NOTES OF FEBRUARY 17, 2009, RETIREMENT BOARD
CITY OF ALEXANDRIA FIREFIGHTERS AND POLICE OFFICERS PENSION PLAN
DUE DILLIGENCE MEETING

PRESENT

Members	Others
Mark Jinks	Chuck Arrington, Trusco Capital Management
Bruce Johnson	Chason Beggerow, Altius Associates
Shirl Mammarella, Alternate	Steven Bland, Retirement Administrator
Ed Milner	Barry Bryant, Dahab Associates
Cheryl Orr	Tom Kerr, Hamilton Lane
Al Tierney	Arthur Lynch, Retirement Specialist
Laura Triggs	Dean Molinaro, Prudential
	Theresa Nugent, Communications Specialist
	Lisa Powell, Prudential
	Jackie Rantanen, Hamilton Lane
	Napoleon Stevenson, Hamilton Lane
	Tom Winters, Trusco Capital Management

The meeting began at 8:30 AM. There was not a quorum so there was no Call to Order.

PRIVATE EQUITY

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."

Private Equity
Typically falls into one of three groups:
Buyouts - Fixing up companies
Growth - Venture Capital
Mezanine Financing - in between the two

The variation of results between a median manager and those in the first quartile is significantly larger than the variation between comparable fund managers for typical mutual funds.

There are additional layers of fees with fund of funds managers. However, access to better managers results in significantly higher income.

Each fund of fund manager will invest with roughly 20 managers who will in turn invest in roughly 15-20 companies. Thus, the plan has a share in upwards of 300 companies.

The J-Curve is the phenomenon that most partnerships begin with initial low or negative returns then have sharply increasing returns.

Mr. Bryant said that the primary market had long dominated the market for Private Equity. Recently the secondary market was picking up as some funds needed to rebalance and others were having cash flow challenges. Staff referenced a handout that addresses the increase in secondary activity.

ALTIUS ASSOCIATES

Mr. Beggerow 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.

Altius is a boutique specializing in Private Equity. They describe themselves as a core, global, fund of funds.

Mr. Beggerow discussed Private Equity investment while referring to the handout. Page 5 listed the primary considerations of Private Equity investing:

- A long time horizon
- Higher fees
- Limited or restricted information
- Illiquidity
- The J-Curve effect

Staff asked when is the plan's investment deployed? Typically within three to five years.

Al Tierney arrived at 9:00 AM.

Mr Beggerow reviewed the Altius booklet handed out:

Page 6 portrays historical rates of return of Private Equity compared to other asset classes.

Pages 7 & 8 show rates of return by year. Investments at or immediately following recessions have tended to do well.

Page 10 provides a company profile. Half the investment professionals are US based and half are in London.

Page 13 demonstrates the difference between the average manager and the best managers. Access to the best managers may well be worth the additional layer of fees.

Page 15 describes the profile of the Private Equity Fund II by size, domestic/international split, buyout/venture/growth mix, etc.

Mr. Jinks asked what is the typical leverage? Mr. Beggerow indicated that typically the investment was 30-40% investor equity. Recently the leverage had increased.

Page 17 discusses the fund's timing. It is scheduled to close in the second or third quarter of this year with funds deployed in 2010.

Mr. Bryant was asked to define the term "Initial Close." He discussed the commitment made by those who joined the partnership prior to the initial close and how those buying an interest in the partnership after the initial close may be obliged to make payments to the former group.

Mr. Jinks asked how appraisals are made. Mr. Beggerow discussed the appraisal process, audits, and time lags involved. These are governed by Financial Accounting Standard (FAS) 157 which has increased standards of practice and regularity in this area. Mr. Jinks asked if the fund manager was making the appraisals. Mr. Beggerow said the fund manager makes appraisals and they are audited. Mr. Jinks asked how these rules might apply to non-US companies. The thought was the standards are reasonably close to universal.

Mr. Jinks asked what kind of reports are provided to the board? There is a 45-day lag in quarterly reports. These are very simple accounting statements of dollars in, dollars out. Additionally, there is an annual report that is much more detailed. Mr. Jinks requested Altius Associates send samples of their quarterly and annual reports.

Staff asked about the three types of funds mentioned on page 11. The AAPEF II is the fund under consideration. The Real Assets Fund focuses on energy, timber, and infrastructure. The AAPEF II fund would invest in some energy, but not infrastructure and timber. The Select European Fund focuses on small Private Equity transactions in Europe.

