MINUTES OF NOVEMBER 11, 2008, RETIREMENT BOARD
CITY OF ALEXANDRIA FIREFIGHTERS AND POLICE OFFICERS PENSION PLAN
DUE DILLIGENCE MEETING

PRESENT

Members	Others
Michael Cross, Chair	Chuck Arrington, Trusco Capital Management
Michele Evans	Chason Beggerow, Altius Associates
Pat Evans (Alternate)	Steven Bland, Retirement Administrator
Mark Jinks	Barry Bryant, Dahab Associates
Bruce Johnson	Pawan Chaturvedi, Altius Associates
Chris Lockwood	Tom Kerr, Hamilton Lane
Shirl Mammarella	Arthur Lynch, Retirement Specialist
Kathleen Schramm, (Alternate)	Dean Molinaro, Prudential
Laura Triggs	Theresa Nugent, Communications Specialist
	Lisa Powell, Prudential
	Jackie Rantanen, Hamilton Lane
	Michael Sahakian, Trusco Capital Management
	Napoleon Stevenson, Hamilton Lane

The meeting began at 8:40 AM.

EDUCATIONAL TOPICS

Mr. Bryant began with an introduction to Private Equity. This type of investment is attractive because of high returns and diversification. The drawbacks include illiquidity, the variation of returns by managers is substantial, and the phenomenon known as the “J Curve.” Mr. Bryant indicated that the big deals are gone, but that the secondary market will be big in 2009.

Ms. Mammarella arrived at 8:44 a.m.

CALL TO ORDER

The meeting was called to order at 8:44 a.m. on November 11, 2008.

Mr. Beggerow and Mr. Chaturvedi of Altius Associates continued the discussion on Private Equity.

Mr. Beggerow introduced his company and described their structure and facilities. He suggested that Private Equity should have a promising future in the next years since it was increasingly difficult for businesses to arrange financing.

Mr. Beggerow continued to discussed Private Equity investment while referring to their handout. Page 3 listed the different categories of Private Equity. The investor acquires controlling and non-controlling interests in established companies in a Leverage Buyout. Venture Capital largely focused on the fields of medical technology and Information Technology. The Growth Equity strategy can be thought of as a hybrid between Venture Capitol and Leveraged Buyouts.

Page 4 lists three ways to invest in Private Equity. They are 1) invest directly into companies, 2) invest in Private Equity Funds, and 3) invest in Private Equity Fund of Funds. Mr. Beggerow suggested that a company would need an in-house expert to invest directly into companies. Altius chooses to invest using the in Fund of Funds method.

Page 5 illustrates the Fund of Fund investment method. Staff asked what portion of the funds were commitments to Leveraged Buyouts (LBO) compared to Venture Capital, Growth Equity, etc. Mr. Beggerow said 80% were LBO and 10-20% were Venture Capital. Altius might invest in 15-20 funds. Each of these funds would in turn invest in five to twenty five companies. The domestic international split might be 60/40.

Ms. Evans arrives at 8:55 a.m.

Page 6 describes the Private Equity Investment Cycle. In the typical investment cycle: the investor makes commitment~~s~~ to Private Equity management firms, then the commitments are funded, later distributions are made to investors, and the Private Equity management firm begins exiting from the investment. Mr. Beggerow said most cycles are 7-8 years in length.

Page 7 of his handout displays a hypothetical schedule of annual funding requirements and cumulative funding. This is compared to the graph on page 8 which shows the net contributions less distributions.

While discussing page 8, Mr. Beggerow made a distinction between the commitment and investment phases. He noted that in some years investments and distributions are being made at the same time. In the final years, cash is typically only flowing back to investors.

