

Minutes of the Regular Monthly Meeting
Board of Trustees
Employees' Retirement System of the City of Norfolk
September 14, 2011

The regular monthly meeting of the Board of Trustees of the Employees' Retirement System of the City of Norfolk was held in the City Hall sixth floor conference room in the City of Norfolk, Virginia. The meeting began at 11:00 a.m. on Wednesday, September 14, 2011 with Chairperson, Stephanie A. Calliott presiding. The following was the result of the roll call:

Attending the Meeting

S.A. Calliott
C.R. Neikirk
E.G. Tucker
L.A. Bernert
K.W. Crowder
N.E. Nelson
Y.T. Allmond
S. Felton
M. D. Jones

Mary L.G. Nexsen, Deputy City Attorney as well as Darrell Hill and Melanie Purcell, Assistant City Managers, also attended the meeting.

The minutes for the meeting on August 10, 2011 were approved.

Prior to the meeting, Mrs. Fiona E. Liston (Cheiron) was provided questions on potential changes to the design of the Norfolk Employees' Retirement System (NERS) and what impact those might have on the future funding needs from the City. Mrs. Liston did mention that Cheiron is in the middle of working on the actuarial valuation as of July 2011 so she used last year's (FYE 2010) actuarial valuation results for the presentation today, and plans to have this year's valuation results completed in the next couple of months. Since the System's assets as of June 30, 2011 were available, the costs that were in the presentation were base on the actual current fiscal year return.

She addressed a number of possible scenarios. The Trustees asked Cheiron to review VRS' plan changes. They have a Plan I and now have a Plan II for new hires. Cheiron was asked to show what would happen if NERS made exactly the same Plan II changes. Other topics for discussion:

1. Information about the current Employees Retirement System, defined contribution plan, and VRS Plan II. The benefit provisions pros and cons, and funding projections were included in the presentation.
2. What if the City decided to make additional contributions over and above the Actuary calculations? How quickly could the unfunded liability be exhausted to remove the legacy costs of the current plan?
3. There was a question about what would be the impact of the overall funding if people in the current plan are given a choice of a defined contribution plan. That is for employees who are in the current plan, or choose a defined contribution plan.

Mrs. Liston provided the Trustees with a presentation book titled *Future Plan Design*. Attachment A is a chart from the presentation that shows accrual cost of VRS type changes.

Virginia Retirement System (VRS) has the rule of 90 or Social Security age for general employees. The rule of 90 means your age plus years of service must equal 90 before an employee can retire. VRS also provides automatic cost of living increases. They also have an additional benefit that is paid to public safety workers in VRS Plan I and Plan II of a monthly supplement. This is considered as a bridge between when an employee is eligible to retire, and is eligible for Social Security.

In Summary, Mrs. Liston said in designing a new plan, the goals of the City would need to be considered:

- Cost savings only?
 - Could expand 5% member contribution to current actives
- Provide portability to younger more mobile workforce?
 - Explore DC option, or add DC elements to the existing plan
- Provide substantial benefits to career employees who retire from the City?
 - Maintain DB plan
- Get out of the retirement business completely
 - Move all new hires to VRS

Mrs. Cheryl Xystros, Engagement Partner, and Mrs. Karen Bjune, Engagement Manager, of KPMG met with the Board to review the upcoming June 30, 2011 audit. Laszlo Schneider who has joined the client service team will be the engagement lead for this audit. She reviewed the following areas with the Board:

- KPMG Client Service Team
- Required Communications
- Risk Assessment
- Fraud Risk
- Audit Calendar
- Reports to be Issued

Mrs. Xystro said that since this is the first year that the employee contribution rate is in effect that KPMG will review the process from a compliant perspective. She concluded by saying that the meeting today allowed the Board the opportunity to address any issues or concerns with the auditors prior to the start of the engagement.