Mr. Johnson asked for a review of page 21, the terms of the limited partnership. The annual management fee is based on committed capital. In years 1-4 roughly 70% of the funds will be called. There are typically 4-6 calls per year with ten days to respond to each call.

Mr. Jinks asked for a discussion of carried interest. Carried interest is the participation in profits above a predetermined hurdle rate. For Altius Associates their share is 5% of profits above the 8% hurdle rate.

This concluded the presentation by Altius Associates at 9:50 AM.

HAMILTON LANE

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.

Mr. Kerr defined secondary Private Equity as buying an interest in existing funds. Recently there has been unprecedented liquidity needs. The general partner must approve the transfer to a secondary buyer. Typically the sales are of 100% of the investor's interest as opposed to a portion.

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 secondary offerings being purchased at a discount to net asset value. This leads to more profitable investments as well as reducing the "J curve" effect.

Mr. Tierney asked what is the legal structure of this investment? Mr. Kerr said they were interests in limited partnerships.

Mr. Kerr, and then Ms. Rantanen reviewed the booklet Hamilton Lane distributed:

Pages 6 & 7 display deal flow. Hamilton Lane has a 2% "hit rate" meaning they buy only 2% of the limited partnership interests that they are asked to bid on.

Page 11 displays the vintage year, type, and strategy of their secondary investments. The chart suggests a diversified portfolio.

Page 14 suggests most funds would be contributed within three years of closing the fund. Staff asked how quickly should we expect funds to be returned. Mr. Kerr said typically distributions are complete within five years following the final funding to the partnership. However, the current environment is highly illiquid. The returns might be slower.

Mr. Tiernay asked about the Internal Rate of Return (IRR) calculations on page 11. The Gross IRR is 21.2% and the net IRR is 15.9%. Mr. Kerr explained this was due to the timing of fees being front loaded.

Mr. Kerr described Hamilton Lane as being opportunistic. Staff referred to page 11 and asked if the strategy going forward should be expected to be different than those employed historically. Mr. Kerr anticipates a greater allocation to distressed debt.

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.

The next limited partnership they offer targets 75% primary Private Equity, 15% - 25% secondary, and 0% - 10% Co-investments. Co-investment allows an investor to invest directly into a company. Coinvestments also have advantageous fee structures.

Page 13 shows the anticipated breakdown by geographic region and investment strategy.

Mr. Johnson asked about the 2005 and what were its vintage years. Ms. Rantanen said the vintage years were 2001-2004. In reviewing all funds the 2002-2004 years were most profitable.

Mr. Tierney asked about fees. Mr. Bryant will work with staff to develop examples to illustrate the fee structure of the three companies and the five funds.

The meeting went into recess at 10:55 a.m. and the Hamilton Lane representatives left.

AUDA

Tim Brody and Don Rigoni presented.

Mr. Rigoni suggested in a down economy Private Equity should outperform.

Mr. Brody said Auda grew out of a Family office environment in Germany. The family office environment would stress preservation of capital, positive returns, and client service.

The company has five billion dollars under management, four billion in Private Equity and one billion in hedge funds. Of the Private Equity funds one half billion is in secondaries and one half billion is in co-investments. They do invest in late stage venture capital but not early stage. In Europe they prefer the middle market over mega cap. Also, they will go anywhere, but their preference is for western Europe over eastern.

Mr. Brody reviewed the Auda booklet handed out:

Page 11 of their handout discusses the benefits of secondary funds.

Page 12 lists reasons supporting secondary investments today. 2008 was s cyclical peak in Private Equity investing. Mr. Brody suggested discounts are widening for all years, not just 2008. Typically discounts might be 30%- 50%. A deep discount might be 70%. They expect discounts to remain larger than historical levels for 12-24 months.

Their primary fund seeks to integrate primary Private Equity with secondary and coinvestments.

The focus is on $10 - $20 million transactions.

Page 18 suggests that distributions may begin as early as the second quarter following the closing.

Mr. Bryant provided background on the family office structure.

Laura asked how many deals did not get done. There were 103 deals, they bid on eight and won five. They look for situations where they know more than the seller. The expected duration is seven years.