Staff asked if the cash flow model was different for the secondary market. Mr. Beggerow said it is. Secondary market investment might involve coming in at year 2 or 3 instead of year 1. Mr. Jinks asked if the commitment is binding and Mr. Beggerow indicated it was. Mr. Jinks asked if might be a requirement for additional money from the investor. Mr. Beggerow indicated the investor only has to fund the commitment. Mr. Johnson asked if all the committed money could be required to be paid in year 1. Mr. Beggerow said that in tens years of investing in Private Equity he had not seen this happen. Mr. Lockwood asked about the graph stopping at 65% instead of 100%. Mr. Beggerow pointed out that committed money stays with the investor until called and that in the final years money is also being distributed. The net result is that the investor does not reach a point where 100% of the money is flowing to the investment. Staff compared the Private Equity Cash Flow Cycle to investing in the real estate market. Earmarked money (commitment) comes from PIMCO. Mr. Bryant added that the real estate money could also come from other funds.

Page 9 of his handout displays how a pension fund could make rolling commitments to funds in order to maintain a roughly even commitment to Private Equity. Staff suggested that Arlington's pension plans had employed a strategy similar to this.

Mr. Chaturvedi continued the discussion beginning with page 10 of the Altius handout. Drawbacks of Private Equity investment include higher fees, limited information, illiquidity, and the "J curve" effect. The "J curve" was illustrated on page 11; it shows that in the early years returns may be low or negative. Mr. Jinks asked how we would know the value of investments. Mr. Chaturvedi said there are quarterly reports; however, they are not timely and may not be available until after the quarterly reports for the rest of our funds have been distributed. Investments are appraised and managers audited annually. Mr. Jinks asked if these firms follow accounting standards. Mr. Chaturvedi indicated the firms use similar standards and that the standards they use are becoming more like accounting standards. Ms. Schramm asked if we would know which companies we have invested in. Mr. Chaturvedi indicated we would know what companies we had invested in but we would not have full disclosure on their business statistics. This is not made public as it might impact future sales. The "J curve" was illustrated on page 11.

Mr. Lockwood asked about returns from Private Equity investments. This led to a review of page 12. Staff asked why most investments were in Buyout funds when Venture Capital tended to have higher returns. Mr. Chaturvedi said this was because Buyouts funds are less volatile than Venture Capital funds.

Mr. Chaturvedi discussed page 13 focusing on vintage year, the year the investment was originated. There was dialogue around two conflicting ideas: 1) markets cannot be timed, and 2) Private Equity tends to do well in periods coinciding with or immediately following recessions.

Page 14 highlights the importance of selecting good managers. The difference between the median manager and the manager in the top quartile varies by asset class. For Venture Capital and Private Equity it is substantial. Mr. Jinks asked about reporting standards. Mr. Chaturvedi said the issues of the past were being addressed and new professional standards were being addressed by FAS 157.

The question of market timing and projecting results was addressed again on page 16 and 17. This concluded the presentation by Altius Associates. Chason Beggerow and Pawan Chaturvedi left at 9:42 AM.

Napoleon Stephenson introduced the representatives from Hamilton Lane, Tom Kerr who specializes in the secondary Private Equity markets and Jackie Rantanen whose focus is primary Private Equity.

Markets are difficult to time so investments are constructed in layers to resemble a ladder. Historically the best investments are made in recessions.

Private Equity was considered a global asset class. It may have had origins in the United States but it has spread worldwide.

Mr. Bryant commented there may be a perception of Private Equity having an anti-union bias. This is because one facet of Private Equity, Leveraged Buyouts, will frequently make significant reductions in workforce. However, Taft-Hartley (a.k.a. union) plans are significant participants in Private Equity.

Ms. Rantanen said funds of funds were diversified by vintage year, geography, and strategy. Her firm made options available to participate exclusively in domestic Private Equity, or exclusively international, or a 60/40 mix.

Mr. Kerr sees tremendous opportunity in the secondary Private Equity market. He thinks there are three camps to consider:

- Distressed investors wanting to exit the allocation because they need cash,
- Institutions that were rebalancing, and
- Portfolio managers seeking to re-deploy assets

Mr. Kerr indicated sometimes the general partner in a limited partnership arrangement retained the right to approve secondary sales. In these cases Hamilton Lane had an advantage in that they had existing relationships with Private Equity funds and the secondary funds were comfortable having Hamilton Lane as partners via the secondary market.

