryant had said that in the past they had often made the right move a little too early. PIMCO is an aggressive investment manager. Staff said this usually leads to a brief period of underperformance followed by a longer period of outperformance. PIMCO is aggressive relative to other fixed income managers, but that the volatility in their performance is dwarfed by the volatility of other manager styles.

Ms. Evans arrived at 9:04 AM.

The fund had six percent in cash.

Mr. Evans arrived at 9:25 AM.

Mr. Bryant replied to a question by Ms. Orr that the managers without performance reports were of two types. First, professional standards call for a manager to be in place for the entire quarter and some managers began after June 30. Second, the limited partnerships (timber and private equity), had significant time lags in reporting results.

The Board discussed page three of the defined benefit tab of the Dahab report. Mr. Bryant recommended the report be collapsed into: 1) equities, 2) fixed income, and 3) real assets. The consensus was to try this approach.

Mr. Johnson and Ms. Evans left at 9:33AM.

Mr. Molinaro and staff discussed the guaranteed deposit account (GDA) and the right to withdraw up to 16% annually without a market value adjustment. Recently the market value adjustment was very small. Staff recommended transferring the maximum allowable 16% plus additional amounts. The adjustment is determined at year end, not at the current time. Also, there would be additional cash flows (contribution in and benefit payments out) by year end. This meeting was the last scheduled board meeting of the year and intervening events might impact the merits of a potential transfer. There is a standing motion that directs staff to transfer out up to but not exceeding 16% per year. Staff suggests a flexible motion that allows - but does not require - withdrawing additional funds. Staff also recommends that before proceeding there would be consultation with Mr. Bryant and notification to Ms. Triggs, and Mr. Cross.

There was a motion by Ms. Mammarella to:

> Allow staff the flexibility to transfer any amount of the Prudential GDA to the PIMCO account. Such a transfer would be in consultation with Mr. Bryant and Mr. Cross and Ms. Triggs would be notified in advance.

Ms. Triggs seconded the motion. The motion was unanimously approved (7-0).

Mr. Molinaro and Mr. Bryant discussed the defined contribution component. Davis and LSV are on the watch list. Each has one participant and a low balance. There are three large cap value offerings. Recently value has underperformed and deep value has underperformed more so. Davis is classified as blend (or core) in name, but has a strong value bias and exposure to financial stocks.

Mr. Molinaro said 49% of the plan's balance was in the GDA.

Mr. Bryant asked Mr. Molinaro what he thought of PIMCO. He responded by saying PIMCO has a very long history of outperformance so it very hard to drop it after a short period of underperformance. It is often paired with a stable value fund. Ms. Orr asked how often the watch list was prepared and how long a fund would be on the watch list before removal. Mr. Molinaro said things did not stay on the watch list indefinitely.

NEW BUSINESS

Mr. Spera distributed a handout, *Board Education Presentation*. Staff provided a context for the presentation by saying there were two distinct occasions where confidentiality was a particular issue. One is vendor materials such as in reviewing RFPs or manager presentations. The other is personnel issues. Mr. Cross had requested that Mr. Spera specifically review confidentiality along with other general fiduciary issues. Mr. Spera went through his handout which covered liability, bad faith, misconduct, negligence, and scope of duties. A portion of the Plan document was referenced.

Mr. Spera said most confidentially issues would be solved in two ways. The first is use of executive session which binds trustees and staff to confidentiality. The second way is to have a the limited number of people involved in an RFP sign a confidentiality agreement prior to reviewing documents in the RFP process. Mr. Spera offered to prepare such a confidentiality agreement for the board.

The Virginia Procurement Act permits rerouting the procurement process from the Procurement Division to Dahab Associates, but it need not be replicated precisely at Dahab Associates.

Mr. Bryant introduced the topic of Farmland. It is a niche. As the world's standard of living improves meat based diets will require more grain. The farmland index is composed of four firms. It is asset weighted with Hancock representing 50% of the index and UBS Agrivest 25%.

Hancock has a private placement structure and a closed term. Mr. Kenney and Mr. Williams were introduced. The current exposure is 85% domestic and 15% international. Staff asked if that weighting would change in the next partnership. They expect it may be closer to 80% domestic and 20% international. Non- U.S. would include Australia & Quebec.

Referring to their booklet:

Page 2 displays photos of farm products. Hancock's scale is evident in that it is a top producer of the products pictured on the bottom of the page.

Page 4 addresses macro trends increasing farm demand.

Page 5 shows the correlation between wealth and meat consumption. It takes two pounds of grain to create one pound of chicken, three to four pounds of grain to create one pound of pork, nine to twelve pounds of grain to create one pound of beef.

Page 6 lists reasons to consider farmland: income, low correlations, inflation protection, and risk adjusted returns.

Page 8 displayed correlations of farmland to other assets classes over a forty year span. The vast majority of the fund's assets have had a negative correlation to farmland over this period.