New Business

A. Application for vested service retirement:

Anne Marie Patterson, Active No. 22173, March 1, 2011, with no refund due.
[Courts]

Ronald T. Wakeham, Active No. 22940, October 1, 2011, with no refund due.
[Fire Rescue Services]

B. Applications for normal service retirement:

Mark H. Schneider, Active No. 21968, October 1, 2011, with no refund due.
[Executive]

Roderick S. Woolard, Active No. 27931, November 1, 2011, with no refund due.
[Development]

C. Recommendations by the Medical Board that the following be retired:

Kathryne P. Martin, Active No. 27590, October 1, 2011, with no refund due. This member requested ordinary disability retirement. [Police]

The Trustees approved Kathryne P. Martin for ordinary disability retirement with a medical evaluation in one year.

John Y. Richardson, Jr., Active No. 28365, October 1, 2011, with no refund due. This member requested ordinary disability retirement. [Law]

The Trustees approved John Y. Richardson, Jr. for ordinary disability retirement. No yearly medical evaluation is required.

D. Ordinary death:

Jerry Holton, Active No. 26190, death occurred February 3, 2011. Spouse elected monthly benefit of \$1,688.02.

James M. Proud, Active No. 25246, death occurred July 1, 2011. Spouse elected monthly benefit of \$508.42.

Patricia A. Byrd, Active No. 23158, death occurred August 1, 2011. Beneficiary due lump sum benefit of \$18,962.55.

E. Death of retired members:

Ida Bell, Ret. No. 2601, death occurred July 24, 2011. Spouse elected lump sum benefit of \$3,841.65.

F. Death of spouses:

Lahni P. Harshaw, Spouse No. 1001, death occurred June 15, 2011. No benefit payable.

The Board approved withdrawal of the following non-contributing members:

<u>Name of Member</u>	<u>Active Number</u>
Krystal Stevens	31591
Michael E. Thompson	31718
Andree Sadler	31845
Jason Arnette	32468
Antonina A. Macneish	32515
Scott Kephart	32668
Robert Frederick Casey	32739
Susan D. Ash	32765
Keesha N. Rodgers	32892
Tyeisha N. Clanton	32974
Gary Belmer	33096

Total Members - 11

The following report of payments from the Trust Fund received and filed:

Federal Express (1)	\$ 40.19
Baker's Crust (2)	137.53
City of Norfolk (3)	2,498.23
Cheiron, Inc. (4)	4,946.19
State Street Corporation (5)	19,715.17
Summit Strategies, Inc. (6)	45,420.33
Retirement Payroll (Payroll est. for September, 2011)	<u>5,830,000.00</u>
 Total	 <u>\$5,902,757.64</u>

- (1) Information sent to Cheiron, Inc.
- (2) Lunch served for Board Meeting - August 10, 2011
- (3) Balance due for administratvie expenses for FY 2011
- (4) Retainer Services - July, 2011
- (5) Custodial Services - June and July, 2011
- (6) Investment Consulting Services - July, August and September, 2011

Committee Reports

Administration and Planning:

Ms. Felton reported that the Committee did not have a meeting.

Investment Management:

The Investment Committee did not have a meeting.

Mrs. Jessica Portis of Summit Strategies, Inc. participated in the board meeting discussion on investments via conference call.

Mrs. Portis addressed several issues: One related to real estate since we are still in the queue for UBS. The question posed was whether or not the System has missed the bulk of the potential capital return for core real estate given the strong performance over the past year. As a follow up question, Mr. Neikirk wanted to know if Summit believed the System should withdraw from the queue. The following discussion ensued regarding core real estate and the System's targeted allocated.

Given that UBS has not called the System's money and the System has been in this queue over six months, the System has the ability to rescind its commitment without penalty. The only requirement is that UBS requires the System submit a request to rescind 60 days prior to the next date they are going to call funds. The next opportunity that UBS would have to call down capital is October 1, 2011; the System missed the window to rescind for this date. The next date UBS can call down capital is January 1, 2012, which means notification will be required by October 28, 2011 if the System would like to rescind its commitment. Mrs. Portis called UBS to inquire whether the Employees' Retirement System's \$16 million commitment will be called for October 1. It is more than likely that it will not be called as typically UBS provides a few weeks' notice to clients to raise funds. This is not 100% absolute but their belief is the chances are slim that they would call for October 1. If a decision is made to rescind, we would write a letter to our contact at UBS and they would make a modification to the subscription documents for either a full rescission or partial rescission. To date UBS has not had any clients rescind in terms of those that are in the queue.

