

POLICE & FIRE PENSION INVESTMENT BOARD

October 16, 2014

Summary Minutes

The information in these meeting minutes is intended to assist Police and Fire Pension members in understanding the activities of the Investment Board. The information is not intended to provide investment or financial advice to any individual or organization and should not be relied upon for that purpose. While we attempt to keep the content accurate we cannot guarantee that all information is current, accurate or complete.

Members present: Doug McDaniel – Human Resources Director (Board Chairman)
Mark Westphalen – Mayoral/Council Appointment
Gerry Finnegan – Mayoral/Council Appointment
Steve Niemeyer – Police Electee
Jeremy Gegg – Fire Electee
Steve Hubka – Finance Director

Human Resources
Staff: Paul Lutomski – Police and Fire Pension Officer

Others present: Dale Connors – Watershed Investment Consulting
Gary Radliff - Watershed Investment Consulting

Members Absent: Matt Franken – Police Electee
Guy Pinkman – Fire Electee
Becky Ferguson – Mayoral/Council Appointment

Unless otherwise noted, Watershed meeting materials were provided to Investment Board members in electronic format, or printed format, a few days preceding the meeting for their advance consideration. Printed copies of the materials were provided at the time of the meeting.

Watershed documents:
Performance as of September 30, 2014
Asset Allocation Review and Decision Guide
PE - FOF Small Buyout Search
PE - FOF Venture Capital Search

A quorum is any five Board members.

Doug McDaniel calls the meeting to order at 1 pm. Watershed Investment Consulting is asked to make their presentation.

Watershed passes out printed copies the “Monthly Performance Report for September 2014”.

The Monthly Performance report contains a balance sheet with individual investment figures, actual allocations vs target allocation, returns by month and YTD, gross and net of fees. Watershed reviews the details of the report summarizing that September was a declining month with approximately -2.3% net return. Almost all assets declined in value. Calendar YTD return is approximately 4%.

Using the Asset Allocation Decision Guide (6 pages) printed material as a basis Watershed discusses a concern about earning 7.5% given high equity valuations, low interest rates and the potential for rising rates, low real estate cap rates, slow global growth.

Dale Connors reviews their recommendations to date; improve risk/return by diversifying away from the stock market with real estate, hedge funds. Add private equity for return enhancement. Reduce interest rate sensitivity by adding floating rate debt. Next month we will review existing managers and suggest replacements to improve the probability to outperform passive benchmarks.

Markowitz mean variance optimization was used to create two efficient portfolios, one with current constraints and one with constraints expanded to include PE, Hedge Funds and more real estate. Model inputs, resultant allocation mixes, 20 year return forecasts and probability of attaining the return were described.

Mathematical and forecasting limitation of the model are discussed and a third portfolio is recommended which uses an allocation mix between the previous two:

| | Now | Recommended |
|----------------|-------|-------------|
| Global Equity | 63.5% | 55% |
| Fixed Income | 28.2% | 20% |
| Real estate | 8.0% | 15% |
| Hedge FOF | 0.0% | 5% |
| Private Equity | 0.3% | 5% |

Doug McDaniel leaves the meeting.

Board members ask several specific questions to Watershed with topics including style drift, volatility measures and frequency of measurements, fixed income return assumption. Watershed representatives answer questions.

Paul Lutomski passes out and read an email from Becky Ferguson stating she would vote in favor of Watershed’s recommended mix if she were in attendance.

Board members and staff ask Watershed questions about the recommended mix and PE managers, including the restriction on short selling circa 2008, downside protections, CALPERS selling hedge funds. Watershed representatives answer questions in detail.

Jeremy Gegg moves to approve the recommended allocation targets.

Steve Niemeyer seconds.

Board discusses allocation with clarification on percents and expresses Watershed has answered all questions satisfactorily.

5 members (a quorum) are in attendance.

In favor:

Jeremy Gegg
Steve Niemeyer
Gerry Finnergan
Steve Hubka

Against:

Mark Westphalen

Motion passes.

Doug McDaniel returns shortly after the vote at 1:46 and Paul Lutomski informs him of the vote.

Paul Lutomski asks that the Board consider Watershed's manager recommendations for the real estate increase before it considers Private Equity managers.

Dale Connors presents regarding Watershed's real estate recommendations including referring to page 6 of the Allocation Guide document detailing the real estate recommendation overall increase from 8% to 15% with Voya increased by 2.1% and RREEF America REIT II increased 6.1%.

Steve Niemeyer moves to approve Watershed's real estate manager recommendation.

Jeremy Gegg seconds.

Doug McDaniel calls for discussion. There is none.

All members vote in favor.

Jeremy Gegg states he just received a text from Guy Pinkman that he will not be attending the meeting because he is responding to a medical emergency.

Gary Radliff reviews the Private Equity pacing study. He recommends a buyout strategy be purchased first, and then a venture capital investment with eventual 70% buyout and 30% venture.

Using the booklet first distributed in September, Small Company PE buyout, he reviews PE buyout characteristics in general and details on four Fund-of-funds managers. Buyout firms under consideration were: FLAG Capital, Horsley Bridge, Private Advisors, and Siguler Guff. Specifics given on

each, Organization and Background, Management Team, Investment Strategy, Value Add Capabilities, Deal Flow/Sourcing. Historical Performance for each manager's past funds including years, fund size, number of partnerships, and net IRR. Comments include investment strategy that lead to performance. Board members ask specific questions and Watershed answers including an explanation of net IRR, EBITDA and Average fund duration as 12-15 years. Current offering of each manager listed in booklet and discussed.

Fee Structure of all four managers is contained in the booklet . The conversation begins to concentrate on Private Advisors and FLAG as they have funds available for current investment. Management Fee was 1% v. 0.75%, Preferred Return 8% v. 10%. The Investment Boards asks questions and Watershed answers.

Private Equity general partner's compensation comes from carried interest and management fees. Carried interest is the general partner's share of the profits of the investments made within a private equity fund. The preferred return is an annual return that the limited partners are entitled to before the general partners may begin receiving carried interest. European style waterfall means investor gets all capital back plus management fees before general partner receives carried interest. Limited partners entering after the initial close do not participate in creating the terms of the documents, and their money is potentially invested sooner. The Assets Under Management figures listed are on a firm level, not a fund level. The current FLAG fund is only buyout, not venture capital, but they do offer venture capital. Private Advisors is only small buyout. Discussion of benchmarks and objectives for this asset class. In the future, for Venture Capital, Horsley Bridge, is discussed.

Doug McDaniel asks if the Board is ready to make a motion.

Steve Niemeyer makes a motion to invest \$4.5 million into FLAG.

Doug McDaniel asks if there is a second to the motion.

Jeremy Gegg seconds the motion.

Doug McDaniel asks if there is further discussion. There being none, he asks for a vote.

All members vote in favor.

Dale Connors thanks the Board and states his intention to present a review of existing managers in the next Board meeting.

Doug McDaniel adjourns the meeting at 2:47 p.m.