MINUTES OF SEPTEMBER 9, 2009 RETIREMENT BOARD
CITY OF ALEXANDRIA FIREFIGHTERS AND POLICE OFFICERS
PENSION PLAN
DUE DILLIGENCE MEETING

PRESENT

Members	Others
Michael Cross, Chairman	Chuck Arrington, Trusco Capital Management
Michele Evans	Steven Bland, Retirement Administrator
Patrick Evans, Alternate	Barry Bryant, Dahab Associates
Bruce Johnson	Arthur Lynch, Retirement Specialist
Chris Lockwood	Dean Molinaro, Prudential
Shirl Mammarella, Alternate	Theresa Nugent, Communications Specialist
Ed Milner	Lisa Powell, Prudential
Cheryl Orr	Mike Sahakian, Trusco Capital Management
Morgan Routt	
Al Tierney	
Laura Triggs	

The meeting was called to order at 8:35 AM.

APPROVAL OF JUNE 24 MINUTES

Ms. Triggs made a motion to accept the minutes of the June 24, 2009, meeting. Mr. Johnson seconded the motion. The motion passed unanimously (8-0).

FINANCIAL REVIEW

FINANCIAL AND ECONOMIC OVERVIEW

Mr. Bryant said that the recession came faster than expected but that the recovery may also be quicker than previously expected.

Mr. Bryant expects more inflation beginning within five years but not within the next two to three years. Inflation is a consequence of the Federal Reserve policies. However, factory utilization is so low that inflation is not expected for some time. Real estate will probably have negative returns through early next year. In an inflationary environment real estate is a good investment. Next year may be the best entry point.

In the second quarter asset allocation was very helpful. Manager performance was not. Small cap, emerging markets, and international investments helped. The rally that began in early

March was driven by those stocks beaten down the most – the most leveraged, weakest companies in the most vulnerable industries. The better run but less leveraged companies did not fall as far nor did they bounce back as much. In this environment many of our managers did not perform particularly well.

Ms. Evans arrived at 8:40 a.m.

Mr. Lockwood asked why the large cap growth manager Turner was on the watch list. Mr. Molinaro referred to pages 24 & 25 of the Prudential quarterly report. Turner is on the watch list for its five-year risk adjusted performance. Recently their performance has improved. The year to date performance (for eight months) is above the benchmark.

INVESTMENT REVIEW – PENSION COMPONENT

Mr. Molinaro discussed the international equity manager Artio. Prudential looks at risk adjusted performance 1, 3, and 5 year basis. The five year scores include a period that Artio was not with the plan. Artio tends to emphasize quality and that component of the investment universe has underperformed recently. Also, they are over weighted to Europe, and that has also underperformed recently. However, the 1 and 3 year under performance is attributable to the last six months.

Mr. Milner arrived at 8:50 a.m.

Mr. Bryant said there were two risks in considering a manager change. First, the Board may elect to leave a manger just as performance is swinging back in their direction and they miss out on the recovery. Second, they could ride it out and do worse and worse over time. Both Mr. Bryant and Mr. Molinaro suggested we continue to monitor Artio but stay with them for the time being.

INVESTMENT REVIEW – DEFINED CONTRIBUTION COMPONENT

Ms. Mammarella asked about lifestyle funds. What was the ranking of the five year performances? It is a ranking within the performance of all funds. Mr. Molinaro referred to page 86 of the Prudential Quarterly review for ranking against other balanced funds. That displayed greater detail of the lifestyle funds.

Ms. Mammarella asked about target date funds. These funds and the lifestyle funds are currently very popular and heavily promoted. Should members have more information for the participants or opportunities to invest in these funds? Prudential uses the name Retirement Goal Funds. The Retirement Income Plan does offer lifestyle funds, but not the target date funds. After some discussion the Board feels most in the Retirement Income Plan have made an active election to manage their own funds. Therefore providing target date funds would not be helpful.

Ms. Evans left at 9:00 a.m.

