# TUCSON SUPPLEMENTAL RETIREMENT SYSTEM
# BOARD OF TRUSTEES

**Meeting Minutes from October 24, 2008, 8:15 p.m.**

**Members Present:** Brian Bjorndhahl, Chairman
Kevin Larson, City Manager's Appointee
Frank Abeyta, Finance Director
Cindy Bezaury, Human Resources Director
John O'Hare, Employee Representative
Gage Andrews, Employee Representative
Paul Miner, Retiree Representative

**Staff Present:** Jacinta Figueroa, Board Counsel
Silvia Amparano, Deputy Finance Director
Joel Peterson, Risk Management Administrator
Allan Bentkowski, Investment Manager
Mike Hermanson, Retirement Manager
John Behrens, Investment Analyst
Doris Rentschler, Finance Analyst
Claire Beaubien, Administrative Assistant

**Guests Present:** Martha Durkin, City Attorney's Office
Debra Hillary, Deputy Human Resources Director
Jean Wilkins, CTRA Representative
Brandy Kadous, Employee Representative-Elect
Mark Klimek, Hewitt Investment Group
Rob Van Den Brink, Hewitt Investment Group
Jean Wilkins, City of Tucson Retirees Association Representative
Jesse Price, PIMCO
John Miller, PIMCO
Ann Cole, JP Morgan Asset Management
Jim Hutchinson, LaSalle Investment Management
Patrick O'Connor, University of Arizona

**Chairman Bjorndahl called the meeting to order at 8:31 a.m.**

1) **Consent Agenda**
   a. Approval of September 25, 2008 TSRS Board meeting minutes
   b. Service & Disability ratifications for October 2008
   c. June 30, 2008 TSRS Financials
   Cindy Bezaury **moved, seconded** by Gage Andrews, to approve the Consent Agenda. **Motion passed 7 to 0.**
2) **TSRS Budget**
   a. Review of changes for current FYE 6/30/09 budget
   Mike Hermanson gave an overview of the FY08 and FY09 budgets. He noted that the member and City contributions were projected revenue sources. He also noted that the Purchase of Service program is fairly unpredictable and was not budgeted to add much in prior year, but due to the End of Service Incentive and the Medical Benefits Incentive that ends at the end of 2010, there has been increased interest, with the plan year end '08 purchases totaling over $5 million. Service retirements are projected at $57 million in payments, according to the actuary. He reported that there would be no change in administrative expenses except for the costs to reconfigure the Pension Office at a cost of $15,000, caused by reorganization and relocating offices in City Hall. There was also an added expense of $75,000 for retaining outside counsel requested by the City Attorney's Office to assist with the plan document rewrite/update.

   Gage asked what the 902 line consists of. Mike responded that it is basically a balancing line because Retirement runs on a zero budget. Line 902 is used to balance negatives and positives coming in and going out of the department. John O'Hare asked what the 191 Line Item consists of and how are they allocated. Mike responded that those are charges that Accounting and Investments charge for their services to the pension system. For example, Allan charges our budget $51,000 for services provided by his division. John O'Hare commented on the 203 Line Item of Developmental Services, specifically that it is of primary importance for the new members of the board to attend a minimum of two conferences per year that are pertinent to fiduciary responsibilities. The consensus of the Board is that the in-house education provided at the Board meetings is adequate for their purposes, but their may be individual members that request more support for this, depending on their preference and available schedules.

b. Approval - Cindy Bezaury **moved, seconded** by John O'Hare to accept the budget changes as presented. **Motion passed 7 to 0.**
c. Review of FYE 6/30/10 budget - Mike commented that this budget is a rollover of FYE 6/30/09. The only increases are displayed on the Line Item 191. John O'Hare asked how many employees were now on the variable rate compared to on the fixed contribution fund. Mike responded that there were approximately 500-600 employees on the variable rate, which amounts to about 20% of total employees. He said the amount of employees on the variable rate has increased due to the attrition of people retiring and new employees added to the work force.
d. Approval - Gage Andrews **moved, seconded** by Cindy Bezaury, to adopt the FY2010 budget as presented. **Motion passed 7 to 0.**

**3) Actuarial Review Issues -**

a. Results of Valuation Analysis for plan year ended June 30, 2008 - Leslie Thompson reviewed the current valuation report, beginning with a comparison of 2007 and 2008 to explain the change in the recommended contribution rate. Contribution rates satisfy the sum of two types of costs: normal cost, from the actuarial present value of current benefits being accrued by members that are not yet retired, and the amortization of that cost over 15 years. The sum of these two costs results in the required contribution rate. For 2007, the contribution rate was 19.47% (normal 12.63%, amortization of 6.84%), and 2008's recommended contribution rate (effective July 1, 2009) is 22.13% (normal 12.69%, amortization of 9.44%). Leslie explained that while the total normal cost rate remains relatively stable, the amortization component can be more volatile, depending on the gains or losses on the unfunded accrued liability. Because investment shortfalls were significant, the unfunded accrued liability increased. The new contribution rate for employees paying a variable rate (those employees hired July 1, 2006 or later) is 8.852%, (up from 7.788% in the current year). Comment: the actuary's slides incorrectly stated new hires pay a maximum contribution rate of 7.5%, that limit was only applied during the initial year this policy was adopted.