Mr. Kerr said their firm avoids the auction markets because they do not feel they have a good competitive advantage in that.

Mr. Kerr discussed page 23. This page showed secondary offerings were being purchased at a discount to net asset value. This lead to more profitable investments as well as reducing the “J curve” effect. Mr. Kerr said they were purchasing at an average discount of 16%.

The next limited partnership they offer targets 75% primary Private Equity, 15% secondary, and 10% Co-investments. Co-investment allows investor to invest directly into a company.

Mr. Lockwood asked about the turnover in Howard Lane. Mr. Kerr said there are 25 employee owners. The firm started with ten employees and now has 110 employees. The junior employees also share in the success of the company. In response to Mr. Lockwood he said that they may expand into Asia if they were to expand any more.

The meeting went into recess at 10:18 a.m. and the Hamilton Lane representatives left.

The meeting resumed at 10:27 a.m.

FINANCIAL REVIEW

FINANCIAL AND ECONOMIC OVERVIEW

Mr. Bryant said that the past ten years have been the worst ten years in stock market history. He began with a review of the factors leading to the current financial environment: debt, leverage, changes in underwriting standards, and management of Fannie Mae, Freddie Mac, and other financial institutions. While the financial institutions need to deleverage, economic growth is aided by debt creation.

Mr. Bryant said we were probably in a recession and that it will run until 2009. He pointed out the worst toxic relationship was that between Congress and Fannie Mae and Freddie Mac.

Kathleen Schramm returned at 10:35 a.m.

Mr. Jinks asked about the effect of currency on international investments. A stronger dollar will decrease the value of international investments, whereas a weaker dollar will increase the value of international holdings.

INVESTMENT REVIEW

Mr. Bryant spoke of a liquidity problem. Hedge funds were forced to liquidate to cover loses and meet loan covenants. Their preference was frequently to sell the best companies with the lowest bid asked spreads. Goldman Sacks did a study on stocks most held by hedge funds compared to those least held by hedge funds. During a recent period of financial distress those companies most held by hedge funds under performed by 1,000 basis points whereas the least held outperformed by 600 basis points.

Our real estate investments held up well. PIMCO performed well. Oppenheimer was in the 9th percentile and MCG was in the 31st percentile. Wells Fargo was overweighted in building and energy. They did very poorly.

The Defined Contribution participants are overweighted in fixed income and stable value. This was a rare period in which they out performed.

Mr. Molinaro said Artio had the ability to invest up to 20% in emerging markets. This had reached the 20% cap. In the recent quarter emerging markets did badly. Artio has since worked its exposure down to 8%.

Mr. Sahakian of Trusco pointed out an error on page 11 of the Trusco report. The table below the graph was correct, however the graph did not use the values from the table.

Mr. Sahakian discussed rebalancing. Fixed income is currently overweighted. He proposed to rebalance to target over the next three to six months.

Staff distributed a handout. It included a citation from the Investment Policy Statement on rebalancing. It had a recommended motion. After a discussion of rebalancing Mr. Cross made a motion:

The Investment Policy Statement is amended to add the following:

1. Suntrust shall review the asset allocation at least monthly.
2. Suntrust may rebalance at any time to bring the asset allocation to within its predetermined range.
3. The Board retains its right to rebalance at any time.
4. Staff shall periodically monitor the asset allocation and notify Suntrust if rebalancing is appropriate.

The motion was second by Mr. Johnson.

Discussion: Mr. Jinks questioned the need for this motion. He is concerned that City is seen is perceived as second guessing SunTrust's actions. Staff indicated this would allow them to contact Suntrust if funds become out of balance during times such as middle of month.

The motion passed (7-0).

Staff distributed a fact sheet for the International Equity Index Fund.

