MINUTES OF SEPTEMBER 9, 2008, RETIREMENT BOARD
CITY OF ALEXANDRIA FIREFIGHTERS AND POLICE OFFICERS
PENSION PLAN
DUE DILLIGENCE MEETING

PRESENT

Members	Others
Michael Cross, Chair	Chuck Arrington, Trusco
Michele Evans	Carl Beveridge, Suntrust
Pat Evans (Alternate)	Steven Bland, Retirement Administrator
Mark Jinks	Barry Bryant, Dahab Associates
Bruce Johnson (Alternate)	Arthur Lynch, Retirement Specialist
Chris Lockwood	Dean Molinaro, Prudential
Shirl Mammarella	Theresa Nugent, Communications Specialist
Edward Milner	Lisa Powell, Prudential
Albert Tierney	Michael Sahakian, Suntrust
Laura Triggs	Kathleen Schramm, Acting Director Personnel Services

CALL TO ORDER

The meeting was called to order at 8:34 a.m. on September 9, 2008.

Mr. Jinks indicated that in light of Henry Howard's recent retirement there is an item on the September 9, 2008, City Council Docket to approve the appointments of Mr. Johnson as a voting City Representative and Kathleen Schramm as the City Representative Alternate.

MINUTES

Mr. Cross made a motion, seconded by Mr. Jinks, to approve the July 10, 2008 minutes. The motion was unanimously approved (6-0).

Mr. Tierney and Ms. Schramm arrived at 8:36 AM.

Mr. Cross made a motion, seconded by Mr. Jinks, to approve the August 6, 2008 minutes. The motion was unanimously approved (7-0).

Mr. Cross made a motion, seconded by Mr. Jinks, to approve the September 2, 2008 minutes. The motion was unanimously approved (7-0).

FINANCIAL REVIEW

FINANCIAL AND ECONOMIC OVERVIEW

Mr. Bryant discussed the second quarter investment performance. The asset allocation did well enough. However, the money managers did not.

The GDP (Gross Domestic Product) figures for the quarter originally came out as flat, and then were revised to 1.9% increase. Following the publishing of the quarterly performance report the finalized GDP figures were announced as a 3.3% increase. This may not jive with worker's perceptions, especially with unemployment rising to 6.1%. However, the weak dollar may have helped increase exports.

Mr. Bryant discussed the implications of the government's taking over Freddie Mac and Fannie Mae. Mortgage rates are expected to fall, or at least spreads over treasuries will fall. The U.S. government is assuming a huge debt obligation. Loans originated in 2007 with poor underwriting standards will begin to have increasing default rates in 2009. The market rate may bottom sometime in 2009.

INVESTMENT REVIEW

Mr. Bryant indicated that in the recent period growth had outperformed value. The defined benefit (DB) plan returned –1.2% compared to a -.3% return for the benchmark. PIMCO had a particularly poor quarter. However, they had added value over time. They had anticipated a federal takeover of Freddie Mac and Fannie Mae, but were early in their preparation for that event. In all likelihood the third quarter will show significant gains reflecting the federal governments September 7th takeover of the mortgage enterprises.

Mr. Molinaro mentioned his concentration was on the longer term as opposed to some of Mr. Bryant's focus on the shorter term. Prudential had added Munder to their watch list. There was a conference call Monday on Monday with Munder and there will be an on site visit to Munder in early October.

Munder performed very badly in 2006, above par in 2007, and quite poorly in 2008. Their 2006-2007 problems related to REIT exposure and over weighting homebuilding. More recently its poor performance was not due to an asset allocation problem but across the Board stock picking as well as an under-exposure to energy and materials.

Turner had a poor year to date return but their long-term record was good. Turner had high exposure to financials, Goggle, and General Electric. They exited Google during the year and did not return when Google did better.

The focus was shifted to the Defined Contribution (DC) component. These funds are invested very conservatively. Thornburg did poorly. The fund is highly concentrated. They have no energy and they are not on Prudential's watch list.

Mr. Lockwood asked about the two firms on the watch list. T. Rowe Price is on the watch list because of a manager change. Cooke and Bieler is on the Prudential watch list but has been removed from the menu of offerings for City of Alexandria.

Ms. Schramm asked about Essex. Mr. Molinaro indicated that they felt the performance of Essex in the quarter reported was an anomaly. They have little energy and yet some exposure to micro caps.

Mr. Bryant considered the difference between Essex and Munder. Munder was heavy in the housing market. It was a good value, but housing has declined deeply. Munder has picked more stocks that have not performed well. The Board may want to consider getting rid of Munder.

Mr. Molinaro noted that there is an additional option in the asset class. Wells Fargo is currently included as one of the DC funds. Wells Fargo had done well, but their volatility was slightly higher than the benchmark. They are a more opportunistic investor.

Mr. Bryant defined "tracking error" as a statistical measure of a manager's deviation from a benchmark. Some managers consider this to be their "fudge factor." But managers do try to control their "tracking error." Mr. Johnson asked about the difference between taking Munder off the DC platform versus the DB platform. Mr. Bryant indicated the DC plan already had a replacement up and running.