Page 9 compares risk/reward characteristics of various asset classes.

Page 10 distinguishes row crops from permanent crops. In row crops the vast majority of the investment is in the land and to a lesser degree irrigation equipment. In permanent crops two thirds or more of the acquisition price and value may be in the trees or vines.

Page 11 shows the expected gross return is 8 – 11%. Expected net return is 7 – 10%.

Page 12 shows geographical diversification.

Page 13 suggests an application of modern portfolio theory to farmland. Diversifying as to geography and crop can lead to less risk and more return.

Page 14 mentions some risks to farmland.

Page 17 lists financial information for American farmers as a whole.

Page 20-1 display annualized returns for income and total return

Since inception the NCREIF index has returned 6% income and 4% appreciation. Their expectation going forward is total return will fall in the range of 8 – 10%/year. The corporate parent of Hancock (ManuLife) will coinvest 10%. Staff said that this should align interests.

Mr. Bryant asked why more aren't buying into farmland. Mr. Oliver said one reason is volatility. Another reason is that it is an immature asset class. Institutions own less than ½% of farmland.

The minimum investment is $5 million. The average transaction (farmland purchase price) is $4 million.

Mr. Kenney and Mr. left the meeting. Wayne Wallace of UBS Agrivest was introduced.

Mr. Wallace defined row, vegetable, and permanent crops. UBS operates in Canada, U.S. and New Zeeland because there is little volatility, good infrastructure for farmland, capital, and weather. There are also land rights and the rule of law.

UBS prefers a cash lease as opposed to being paid in crops. They do not take farming risks on row crops and vegetable crops. These lands are leased. They do take a share in production of permanent drops.

They do not want to be subject to consumer tastes which might be fickle. They seek to avoid environmental risks and are mindful of liquidity needs.

It is hard to buy family owned land. Some states place limitations on corporate ownership of farmland.

Referring to their booklet:

Page 3 shows regional offices.

Page 4 displays geographic diversification.

Page 5 shows rates of return.

The graphic on page 7 shows the value of investible farmland in America as well as displaying where ownership is regulated by state law.

Page 10 shows the allocation. Since buying and selling is infrequent and limited in scope, the actual allocation will not exactly match the target allocation.

Page 13 mentions farmland risks: economic conditions, business risks, environmental risks, and illiquidity.

Page 14 shows geographic distribution of crops.

Page 15 has a graphic that shows the transportation network for distributing farm products. Mr. Wallace believes the country's farmers benefit from excellent infrastructure.

Page 17 displays significant trading partners.

Page 18 addresses demand for corn for manufacturing ethanol. Staff questions the sensitivity of demand to subsidies. There were two subsidies. One is on the crop side, and that program continues. The other subsidy was for developing the manufacturing plants. Those subsidies have come to an end.

Page 19 illustrates farm productivity has increased.

The expectation for future returns is 5% real.

Page 25 displays correlations between asset classes.

Page 26 supports the thesis that including farmland increases a portfolio's Sharpe ratio.

Page 28 compares farmland to other real estate investments.

Since inception in 2006 UBS has raised $231 million and has a cue of $169 million. This has been variously estimated as taking one to three years to work through the cue. The fund has no leverage but is allowed to borrow up to 25%. Typically there will be a bridge loan in financing a deal. Following the closing of the deal the fund would draw on the investor(s) next in cue and pay back the bridge loan.

Mr. Kenney and Mr. Williams returned.

Staff distributed a list of questions to Board members and to the investment managers. The investment managers discussed the wide range in prices farmland acreage from annual crops to vegetable crops, to permanent crops.

Both investment managers were inclined to minimize farming risk and focus their transaction on renting the properties for cash rather than a percentage of the harvest.

Staff asked about the long period of outperformance in the 1970s followed by the long period of underperformance in the early 1980s. Mr. Wallace discussed the debt burdens carried by farmers. He believes that farmers' balance sheets should make the future more stable than past periods.

Mr. Williams said farmland would be affected by interest rates as almost all asset classes are.

Staff distributed an article that mentioned pecan prices escalating. The point was to highlight the lack of correlation between events that drive crop results (frosts, floods, droughts, etc.) and those events that drive equity and fixed income markets.

There was a motion by Mr. Milner to:

Request Dahab Associates to issue an RFP for Farmland.

Mr. Routt seconded the motion.

DISCUSSION: There was a question about which current allocation(s) might be reduced to fund a potential farmland investment. Mr. Bryant suggested that if farmland is selected for the purpose of increasing returns it would replace fixed income. However, if farmland was selected for the purpose of diversification it would replace some fixed income. There was no resolution.

A question was asked how common farmland is in plans similar to the Fire & Police plan. Farmland is closely held, mostly owned by families. About ½% is owned by institutions such as pension plans. This makes it less common, but it is not unheard of.