Mr. Sahakian indicated they had overweighted corporate bonds but had underweighted financials. He pointed to page 22 of the Trusco report that indicated Seix had avoided the damaging impact of a number of negative situations in 2008.

The Securities Exchange Commission (SEC) had mandated "Fair Value" pricing. This was meant to reduce volatility in index mutual funds. This had lead to outperforming the index in the recent period. However, over the long haul it should balance out. Mr. Sahakian believed the price to earnings ratio for international stocks was as low as it had been in a long time and that the investment will win out over time. Currency changes have recently hurt the investment.

Mr. Arrington spoke of the need for liquidity. Hedge funds were under-reserved and selling stocks to raise cash.

Mr. Arrington referred to a graph on page seven of his report. Spreads were higher than normal, but by no means were they unique. Mr. Arrington was using this as an opportunity to upgrade to quality.

2009 MEETING CALENDAR

The following meeting dates were set for 2009. Staff is directed to reserve rooms and send out the calendar.

Date	Meeting Format	Location
January 27th	Interim Meeting	TBD
February 17th	Due Diligence Meeting	TBD
April 1st	Interim Meeting	TBD
May 19th	Due Diligence Meeting	TBD
June 16th	Interim Meeting	TBD (if needed)
September 9th	Due Diligence Meeting	TBD
October 15th	Interim Meeting	TBD
November 17th	Due Diligence Meeting	TBD
All meetings are scheduled to begin at 8:30 AM		

FINANCIAL REVIEW

Mr. Molinaro reported for Prudential. Munder was off the plans' platforms. There are no investments on Prudential's watch list for performance reasons. The one on the watch list is due to a manager change. That fund is T. Rowe Price.

Thornburg had substantially under performed and may go on the watch list for performance. Mr. Cross asked about Turner. Mr. Molinaro said Turner had stayed true to their process and he had confidence in their long term.

Mr. Molinaro reported on the practice of transferring funds at year end from the Guaranteed Deposit Account to PIMCO'S total return fund. A recent projection suggested the plan could transfer $820,000 without incurring a market value adjustment. Staff thanked Mr. Molinaro for the information and told the Board that upcoming distributions for participants exiting the DROP would reduce that number, but the transfer could still be done.

Mr. Jinks made a suggestion that the Board not repeat this exercise annually but authorize staff to carry this out on an ongoing basis.

Mr. Cross made a motion:

> Authorize the Administrator to evaluate the Guaranteed Deposit Account (GDA) each December on a continuing basis to determine available funds to transfer from the GDA without incurring a market value adjustment and authorize the Administrator to transfer up to this amount to PIMCO'S Total Return Fund.

Ms. Triggs seconded the motion.

The motion passed (7-0).

Mr. Cross asked Prudential to explain the timeline involved in selling of the small cap value manager Munder and the purchase of small cap value manager Wells Fargo. Mr. Cross asked why the steps could not be taken concurrently.

Mr. Molinaro indicated steps were initiated that very day. There were no delays in the process. He said it took four days to add the new fund, Wells Fargo, to the platform. It is standard that it takes up to three days to transfer money from one fund to another. The new fund has to be on the platform before the trade order can be put in place to transfer money to it.

Ms. Evans asked Prudential to provide a copy of the procedures or manual that dictates practices for these types of transactions and for Prudential to state in writing that the procedures were adhered to.

Mr. Jinks asked about the security and safety of the GDA. Mr. Molinaro said it was an insurance company product. They were highly regulated. The amounts were held in general account. The assets were composed of Private placements, commercial mortgages, and other high quality fixed income products. There was $20 billion in assets and over $1 billion in excess reserves. Mr. Jinks said this should be included in minutes and Mr. Molinaro should provide a written statement from Prudential on this.

Mr. Johnson left at 11:50 AM.

Mr. Jinks asked if Prudential was a recipient of U.S. government bailout funds. Mr. Molinaro said he was not aware of any, there were no company statements he had seen.