INVESTMENT REVIEW – DISABILITY COMPONENT

Mr. Bryant referred to page 4 of the Disability Plan tab. The plan was in the 18th percentile for the quarter and the 91st percentile for the five years ending June 30, 2008. This is due to the asset allocation that the Board determined, not the manager performance. The key to the good performance was the EAFE allocation.

Mr. Sahakian reported the disability fund had grown to $11.8 million. The Seix portfolio has a mandate of A rated securities and better. This is more conservative than the Barclays Aggregate Index (formerly Lehman Aggregate). Seix did not have exposure to lower quality fixed income that did very well over the last quarter. However, they did have less exposure to U.S. government securities and over weighted high quality corporate bonds.

Mr. Arrington discussed the large cap domestic equity portfolio performance for the quarter.

Chairman Cross asked Prudential representatives to send information on target date funds to the November meeting through Mr. Bryant.

Mr. Arrington and Mr. Sahakian left at 9:22 AM.

PRIVATE EQUITY

Staff referenced the Private Equity handout, Hamilton Lane Cash Flows. This report will display contributions to and distributions from our secondary private equity fund with Hamilton Lane. This was a brand new report so suggestions or comments are encouraged.

TIMBER

Mr. Bryant presented on the timber asset class using his handout, *Timber Investing*. It is a direct asset in that it buys real or tangible assets. Mr. Lockwood asked if the investments were old or new growth. Mr. Bryant suggested typically investments included a range of investments geographically, by species of wood, (hardwoods and soft wood), and by stage of growth. The land is typically managed for 10 – 15 years and then sold. Profits are then shared among investors. It is possible that the land could be sold or leased if there was a higher income use. An investor could sell their interest earlier on the secondary market, but they would take a hit with the fees. Investments in Timber have produced outstanding returns over the last 20 years. However, future domestic returns are expected to be half of what they have been in the past.

Mr. Evans asked if timber was considered a commodity. Mr. Bryant said timber investing was mostly like commodity investing except that it also displayed some aspects of equity. This was different than other commodities because the trees grow in value as they mature.

Mr. Milner asked if the buyer knew what land was being purchased. Mr. Bryant said typically no unless the investor came in after the first closing and prior to the final closing. Even then they would only know of some of the holdings. However, if there were multiple closings then a prospective buyer might learn of purchases before their closing.

Mr. Bryant said timber investments were available domestically and abroad, in softwood and hardwoods. However, the firms that deal with timber investing are limited. Risks include natural risks such as insects and hurricanes as well as price changes in lumber.

Mr. Milner asked if there was a link between Real Estate activity and new home construction and timber investing. Mr. Bryant said less demand for timber would lead to reduced prices and then lower return on investment in timber.

Staff asked if the fees listed on chart 11 of the handout were net of fees or gross. Mr. Bryant said he would look into this and get back to the Board.

Mr. Tierney referenced a Barron’s article in the Board packet about timber which said Harvard had exited the domestic timber business. Mr. Bryant warned that the articles are written with a particular slant and don’t tell the complete story. This article said that Harvard sold its U.S. timber holdings but it did not address its international timber holdings. Mr. Bryant said one of the Timber Investment Management Operators he often works with is RMK. RMK used to place 80% of its funds domestically and 20% abroad. Recently those weightings have been reversed. A suggestion was made that buying timber at this time would be chasing returns after the easy money has long since been earned. Mr. Johnson suggested a long term commitment could be made yet timber need not be immediately funded. Mr. Tierney asked if more institutional investors were entering or exiting the timber. It is clear that during the last few years more and more plans were entering timber partnerships. However, it was not apparent what the recent experience was.

Staff asked what the minimum investment was. Mr. Bryant said $1 million. Staff concluded the Board could set an asset allocation but did not have to fund it entirely. Instead, the investment could be phased in over time with commitments as small as $1 million.

ASSET ALLOCATION

Staff provided background for asset allocation. The Summary of Activity by Fund Report (handout 6 a i) is particularly useful in depicting the plan’s strong cash flow. Currently the combined pension and disability components’ contributions exceed benefits and expenses by $5 million annually. Both are expected to grow over time but benefits and expenses are expected to grow faster and positive cash flows will eventually turn negative. This is not expected for about a decade. This enables more illiquid investments.