It was very clearly articulated and repeated, the motion was limited to asking Mr. Bryant to issue an RFP. There is no obligation to contract with any vendor, the plan's asset allocation did not have to change, and if there was a selection of a farmland vendor no decision was made on the source of funding for the commitment.

The motion passed unanimously (6-0).

Mr. Milner discussed the Ad Hoc Retirement Benefit Advisory Group and meetings with council. Ms. Triggs mentioned some follow up and possible next steps.

Mr. Bryant provided an update on the RFI for defined contribution plans.

<u>ADMINISTRATOR'S REPORT</u>

Staff reported the cash flow report was in a state of flux as the fund transition from the bundled provider Prudential to the separate accounts of Comerica. Going forward the report should be produced on a timely basis. Part 1 does not show all assets, only those at Prudential. Part 2 focuses on liquidity, cash flow before and after meeting cash calls and receiving distributions from the plan's limited partnerships. A related report is the Account Structure & Liquidity Report. These tables show which accounts have daily or monthly liquidity and which accounts are illiquid. The table on the bottom of the page has crude approximations of fund's cash flows for investing in partnerships for the next few years.

The volatility report shows volatility remains above average, but below the peaks of several years ago. Volatility peaks as the market free falls and begins to recover.

Notes from the Association of Municipal Retirement Systems of Virginia were distributed via email prior to the meeting.

The meeting calendar was confirmed for 2012. The international managers Brandes and Johnston are available to attend the February meeting. We would expect the large cap domestic managers Polen and Herndon in May.

Staff mentioned a memo from Bruce Johnson to City Council November 4, 2011about VRS. While it did not directly pertain to the Fire & Police Board trustees might be interested in anything pension related that goes to City Council.

COMMITTEE REPORTS

BYLAWS

Previously, Chairman Cross related a conversation he had with Mr. Spera. Mr. Spera suggested the plan have bylaws. Mr. Cross then asked staff to develop draft bylaws. Staff reported the first pass through creating bylaws was complete. They were developed using samples from other City of Alexandria Boards and other public pension plan bylaws. Mr. Wimer will review the draft.

PLOP/DROP COMMITTEE

Staff reviewed the primary goals of asset accumulation in a way that is cost neutral to the plan and the secondary goals of being administrable, understandable, and having no adverse impact on longevity. In most counts the PLOP is equal to or better than the DROP. The committee is inclined to recommend a PLOP. However, that recommendation is pending research by staff and committee members.

PURCHASE OF SERVICE CREDIT COMMITTEE

The Purchase of Service Credit Committee expressed unanimous interest in: 1) having a set formula for purchases to eliminate going to the actuary each time a request for purchase is made, and 2) purchase for all types of service combined should be limited to no more than four years.

TECHNICAL CORRECTIONS COMMITTEE

The committee did not have a report.

TRAINNING OPPURTUNITIES COMMITTEE

Mr. Wimer and Mr. Milner attended training through the International Foundation of Employee Benefit plans and each provided a report.

VENDOR AND SERVICE PROVIDER COMMITTEE

The committee did not have a report.

NEW BUSINESS (continued)

Kevin Smith of Prudential Real Estate met with Mr. Cross and staff on November 1, 2011. Board members were given a one page summary as well as the 124 page presentation. The summary focused attention on 1) the plan's current investments (pages 12-14), improved risk control (page 16), a comparison of core and non-core investments (pages 19 -20) and the core, value added, and opportunistic spectrum (page 120) and international investment opportunities (page 124).

OLD BUSINESS

ADJOURNMENT

There was a motion by Mr. Routt to:

Adjourn.

Mr. Gates seconded the motion. The motion passed unanimously (5-0).

NEXT MEETING

The next meeting will be Thursday, January 12, 2012 in the Sister Cities Conference Room at 8:30 AM.

<u>Handouts distributed in advance</u>

1. Agenda
2. Minutes of October 13, 2011 meeting [1]
3. Investment performance Review, Third Quarter 2011, Notes & Questions [2 (b) & (c)]
4. Dahab Performance Review September 30, 2011
5. Investment Review, Prudential
6. Cash Flow Report, Assets held at Prudential [3 (a) (ii) (1)]
7. Account Structure & Liquidity [3 (a) (ii) (2)]

8. Private Equity Cash Flow Report – Hamilton Lane Primary – Series A [3(a)(iii)]
9. Volatility Report [3 (a) (v)]
10. PRISA, Prudential Real Estate [6 (c)]

Handouts distributed during the meeting

1. Volatility Report [3(a)(viii)]
2. Correction to Dahab Performance Review September 30, 2011, *Manager Performance Summary* and *Executive Summary*
3. Farmland Asset Class – Hancock Agriculture Investment Group
4. Global Real Estate – Farmland, UBS
5. *Board Education Presentation* - Mr. Spera
6. Pecan prices set to pop 22%, CNN Money
7. Farmland – Some Questions from staff
8. Virginia Retirement System Issue, Memo from Bruce Johnson to City Council November 4, 2011