EDUCATIONAL TOPICS (Continued)

Mr. Bryant summarized Private Equity as being complicated, having high fees, and requiring more sophistication. There were three decisions that the Board could make:

1. Make no commitment to Private Equity
2. Seek more information,
3. Initiate a RFP.

Mr. Cross asked how long a RFP might take. Mr. Bryant said eleven weeks, or about the time of the next due diligence Board meeting in February.

If every fund of fund manager were invited there would probably only be two presenters, Hamilton Lane and AUDA. He believes there are only two managers that provide secondary Private Equity, use a fund of funds structure, and have minimums within our reach.

Florida State Retirement Systems are limited by state law as to their alternative investment holdings. They are now liquidating their holdings because Private Equity exceeds the legal limit.

Chris Lockwood asked if there was a difference in fees between primary and secondary Private Equity managers. Mr. Bryant recalled each fund of funds manager had a 1% of assets management fee. Additionally each participated in profits above an 8% hurdle rate. One of the presenters participated in 10% of profits above the hurdle rate and the other 12½ %.

Mr. Lockwood continued with his questions. Will we pay higher fees if we use the top fund performing managers? A statement made earlier in the day was clarified. The lowest fees are with index managers for fixed income and equities. These asset classes also had lower expected returns. As pension plans moved into more aggressive asset classes such as LBOS and Venture Capital the fee structures went up.

The Private Equity managers typically charge 2% of assets plus carried interest over 8%.

There may be some political risk. The notion that broadly diversified fund of funds approach should minimize negative publicity over a particular investment is attributed to any one pension fund investor.

Mr. Bryant was asked if anyone does just secondary offerings? Mr. Bryant said yes, but maybe not using a fund of funds approach.

Mr. Jinks made a motion:

> Authorize Dahab and Associates to perform a Request for Proposal for a fund of funds Private Equity investment. The amount would indicate 5% of fund assets. The RFP would be open to the type of Private Equity vehicle to allow primary, or secondary, or a combination.

Ms. Evans seconded the motion.

Discussion: Should the RFP specifically identify the City of Alexandria by name? No, it should identify the fund as a mid-Atlantic investor.

The motion passed (7-0), Ms. Schramm voted for Mr. Johnson.

ADMINISTRATOR'S REPORT

Staff referenced the Monthly Investment Reports. The table listing fund amounts now includes the returns. The Summary of Activity by Fund for the Disability component showed a marked increase in contributions in third quarter. This was a result of the actuarial valuation requiring an increase in funding.

Ms. Evans left at 12:30 PM.

Staff explained a procedural correction that was about to take place. The actuary's valuation report developed a contribution rate when applied to salaries would create a contribution for us to budget and then fund the pension plan. However, the valuation did not specify that the salaries used for this calculation were intended to exclude participants in the DROP program. The City had contributed 21.96% of pensionable salary for participants in the DROP program when it should not have. A correction will be made. The November or December entry in the

Activity by Fund Report will reflect this lower payment. Staff presumes the same needs to be done with the disability plan. This is being verified.

Staff reported on Frequent Trading. This was the third and fourth report from Prudential this year on a participant's breaching Prudential's limits on frequent trading. The individuals who had heightened trading activity were not the same people who did this earlier in 2008. At the time of the transactions volatility was at near record levels. Staff indicated nothing would be done at present. If the trading activity continued further action could be taken.

Staff referenced the Volatility Report. The Trusco report also has a fine graph of volatility on page 6. The graph and Volatility Report provide historical context for today's market environment.

Mr. Lynch discussed a recurring issue with Suntrust. The 1099 tax form from Suntrust to disabled participants did not always have the tax status of the payment correctly marked. More than one retiree has been audited by the IRS and had their tax returns challenged. Staff has written letters to the IRS attesting to the benefit payments' non-taxable status.