There was an article in the Wall Street Journal that highlighted how many trophy properties in the real estate market had started to surge in market value over the last few years making them less attractive from a potential return perspective from a year to 18 months ago. The article pointed out that some public funds and other institutional investors were starting to focus on properties that need additional capital infusions in order to fix secure short-term leasing problems. To some degree, some of these institutional investors are abandoning core real estate, and moving into strategies which are more riskier such as value added real estate where you typically find lower leasing levels versus what you would find in core real estate. Also, some of the institutional investors were starting to reduce their commitments to commercial real estate.

Summit still likes real estate as a diversifier in the portfolio. They expect much lower returns than what was generated in the past. Mrs. Portis said one of the things Summit anticipated was there would be a surge in appreciation in 2010 and 2011 which would enhance returns beyond just the income return that is expected from core real estate. The reason is many of the property values had been over written down. Summit expects a good portion of return for 2011 and leading into early 2012 to be driven by appreciation. They feel the majority of the return that we are going to experience for most of 2012 is going to be income oriented. This is why Summit wanted real estate in the portfolio because of the income it generates. They expect somewhere in the neighborhood of 6% return next year for the asset class.

The UBS strategy is quite conservative relative to their peer group with a high occupancy level of 93%. They have a very low debt ratio percentage of 13% probably one of the lowest Summit has seen out of all the core real estate peers. UBS is an extremely patient investor

even though they have \$2.6 billion in the queue they have not been throwing money at properties in overheated areas. They have been waiting for the most attractive opportunities to present themselves. This is one of the reasons the System has remained in the queue for 13 months.

There are a couple of things the System can do if they are concerned about the valuations of real estate:

1. Slow the pace that the asset class is funded—we do not have to fund the entire 2 1/2% allocation at once.
2. Dollar cost average over a period time by enacting a partial rescission (assuming UBS does not call on October 1).

Summit still thinks that there should be real estate allocation in the portfolio and likes the weight of 5%. In recognition of how strong the asset class has performed, the dollar cost averaging method might be a solution.

Mr. Neikirk did say he thought it is a riskier entry point now than it was. He still believes in core real estate and questions the timing issue. From a fundamental point of view, there are more capital risks than there was before purely because these properties have risen in value. Mr. Bernert said since the decision to invest in real estate was based on a long-term allocation framework, and the allocation is small coupled with the pace at which UBS has drawn down capital should provide a level of protection. The strategy of high quality real estate core is as safe as anything else that is out there.

Summit has a few other clients who are in the same queue as the ERS, and they have not advocated any changes. It is a long-term investment. Over the course of 2008-2009, the UBS strategy was marked down approximately 40%, and the appreciation reported so far for 2010-2011 has been approximately 15%. There is still room for the other properties to appreciate.

PIMCO made some changes in terms of positioning to their portfolio. In the August Flash Report, their strategy lagged the benchmark quite a bit. There are a couple of reasons:

1. They had positioned the portfolio with a shorter duration than the benchmark. The reason for this they expected rates to rise after the end of Quantitative Easing II, and they also expected to have a bit of a surge in terms GDP growth on the back half of 2011. The portfolio was positioned with an overweight to investment grade credit, and PIMCO had exposure to non US debt (in particular emerging markets),
2. In the long-term they were concerned about rising rates and inflation so they had longer dated TIPS in the portfolio. This worked against them in the month of August as we saw US debt downgraded to AA+. There was concern regarding the deficit that there was a reaction in the fixed income market that really led to a flight to quality and in particular US treasuries that caused them to rally. Given that PIMCO had been underweight in this segment of the marketplace this was a detractor to performance.

PIMCO has since repositioned the portfolio and at the end of August, the duration was 5.74 years. They are 7/10ths of year longer than the Barclays Aggregate. They have extended the

duration of the portfolio. Mrs. Portis said she would provide a graphic that might be helpful to understand how duration has changed over the past year.