Mr. Jinks asked if the Board were to remove Munder as an option for one plan (DB or DC) do we typically do the same for the other plan. Mr. Cross suggested that any change to the DC funds should also be made to the DB funds. Mr. Molinaro said another alternative would be to do nothing and let a fund change happen if Prudential fired the fund. Mr. Cross asked Mr. Molinaro what is the recommended replacement. Mr. Molinaro said he recommend Wells Fargo for both plans. Wells Fargo is currently on the DC platform and can be added to the DB platform quickly.

Mr. Tierney asked Mr. Bryant what he recommended. Mr. Bryant said, "Yes, I think you should change." Mr. Bryant said they are slow to change managers because sometimes a market is not the type in which the fund performs well. He thinks this is the time to make a change.

Mr. Johnson made a motion to drop Munder as an investment manager. Ms. Triggs seconded the motion.

Discussion: Mr. Jinks asked to clarify if the motion was meant to include both the DB. plan and the DC Plan? The motion is meant to include both. Ms. Evans mentioned the need for a 60-day notice. Staff indicated the notice would be reasonable. However, the exact period might revolve around the beginning of a month and might be more or less than 60 days.

Mr. Tierney asked if there was a difference in fees between Wells Fargo and Munder. Mr. Molinaro indicated that the Wells Fargo fund cost is 30 basis points per year more than the Munder fund.

The motion was: Replace Munder with Wells Fargo in both the DB and the DC plans. Track Munder assets to Wells Fargo. Expedite change as quickly as possible.

The motion passed (8-0).

Mr. Jinks left at 9:27 AM.

Mr. Sahakian reviewed the 2nd Quarter Report for the Disability component. He provided an August 31, 2008, update for pages 9, 12, and 29. The fund allocation is on target of 70% equity and 30% fixed. Mr. Arrington noted that these are challenging times for their style of investing. He said the good news is that the worst quarters for the fund were in the 3rd and 4th quarters of 2007. He also reminded the Board that up until recently there was a lower allocation to equities. They are working on improving their stock selections.

Mr. Sahakian reported that timing of the 20% ($2.5 million) reallocation to International equities that was done in July was not good. The International funds a took a hit in July in August. He believes they will make this up over time. Yesterday, Treasuries were hurt. The fund is heavily weighted in Treasuries.

Mr. Bryant noted that he is not so interested in the 3-5 year fund numbers because he does not think they are stable. He is more interested in the annual numbers for a fund. But, the industry does not tend to report this way.

Mr. Cross asked if there were any other changes that should be made. Mr. Bryant replied that earnings on all equity classes will be lower. To get above average returns the plan needs to consider alternatives such as investing in timber or private equity. One problem with investing in timber is its liquidity.

Mr. Tierney made a motion for the Plan to purchase timber. Mr. Bryant suggested that the Board wait until after the Private Equity presentation to make any decisions on investing in timber. The City Attorney's office may have concerns about any contracts that the Plan would need to sign. Making a change to invest in timber will require a lot of time from the Board and staff. Mr. Tierney withdrew his motion.

ADMINISTRATOR'S REPORT

Staff reported on Frequent Trading. This was the second report from Prudential this year on a participant's breaching Prudential's limits on frequent trading. The individual who had heightened trading activity was not the same person who did this in January 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.

Mr. Lynch reported on difficulties with the Prudential website. Investment modules were down for not quite a week. Running estimates for Fire and Police participants was not possible for over a week. Prudential worked to fix that problem. Estimate capabilities for the Supplemental plan were lost for a month. It was determined that the problem was related to a firewall our I.T.S. Department had created. While systems were down Prudential was helpful in providing information to us through alternative means.

The Board discussed Prudential's labeling of Social Security benefits on benefit statements. A member might read the statement to mean the Social Security benefit is payable when the pension benefit is payable. This would be misleading. Lisa Powell will work with Staff on this.

Follow up items were briefly mentioned. The prior meeting was only one week prior and staff had not followed up on everything yet.

Staff referred to a handout on allowable expenses that was included in the meeting packet as well as an additional handout on actual plan expenses that was distributed at the meeting. The first handout (from Prudential) was a summary of Internal Revenue Service rules on using fund assets to pay plan expenses. The discussion focused on page two of the handout that included examples of acceptable and unacceptable expenses. Staff stated that the Plan would need to request funding from the City Manager's Office on any expenses that are not acceptable for payment from the Plan.

Ms. Nugent reminded the Board of the MATPERS Investment Seminar to be held locally on October 27-28. Both Barry Bryant and Steven Bland will be speaking at the seminar. Currently, four Board members have signed up for the seminar.

Staff referenced the Monthly Investment Reports. Mr. Bryant's comments earlier in the meeting about actual versus target allocation were as of June 30 2008. The Investment Report for August 31, 2008 did not call for rebalancing, but actual allocations had begun to drift from target. International equities were below target for the first time in several quarters.

Staff reminded the Board of the retirement seminars for Firefighters and Police Officers that will be held September 15 – 17, 2008, at the Lee Center and Fire Station 208.