Staff referred to handouts in the packet, Asset Allocation labeled “4”, and to handouts provided at the meeting, Asset Outcomes are Variable.

The Board recessed at 10:45 a.m.

The Board reconvened at 10:50 a.m.

Mr. Bryant referred to his Asset Allocation Report. He strongly recommended trustees reading the report’s letter on pages 2-5. He then turned to and focused on page 6. He believes returns of the last 20 years are the best predictor of the next 20 years. He believes the 70-year and mean reversion assumptions are too high.

Liabilities are projected to be $708.1 million in 20 years. Thus, a starting point in the review should be the likelihood of results meeting or exceeding $708.1 million. Mr. Bryant then discussed the 20 scenarios list. Scenarios A-E are for education, to create a yardstick.

Scenario A is all equity. It has a huge standard deviation. Scenario B is all fixed income. It has less volatility but also less return. Scenario C is 50/50. Its return is close to the mid point of the all equity and all fixed income portfolios. However, its standard deviation is much less than the midpoint of the (all equity and all fixed) portfolio. Portfolios D and E are the current actual and current target portfolios. They are acceptable in the context of producing at least $708.1 million more than half the time.

Mr. Bryant's model generated thousands of scenarios. Scenarios 1 through 7 were among the highest scoring models. Scoring is based on the terminal values of the 75th percentile. Scenarios 8 through 13 were not necessarily ones that produced high scores. Instead they had various restrictions on exposures to alternative assets. Scenario 14 has no illiquid investments. Scenario has no alternatives.

Mr. Bryant suggested Scenario 1 had the best results under the model. However, it may be too much volatility and headline risk. The allocations to private equity (10%), Timber (10%) and real estate (5%) were all illiquid investments. Other plans our size average about 2-3% private equity. Of that average most had 0% and others had 5% or more.

Inflation had not been a factor in the 20-year period 1988-2008. This may very well be how the future differs from the past. In an inflationary environment bonds would fare badly, real estate and international equities would do well.

The value of liquidity can be overstated. If employee and employer contributions are made in full then the Fire and Police Plan will have positive cash flow for nearly a decade.

Mr. Tierney asked the good and bad of scenario # 11. Mr. Bryant said # 11 had a value tilt with large and mid cap because historically value had larger returns than growth. Real estate provided stability. Timber and private equity were down to 5% each.

Mr. Johnson did not identify a "perfect scenario" but #7 was close and it might be tweaked. The 10% timber allocation may be too much. Perhaps the Board might like scenario #7 if 5% of the timber allocation was moved to another asset class. Mr. Johnson distributed a bar graph, Asset Allocation that showed 20-year, 70-year, and return to mean for the 15 models on page 6 of Mr. Bryant's Asset Allocation Project. Mr. Tierney said #10 had the lowest fluctuation according to the bar graph. Mr. Johnson also distributed the handout, Asset Allocation Decision Making.

Ms. Orr asked if the Board had to accept one of Dahab's scenarios. Mr. Bryant said the Board had to provide Due Diligence. The true obligation was the process of deliberate, thoughtful review. His asset mixes could be tweaked as needed. Mr. Bryant indicated the model was a good decision making tool and gives you a good idea of tradeoffs. But, it is not good at predicting performance.

Ms. Mammarella noted that most allocations had timber, there were few options to select from that have no timber. Scenarios D & E were not current. Mr. Bryant pointed out they were consistent with the data staff provided and historical data. The model is based on calendar year end values and the private equity commitment was initiated after December 31, 2008.

Mr. Bryant will rerun his asset allocation model with the following:

- Scenarios D & E will be displayed again for comparison purposes.
- Scenario E will be rerun with a 5% allocation to private equity.
- Scenario #7 will be displayed again for comparison purposes.
- Scenario #7 will be changed in a series.
    - The timber allocation will be reduced to 5%.
    - Then in succession each of the other asset classes (LCG, LCV, MCG, MCV, SCG, SCV, International Equity, Real Estate, Emerging Markets, and Private Equity) will be increased by 5% to gage the impact of reducing timber in favor of that other class.