Mr. Bryant discussed carried interest, or incentive fees. For the Private Equity the rates are:

U.S.	5%
Asia	10%
Secondary	12 ½%

The reason for the higher rate is that there is more work involved in secondary Private Equity.

Ms. Orr asked if the percentage of secondaries in their main fund had changed over the last year or two. Mr. Brody said it had not changed much.

Mr. Tierney asked about the importance of fees. There was a divergence of opinion. Some board members saw fees as a reduction of earnings. Others saw it as part of a package to generate higher earnings.

Ms. Triggs asked how much might the plan commit. Mr. Bryant suggested the amount might be in the neighborhood of 5% of the fund. Staff suggested that some of the investment managers present had small minimums. We could mix and match providers, or primary and secondary funds, or U.S. and international. It was asked if that would be too much to monitor.

Mr. Johnson saw Hamilton Lane as having better customer service.

Mr. Tierney thought Auda was too expensive relative to the others. Therefore he preferred Hamilton Lane. Mr. Jinks said Hamilton Lane had international exposure as opposed to just European.

FINANCIAL REVIEW

FINANCIAL AND ECONOMIC OVERVIEW

Mr. Bryant said that of the past ten years have been the worst ten years in stock market history. He began with a review which sectors performed best: Treasuries, cash, everything else. He projected improvement in the following order: credit, equities, and finally the economy.

Goldman Sacks had traditionally been the most optimistic brokerage firms. It had recently projected equity returns of 6% per annum for the next ten years. This is lower than most others.

Mr. Tierney asked why foreign markets did worse than domestic. Mr. Bryant said they were more volatile. They had gone up more in the past. Staff said there were foreign currency translations. For years the dollar got weaker and this aided international investments. Beginning in 2008 the U.S. dollar got stronger and this hurt international investments.

INVESTMENT REVIEW – PENSION COMPONENT

Mr. Molinaro discussed Turner, the large cap growth manager. They had overweighted financial stocks and higher P/E stocks. Turner is likely to be placed on Prudential's watch list this quarter.

Mr. Molinaro discussed Essex, the small cap growth manager. They had overweighted technology and micro cap companies.

Prudential's real estate fund, PRISA, had performed markedly worse than other real estate funds. Mr. Molinaro said Prudential was more aggressive in writing down property values. This suggests they will outperform later in the year. The cue to exit PRISA was now 13% of the fund value. Initially, those entering the cue wanted to rebalance. Subsequently there were more reasons to exit the fund.

Mr. Bryant talked about securities lending to make an analogy (we do not participate in securities lending but like real estate, there are now liquidity issues). The securities lending program was once thought of as free money because as custodians like State Street and Northern Trust put collateral into high quality short term notes. More recently the collateral went into higher yielding longer term notes. With changes in credit markets the once deemed as safe, securities lending market, has become illiquid and assets are frozen.

Mr. Jinks asked if the revaluing of real estate was due to higher capitalization rates? Mr. Molinaro said it was. Mr. Molinaro expects the total return for 2009 to be -8% to -10%.

Staff mentioned PRISA is holding a client meeting March 5th in Washington D.C.

INVESTMENT REVIEW – DEFINED CONTRIBUTION COMPONENT

Performance was very directly related to the amount of risk assumed. The riskier the investment the worse the performance.

INVESTMENT REVIEW – DISABILITY COMPONENT

Relative performance of the disability plan has improved of late.

Mr. Arrington has not been strict in rebalancing. As the equity markets fell they have not rushed to bring actual allocations up to target. Their view is not quite as optimistic as Mr. Bryant's. They expect the GDP to not have positive year to year comparisons until fourth quarter 2009 or first quarter 2010. They believe credit markets are slowly showing signs of improvement.

Referring to page 18 of their quarterly report Mr. Arrington favors technology investments, especially since their balance sheets tend to be cleaner than many other sectors.

He expects unemployment to peak at 10%. However, this is a lagging indicator so investments should pick up prior to that.

Traditionally once P/E ratios get to ten on a trailing basis equity markets tend to turn up. However, this time earnings may fall significantly.

Mr. Jinks pointed out the blended index they reported in their quarterly report did not match that in Dahab's book. Mr. Arrington and Mr. Bryant will follow up on this and report back to staff.

Mike Sahakian was unable to join us for the meeting. Tom Winters represented Seix Advisors. Seix beat the benchmark for the recent periods. They may have been early in overweighting treasuries in 2007. However, it paid off in 2008.