Mr. Bernert asked has Summit changed their view on PIMCO. Summit has not changed their view. PIMCO considered this a wrong call in terms of positioning the portfolio, and in recognition of new market data has changed the positioning of the portfolio. This is a good reminder that PIMCO is an active strategy. They will move the portfolio around. Going into 2008 they positioned their portfolio and did extremely well where many of the peers lagged. This was a call where they were relatively more aggressive than their peer group.

Mr. Neikirk reported on the fund's assets. He said August was a tough month on equities but the Plan assets are still within the target allocations. The total fund asset is at \$820.6 million. This is an approximately 78.4% funded status based on last year's actuarial liability. The fiscal-year-to-date return is (4.98%).

Mr. Kenneth Crowder informed the Trustees that he accepted an invitation for an all expense-paid trip that was extended to all Trustees from Robbins Geller Rudman & Dowd LLP, attorneys in San Francisco, California, a Plaintiffs law firm. The Ritz Carlton conference began the day after Labor Day and it was extremely informative. There were several distinguished speakers who gave their view on where the markets are, where we need to go, and where the world in terms of corporate dollars and pension plans are headed. The firm paid for Mr. Crowder's air travel, accommodations, entertainment, meals, limo service, etc. Mr. Crowder has since received a letter from Attorney Stephanie Schroder (San Diego) who was the host with the firm, and Attorney Etta Grace (Kentucky). They would like to come to Norfolk and make a 15 minute presentation to the Board about their services. He feels it would be a worthwhile presentation.

Ms. Calliott read the letter from Attorney Stephanie Schroder. They are a plaintiff securities class action firm that monitors others' investments for the purpose of clients recovering money that they are entitled to as a result of fraud. Ms. Calliott said they might be appropriate for the System if we were still in the business of having individual securities in our portfolio where we would need to know about the Enrons or Lehmans of the world who went out of business as a result of questionable accounting. Since we have a passive style and we use the index through the help of our investment consultant, their services were not appropriate for NERS.

Mr. Crowder asked that the Retirement Office staff respond to the letter stating the Trustees voted to decline the invitation on the presentation.

Mr. Wilder informed the Trustees that the Association of Municipal Retirement Systems Fall Meeting is sponsored by the City of Roanoke. The Trustee Training session is scheduled October 23-24, 2011. All trustees are invited, and as soon as he receives the agenda it will be forward to them. October 24-25, 2011 is the Administrative Meeting, and he asked the Trustees to approve his request to attend. He also asked the Trustees to approve Sheryl Potter-Griggs' attendance. The expense will include travel, registration, and hotel. Trustees approved the travel and expenses related to this trip.

Mr. Bernert stated that as related to invitations, Trustees never accept gifts, trips, or anything from vendors as a group. It is appropriate to attend educational conferences. If a trustee should accept a vendor's invitation the individual should pay for their own personal expenses. The trustees as a group should determine if a conference is feasible at the expense of the System.

Mr. Bernert gave the example, if there is a conference by a vendor of index funds or real estate funds, or if UBS was to have a conference and have their investors attend, then these might be acceptable, and the System would pay expense. Mr. Crowder did question as to why. Mr. Bernert said this eliminates any conflict of interest and reduces any possibility of making individual decisions that have been impacted by gifts received.

Mr. Bernert said that the Trustees should consider as a group putting a policy in place to institute a prohibition against accepting any type of gift, reimbursement of expenses, or anything that is related to a product. This is different from an educational conference. He also recommends that there be a caveat that the Chair, sub-committee, or Investment Committee could always approve something. There should be a process; otherwise, maybe unknowingly, it puts an individual at risk as someone who accepted something with the possibility of doing business. Trips should be approved case-by-case, and distinguish whether it is a System budget travel expense. Melanie Purcell said she has access to several policies. The Chair asked Melanie Purcell to pull some policies she had seen and submit to her.

Mr. Wilder informed the Trustees that he has decided to retire effective March 1, 2012. The Chair said that Trustees will work with Mr. Wilder as he transitions into retirement. The Trustees congratulated Mr. Wilder.

The next Retirement Board meeting is schedule for October 12, 2011 at 12:00 noon. There will not be an Investment Committee meeting.

There being no further business, the meeting adjourned at 1:48 p.m.

Chairperson

Executive Director