COMMITTEE REPORTS

Mr. Tierney reported the Disability Committee would hold a meeting September 10. He will report its findings at the October Board meeting.

In Mr. Milner's absence staff reported on the Buyback Committee. The committee is gathering data, as is Prudential. It is premature to provide any information at this time.

Chairman Cross reported for the Valuation & Technical Corrections committee. At the September 2 meeting of the City Council Compensation and Benefits Committee the Proposed

Eighth Plan Amendment was recommended for City Council approval. The Board discussed the timetable for City Council and the 60-day notice.

The Pension Protection Act of 2006 was mentioned. Staff reported that they had just received word Prudential was able to supply needed information. Each December Prudential will send staff an excel file with retiree's medical deductions for the year. Staff will use a mail merge to combine that information into a letter for each participant. Currently, Chris Spera, of the City Attorney's Office, was reviewing that letter. Ms. Evans requested the letter go to Ken Howard of the Retired Police organization. Mr. Tierney added the letter should focus on what the rules are.

Staff is directed to bring the approved letter to the Valuation and Technical Corrections Committee.

OLD BUSINESS

Staff referenced the Actuarial certification from Eli Green Blum in the packet. The letter is needed for IRS compliance to maintain the tax-free status of non-service partial disability payments. With that letter the valuation process was considered complete.

Mr. Cross made a motion that the Board accept the 2007 actuarial valuation.

Mr. Johnson seconded the motion. The motion passed (7-0).

NEW BUSINESS

Mr. Bryant made a presentation on Private Equity (PE). The remaining large asset classes that the Plan does not invest in are Hedge Funds and PE. Hedge funds are expensive and do not provide disclosure or liquidity. Timber was not considered a major asset class. Timber is a subset of Commodities but unlike others in that class.

PE used to focus on venture capital, then more on leveraged buyouts. Now it includes both and mezzanine finance. Staff mentioned Prudential had a mezzanine finance product. PE is limited to qualified investors.

Mr. Johnson asked a question on partnership structure and who was liable for debt. Mr. Bryant said it was most unusual for an investor to be liable for more than 100% of their investment.

PE provided higher return and better diversification than other alternatives and was expected to continue to do so. The disadvantages of PE included: 1) the "J" curve effect (low initial returns), 2) the Structure Problem (complex contracts), 3) the Vintage Year Problem (returns somewhat a function of year of investment), and 4) The Diversity Problem (limits on how much a PE fund can diversify). Some disadvantages can be addressed by using a Fund of Funds approach. However, this does add another layer of fees.

The next steps would be to determine if the City Attorney would permit such limited partnership contracts. Ms. Schramm asked how we find the criteria to evaluate the potential managers. Mr. Bryant suggests that his firm would do due diligence.

Mr. Lockwood would like the Board to pursue the legal issues as to whether or not a limited partnership structure is permitted.

Mr. Johnson asked if a new asset allocation was required. Mr. Bryant said that the prior asset allocation study of 3-4 years ago used historical numbers, not projected. As projected values change over time they change in magnitude but relative performance of the asset classes remains remarkably stable. Also, the diversification provided by PE would reduce risk. Liquidity of PE is better than that of timber that may lock up funds for ten to fourteen years.

Mr. Johnson asked about the costs of PE. Mr. Bryant said not only was there an added 1% for Fund of Funds but also there would be increased demands on staff time, City Attorney's time, Board time, etc. There were significant up front efforts.

Mr. Bryant said quarterly reports would include PE performance results and that the PE Fund of Fund manager would come in annually.

It was asked if contractually the City is permitted to invest in limited partnerships. It was suggested the Real Estate investment through PRISA was a limited Partnership and that was a precedent. Mr. Molinaro said PRISA was actually not a limited partnership but was structured through an insurance contract.

Staff is directed to contact Fairfax County for their approach to alternative investments.

NEXT MEETING

The next meeting is scheduled for October 7 in the Sister Cities Conference Room. The following meeting, November 11, was moved to the Council Workroom on the second floor.

Everyone is asked to bring their calendars to the November meeting.

There was discussion on some recent articles regarding actuarial assumptions and public pension plans. Staff is asked to monitor GASB and Actuarial Professional discussions on discount rates used in pension valuations.

ADJOURNMENT

A motion was made by Mr. Cross and seconded by Mr. Johnson to adjourn at 11:40 AM. The motion passed (6 - 0).

Handouts distributed in advance

Agenda

Minutes of July 10, 2008, meeting

Minutes of August 6, 2008, meeting

Prudential document regarding plan expenses payable from plan assets

Monthly Investment Report as of August 31, 2008

Segal letter dated July 30, 2008, regarding disability contributions

Trusco Second Quarter 2008 Report

Prudential Performance Results as of Jun 30, 2008

Dahab June 2008 Performance Review

Handouts distributed at the meeting

Minutes of September 2, 2008, meeting with the Council Employee Pension Compensation Committee

Expenses summary of actual Plan expenses

Trusco Update as of August 31, 2008

Private Equity slide handouts from Dahab