Staff reported on issue with disabled members receiving Workers' Compensation. The City recently switch vendors. The new vendor has changed the method of calculating the monthly benefit. The previous vendor paid benefit amounts based on the number of days in the month. The new vendor is paying a level amount per month. However, no one notified the Pension Division of the change. The disability benefit needs to be recalculated retroactively. Letters have been sent to affected disabled members that the December SunTrust disability check will be adjusted and then the January check will start level payments.

Mr. Jinks left at 12:32 PM.

Staff referenced handout on NASRA. This is a good source of information on pension and investment issues.

MATPERS (Mid Atlantic Public Employees Retirement Systems) Investment Seminar was held locally on October 27-28. Both Barry Bryant and Steven Bland were presenters at the seminar. The conference had a very somber tone as investment markets were reaching dramatic lows.

The AMRS-VA (Association of Municipal Retirement Systems of Virginia) held its Fall meeting in Roanoke. The most significant educational topic was Infrastructure investments. Mr. Bryant asked staff about Infrastructure investments. The interesting thing was the focus on the re-engineering of the financial aspects as opposed to the bricks and mortar and engineering of maintenance and upgrades.

Ms. Nugent distributed the Savings Fitness brochure from the U.S. Department of Labor and discussed its planned distribution.

Mr. Cross asked about the taxation of insurance premium issue. Staff indicated that letters should be sent to retirees in early January providing information as to how much was deducted from their pension checks for insurance premiums. Mr. Cross if anything in the Plan Document needs to acknowledge this process. Staff will check on this.

COMMITTEE REPORTS

In the absence of Mr. Tierney, the Disability Committee chair, there was no report.

In the absence of Mr. Milner, the Buyback Committee chair, there was no report. Mr. Lockwood asked staff when the next meeting was scheduled. Staff reported no meeting was scheduled. Mr. Lockwood asked the committee's status. Staff said an assignment from the last meeting was to provide a graph or other visual aid to demonstrate the value or retirement benefits provided to Deputy Sheriffs or Medics that later transferred to positions as Police Officers or Firefighters. That graphic has been completed and is ready when the next meeting is called.

Chairman Cross reported for the Valuation & Technical Corrections committee. At the present time the committee is on hold until the plan amendments work their way through City Council. This is expected to be the first City Council meeting in December. Then the Committee meetings will resume.

Mr. Cross spoke about the Training Opportunities Committee. This is an ongoing committee to look at education opportunities.

OLD BUSINESS

There were no old business items.

NEW BUSINESS

There were no new business items.

NEXT MEETING

The next meeting is scheduled for January 27, 2009 in the Sister Cities Conference Room.

ADJOURNMENT

A motion was made by Mr. Cross and seconded by Mr. Lockwood to adjourn at 12:52 PM. The motion passed(5-0).

Handouts distributed in advance

- ♦Agenda
- ♦Minutes of October , 2008, meeting
- ♦Monthly Investment Report as of October 31, 2008
- ♦Trusco Third Quarter 2008 Report
- ♦Prudential Performance Results as of September 30, 2008
- ♦Dahab September 2008 Performance Review
- ♦What People Are Saying About Today's Markets
- ♦Summary of Activity by Fund, Disability Component, September 30, 2008
- ♦Summary of Activity by Fund, Pension Plan, September 30, 2008
- ♦Follow Up Items
- ♦Volatility Report
- ♦Valuing and Reporting Pension Liabilities (from NASRA web site)
- ♦MATPERS October 2008 meeting notes
- ♦AMRS-VA October 2008 meeting notes

Handouts distributed during he meeting

- ♦Agenda
- ♦Language for motion for GDA transfer
- ♦Language for motion for revision to Investment Policy Statement for Rebalancing
- ♦Fact Sheet for International Equity Index Fund
- ♦Savings Fitness: A Guide to Your Money and Your Financial Future
- ♦VRS Fall 2008 Member Bulletin
- ♦ICMA-RC letter to Plan Sponsor regarding recent weeks
- ♦Altius Associates presentation
- ♦Hamilton Lane presentation