PRUDENTIAL – RETAIL BRANDED, SUBADVISED INVESTMENT OPTIONS

In 2008 there were issues regarding several financial companies. Clients as the City of Alexandria and others, wanted to know their exposure to Lehman, AIG, Bear Stearns, CitiGroup, Washington Mutual, etc. The business model called for Prudential's clients to own shares of mutual funds. Information is not readily available to shareholders as S.E.C. required reports have significant time lags. It was difficult to obtain information on a timely basis from the mutual fund companies on their holdings.

Beginning April, Prudential will have a separate account for each mutual fund. The separate account will mimic the retail mutual funds we now invest with. However, while the mutual fund manager will make the investment decisions the difference is that it will be Prudential's separate account. They have instant access to all the holdings.

There will be no change in fees. Staff was asked to work with Prudential to create and distribute a letter to plan participants.

APPROVAL OF JANUARY 27 MEETING MINUTES

This is deferred until the April 1, 2009 meeting.

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.

In the past Suntrust sent tax forms (1099R) that did not always properly reflect the tax status of all retirees. Some benefits were non-taxable but reported as taxable. As of December 2008 all benefits are non-taxable and the 1099R forms reflected this.

Staff reported that the unresolved administrative issues with Prudential discussed in January had been addressed. The issues were all either resolved or great progress had been made.

The Follow Up memo was distributed without comment.

COMMITTEE REPORTS

DISABILITY COMMITTEE
Mr. Tierney discussed the committee's effort to produce standardized procedures for the service connected and non-service connected disability application process. George McAndrews of the City Attorney's office is carefully reviewing the committee's work and is adding a lot to the process. The plan administrator will be the first to review the proposed guidelines.

BUYBACK COMMITTEE
Mr. Milner reported that the work of the Buyback Committee was to first determine the value that should have been provided by the participants' retirement plans prior to their transfer to the Police or Fire Departments. Then staff worked with Prudential to assure these amounts were provided or restored to the participants' defined contribution plan. This has been completed. The next step will be to do analogous work with the defined benefit plan (Supplemental Retirement Plan). Following this the committee may then review what steps if any are left to make the participants whole.

VALUATION & TECHNICAL CORRECTIONS COMMITTEE
Staff reported the bulk of the activity was focusing on the definitions of compensation and employee contributions so that practices and the plan document were consistent.

There were other efforts such as compliance with the H.E.A.R.T. Act. This passed through Congress not long ago and we have a year to include its provisions in our plan document. This provides benefits to those who are called to active military duty and do not return to City employment for reasons of death or disability.

TRAINING OPPORTUNITIES COMMITTEE
There was no report on this committee.

EXECUTIVE SESSION

This topic was deferred.

OLD BUSINESS

Mr. Tierney asked about a contract with Prudential. He also asked what remained in the way of data clean up with Prudential's records. Staff indicated the remaining data issues were smaller in number and the dollar amounts involved per person were also smaller than last year.

NEW BUSINESS

Mr. Jinks announced that this was his last meeting with the board. There was a restructuring. Finance and Pension Administration Division now reports to Bruce Johnson. Also, Risk Management will also report to Laura Triggs.

NEXT MEETING: APRIL 1, 2009, SISTER CITIES ROOM 1101

ADJOURNMENT

Handouts distributed in advance

- Agenda
- Minutes of January 27, 2009 meeting
- Private Money's Balancing Problem (excerpt from FORTUNE magazine November 24, 2008)
- Investment Performance Review Fourth Quarter 2008 Notes and Questions
- Retail-branded, sub-advised investment options - Prudential, December 2008
- Monthly Investment Report as of October 31, 2008
- Trusco Fourth Quarter 2008 Report
- Prudential Performance Results as of December 31, 2008
- Dahab December 2008 Performance Review
- Summary of Activity by Fund, Disability Component, December 31, 2008
- Summary of Activity by Fund, Pension Plan, December 31, 2008
- Follow Up Items

Handouts distributed during the meeting

- Dahab Associates – Private Equity Fund of Funds Manager Search
- Auda Private Equity
- Excerpt from Prudential's October 2008 report on domestic commercial real estate
- Altius Associates presentation
- Hamilton Lane Private Equity Fund VII
- Hamilton lane Secondary Fund II, L.P.