Mr. Bryant will bring the revised report to the October 15, 2009 meeting.

Ms. Orr would like staff to continue distributing articles on timber and real estate.

Staff asked that at least one presenter on timber should have has international exposure.

Mr. Johnson asked about our peers and their asset allocations. Staff referenced handouts labeled 6 b. The AMRSVA (Association of Municipal Retirement Systems of Virginia) has scheduled a meeting October 25 through October 27. Trustees are invited to the first meeting Sunday afternoon through lunch Monday. The meeting is filled with informative talks and an opportunity to meet and discuss issues with our peers. Mr. Tierney made a motion that the fund pays the fee for trustees and administrators to attend the conference. Mr. Johnson seconded the motion. The motion passed (7-1). Voting for the motion were: Chairman Cross, Mr. Johnson, Mr. Milner, Ms. Orr, Mr. Routt, Mr. Tierney, and Ms. Triggs. Voting against the motion was Mr. Lockwood.

REVIEW REAL ESTATE ALLOCATION

Staff reported the current actual real estate allocation 3.5%, well below target of 5.0%. There is no required rebalancing threshold. This was due to a combination of rising domestic and international equities and a falling real estate sector. Staff summarized the options: rebalance immediately to 5%, make steady commitments and gradually bring the allocation up to 5%, and finally defer commitments. Staff said that neither staff nor Mr. Bryant suggest the first option. While the conventional wisdom says commercial real estate has not hit bottom it is not easy to predict the future so the Board may want to make a series of contributions.

Mr. Bryant began by emphasizing this was a discussion of commercial real estate, apartment complexes, hotels, warehouses, and not single family residences. Mr. Bryant recommended deferring real estate investments until 2010.

Staff is asked to monitor real estate and place it on the January and February agendas.

The meeting recessed for lunch at 12:10 p.m.

The meeting reconvened at 12:35 p.m.

The Board discussed the contract with Prudential. Staff referenced handout 6-d-ii, City of Alexandria Purchase Order. The two outstanding issues had been 1) operating with an expired contract, and 2) providing the terms of the entire contract in one document as opposed to a very old contract and collection of amendments that may or may not be complete. The handout was evidence of a contract extension for one year with an option to renew for one year. This addressed the first outstanding issue. Lisa Powell of Prudential is asked to work with Dominick Lackey of Procurement to produce a single and complete document that contains all the terms of the contract. Mr. Tierney requested a copy of all of the documents that comprise the current contract.

ADMINISTRATOR'S REPORT

Monthly Reports

The Summary of Activity by Fund report indicates plan cash flows. The pension component has strong cash flows. The disability component has contributions into the plan that are very close to the benefit and expense payments out of the plan. The former is a stronger more flexible investment position.

Staff provided the quarterly Volatility Report (handout 6 a iii). Volatility has eased since the period during and immediately following the equity and corporate bond markets' collapse. No action is called for. Report shows the volatility is down from the extremes of several months ago.

The AMRSVA conference was previously discussed (handout 6 b). Staff used the opportunity to provide another strong endorsement of the conference.

There are no administrative issues with SunTrust to report.

The valuation data is being prepared and sent to the actuary (Segal & Company) faster than prior years.

Mr. Bryant left at 12:40 p.m.

The Administrator's Follow-Up Items memo, 6-f, was distributed. Staff reported on inflation and referenced handout 6-f-i showing Consumer Price Index through July 2009. Year to date inflation had increased. There was one month in which the cost of living decreased for the particular index the plan uses for Cost of Living Allowances. Mr. Johnson indicated it was pretty flat for the January 2008 – January 2009 period that the fund uses.

Mr. Tierney asked about the posting of the Disability Procedures. Staff indicated where the disability procedures could be found on the web site. Mr. Tierney requested that the plan document be amended to provide the date of determination for eligibility for disability be the date of the physician's determination.

After some discussion about what date to use to determine the date of eligible for disability, Mr. Johnson said the disability provision should be changed to reflect how the City wants it to be. Ms. Orr agreed with Mr. Johnson. Ms Triggs suggested Ms. Orr help with the wording that should be included in the plan document. Ms. Orr agreed and requested background information.

Chairman Cross said the Valuation and Technical Corrections Committee could not endorse the change to the disability provision as a plan benefit change but could include the proposal in its work efforts. Staff mentioned that changing the disability provision might impact the disability contribution rate.

COMMITTEE REPORTS

DISABILITY COMMITTEE
This was discussed while reviewing the Follow-Up Items memo.

BUYBACK COMMITTEE
Mr. Milner reported on the most recent committee meeting. The committee reviewed its past work and is preparing to bring a proposal to the full Board. The proposal would allow plan participants to purchase service credit at the full actuarial cost – meaning there would be no cost to the plan or the City. An open question was who would pay the actuarial fees for the calculations. Ms. Mammarella expressed concern that allowing people to buy back service would change the actuarial assumptions because more people would be eligible to retiree at an earlier date. Mr. Tierney expressed concern something might be submitted as cost neutral to the Board but along the way be it would be changed and end up costing the plan. Mr. Evans reminded all that the Board voted against any City cost-sharing on the previous buy back but that it was changed by City Council.

A letter was co-written by staff and Prudential and sent to plan participants with prior service. It is thought more participants might have received the letter than actually did. Committee Chairman Milner will meet with participants to follow up on this.

Ms. Powell left at 1:15 p.m.

VALUATION & TECHNICAL CORRECTIONS COMMITTEE
Staff reported the bulk of the activity was focusing on the definitions of compensation and of death or disability.

TRAINING OPPORTUNITIES COMMITTEE
Chairman Cross called upon Board members to reinvigorate the committee. In particular he would ask:

1) On an annual basis review the agenda and schedule training or educational topics for the year.
2) Review conferences and make recommendations to the Board.

Chairman Cross asked for volunteers. Committee members will be: Patrick Evans, Shirl Mammarella, Morgan Routt and Laura Triggs.

Mr. Lockwood left at 1:16 p.m.
Mr. Evans left at 1:20 p.m.

Chairman Cross would like to create a Vendor and Service Provider Review Committee. The task is to review the service, value provided, and contract/remuneration of vendors and staff. Chairman Cross made a motion to create the Vendor and Service Provider Committee. Mr. Johnson seconded the motion. The motion passed (7-0).

Committee members are: Mr. Cross, Mr. Johnson, Ms. Orr, and Mr. Tierney. Mr. Chris Spera is asked to provide assistance as needed.

There was additional discussion on the Training Committee. Mr. Johnson reminded the Board that any training costs would be paid out of the Pension Plan. The Committee should consider: 1) what minimum training is necessary; 2) what can be done cheaply in a Board meeting; and 3) the costs of any outside training. Mr. Johnson suggested that one criteria for the Training Committee be making the most efficient use of funds.

OLD BUSINESS

Staff referenced handout 8 b, the letter from Segal dated July 15, 2009, regarding the employee disability contribution. To continue to maximize tax advantages of Non-Service Connected Partial Disability benefits the employee contribution should be increased to at least .79% on a post tax basis.

Mr. Tierney made a motion to increase the employee contribution to .80%. Ms. Triggs seconded the motion.

Discussion: Staff recommended the motion specifically mention the interaction of the contributions. The employees' post tax disability contribution is increased to .80% and their pre-tax pension contribution is decreased to 7.20%. Consequently the employer disability contribution is decreased .20% and the pension contribution increased .20%. Total contributions are unchanged.

Mr. Tierney amended the motion and Ms. Triggs seconded the amended motion to note that the pension contribution would be adjusted to 7.2% for total employee contributions of 8.0%. The motion passed (7-0). The new rate will be effective July 1, 2010.

NEW BUSINESS

Staff referred to the handout on Trading Costs (9a). One consideration in selecting investment managers is their turnover frequency. Managers with high turnover may have high costs that diminish returns.

Staff referred to the handout on Active versus Passive management (9b). The article is recommended reading.

Staff referred to the handout on expenses (9c). Handouts from today included a revised chart because the Dahab fees had been understated on the materials mailed to the Board. The revised report had an error in the grand total. The $187,796.17 should have been $243,785.67.

The report will be distributed annually. Mr. Tierney requested future expense reports include a history of expenses to facilitate comparison. Staff said the 2010 report will include a separate listing of 2009 expenses.

Mr. Tierney brought up the Retirement Income forfeiture account again. Mr. Cross noted that the Board does not have any information on Prudential expenses. He also questioned whether the forfeiture balance can be moved to the Defined Benefit account. Staff will check into both of these Prudential items.

Staff referred to the article on Private Equity/Distressed Debt (handout 9 e). The report suggests there will be many opportunities for secondary private equity funds.

OTHER TOPICS

Chairman Cross asked about the vacancy in the City Attorney position. It has since been filled with the appointment of Mr. James Banks. Chairman Cross said he would make an appointment with Mr. Banks to discuss outstanding items that the Board has request City legal support. Mr. Johnson suggested a list of what legal support is needed for the Board. At various times the City Attorney has provided support via Chris Spera or George McAndrews and others.

Mr. Tierney asked the Retirement Handbook that was supposed to be completed by July 1. Ms. Triggs said it was in two parts. Cheryl Orr and Human Resources had done their part and the Pension Administration Division was a little behind H.R. Substantially all of the pension part was done and it was expected soon.

Chairman Cross asked Board members to bring their calendars to the October 15 meeting.

NEXT MEETING: OCTOBER 15, 2009 SISTER CITIES ROOM 1101

ADJOURNMENT

The meeting adjourned at 1:50 p.m.

Handouts distributed in advance

1) Agenda
2) Minutes of June 16, 2009 (1)
3) Prudential Fund Fact Sheet: Artio Fund (2-c & d)
4) Hamilton Lane Cash Flows (3)
5) Excerpts from Investment Police Statement (4, 5, 6-a-ii)
6) *REITs Are Poised to Pick Up Pieces* (article Wall Street Journal) (5-1)
7) *Funds rethink pulling plug on real estate* (article from Pension & Investments) (5-2)
8) Summary of Activity by Fund (6-a-i)
9) Annual Administrators' Meeting & Trustee Training Sessions (6-b)
10) City Purchase Order renewing Prudential Contract DB and DC plans (6-d-ii)
11) Administrator's Follow-up Items (6-f)
12) Chart on Consumer Price Index (inflation) (6-f-i)
13) Segal letter on disability contribution rate (8-b)
14) Trading Costs (9-a)
15) *Active vs. Passive: The Debate Heats Up* (article Wall Street Journal) (9-b)
16) Expense Fiscal Year 2009 (9-c)
17) *Trouble in the Forest* (article Barron's) (9-d)
18) *Distressed Takeovers Soar* (article Wall Street Journal) (9-e)
19) SunTrust 2nd Quarter 2009 report
20) Prudential Investment Review Second Quarter 2009
21) Dahab Performance Review June 2009
22) Investment Performance Review Second Quarter 2009 Notes and Questions (2-a-c)

23) Asset Allocation notes (4)

24) Monthly Investment Report (6-a-ii)

24) Volatility Report – Number of days with change in S&P 500 exceeds 1/1.5/2/3% (6-a-iii)

25) Discussion Draft dated August 28, 2009 of First Amendment to Pension Plan (7c)

26) List of Section Changes Made by the First Amendment (7c)

27) Asset Allocation Project September 2009

<u>Handouts distributed during the meeting</u>

1) 2009 Wilshire Report on State Retirement Systems: Funding Levels and Asset Allocation page 11

2) Asset Outcomes are Variable 4

3) List of Section Changes Made by the First Amendment to the City of Alexandria Firefighters and Police Officers Pension Plan

4) Timber Investing (Printout of Presentation by Barry Bryant)

5) Expenses Incurred in Fiscal Year 2009

6) Asset Allocation - bar chart of 15 asset mixes in three investment scenarios.

7) Asset Allocation Decision Making