b. Commentary on this year's valuation & review of sources for actuarial gains / losses - Leslie pointed out that last year's (6/30/07) funded ratio was 83.1%, and the current year's (6/30/08) funded ratio has dropped to 79.1% primarily due to investment losses. This ratio is a measurement of the funding progress of the pension system, determined by the ratio of the actuarial value of assets to the accrued liability of the plan. Each year, the funded ratio is affected by the gain/loss measurements from the change in accrued liabilities. It is a measure of the expected liabilities against the actual liabilities. The expected liabilities are developed from the actuarial assumptions that are updated through a regular review of experience vs. assumptions, called the experience study. The last experience study was for the five year period ending June 30, 2003. Mike asked Leslie if it is possible to include 2009's information and include that information in the experience study because of the asset value declines that began trending downward since October of 2007, and going negative at June 1st during this plan year. Leslie said that was indeed possible. Mike reminded the Board that Hewitt would be conducting the asset liability study in conjunction with the experience study being conducted by Leslie so it would be helpful to include the most recent information in both studies.

c. Recommended contribution rate for the plan year beginning July 1, 2009 - John O'Hare **moved, seconded** by Paul Miner, to accept the recommended contribution rate of 22.13% for Fiscal Year 2009 beginning July 1, 2009. Cindy Bezaury asked the Board if any board member would be interested in changing the amortization time to 20 or even 25 years instead of the 15 years the Board currently uses. She commented that the City is in dire straits currently and needed all the help it can get and if changing the amortization length would help, then it should be considered. Mike Hermanson commented on the long journey the system had gone through, moving from a 30 year declining rate down to 15 years, and that all the hard work of getting to a conservative approach would be lost if we changed now. Gage Andrews asked Leslie what, if any, difference changing the amortization length would make to the contribution rate. Leslie replied that her gut feeling was that it would lower the contribution rate from 22.13% to about 21%. Given time, she could provide an exact figure. Frank Abeyta said that he believed the current amortization was a good, sound method and he wouldn't recommend changing it. Jacinta Figueroa suggested that if the board was going to be considering changes that would affect the Plan, the issue should by thoroughly studied so that an informed decision can be made. However, if there were no changes going to be made to the Plan's policy, then the vote could continue. **Motion passed 7 to 0.**

d. Discussion of progress on TSRS unfunded actuarial accrued liability - Leslie said that when you have a gain from pay increases, that comes from salary rates increasing less than assumed. Therefore, in 2007 and 2008 there were actuarial gains because pay increases were less than the actuarial assumptions. From investment experience, there were gains in '06 and '07 but a loss in '08. Under the retiree mortality, there was an actuarial loss for all three years, telling us that retirees are living longer than the actuarial assumptions predicted. When the experience study is conducted, this will be looked at in more depth. Under the topic "other demographic" a loss for this year, due to the number of employees retiring was much higher than assumed. Leslie reminded the Board that actuarial losses are not costs to the system. There will be gains in future years to offset this year's losses because there won't be as many retiring in future years as assumed. There was a total loss of $50 million, due primarily to the success of the End of Service program driving higher than normal retirements.

   Leslie reported that the number of active members decreased by 75 from 3,326 to 3,251 or a 2.25% decrease. There was an early retirement incentive program in force during this valuation period and the number of members who entered the End of Service program was higher than actuarially anticipated. Payroll for active members decreased 3.3% for FY 2008. The average pay for active members decreased from $47,880 to $47,365, or a 1% decrease. The average age of active members is 45.7, compared to 46.2 last year. This occurs when many older members retire and are replaced by young members. The average years of service attained is 10.6 for this year, compared to 11.4 last year.

   The number of members in payment status (retirees) increased by 289, from 2,018 to 2,307. These numbers include service retirees and beneficiaries receiving benefits. The average annual retiree benefit for all retirees is $21,452, compared to $19,764 last year. This is a growth of 8.5% in the average annual retiree benefit, up from the prior year's increase of 5.8%. Leslie reported that the fair market value of the system's assets decreased from $696 million to $650 million. On the other hand, actuarial value increased from $635 million to $650 million. Mike asked why there was nothing left to smooth with gains in the last three years and a loss this year. Leslie replied that the loss from this year completely offset gains realized in previous years. Those gains just cushioned the loss this year so that the rate of return on an actuarial value basis was 4.45% instead of the assumed 7.75%.

   All actuarial calculations are based on actuarial value of assets, not market value. The actuarial value is now $650 million compared to $635 million last year. The actuarial return was 4.45% for FY 2008, compared to 11.27% in FY 2007. The unfunded actuarial accrued liability increased from $129 million to $172 million. The funded ratio decreased from 83.1% to 79.1% (the actuarial assets divided by actuarial accrued liability). Leslie cautioned the Board to not make "knee-jerk" reactions to impermanent conditions.

e. Plan design consideration - permanent change to code for rule of 75, and Tucson City Code 22-50 - Mike reminded the Board that during the past 10 month's, a temporary "relaxed" rule of 75 was used as a retirement incentive strategy, employed with an actuarially neutral reduction to benefits for anyone retiring early. As this strategy was rolled out months ago, staff asked our actuary if the current formula for calculating the early retirement benefits was actuarially neutral to the Plan, and the board asked that this issue be discussed at the annual retreat. Our code has historically defined rule of 75, requiring participants to be a minimum age 55 with a minimum 20 years of service; and the current reduction formula is .05% percent per month shy of magic 80 or a maximum 30% reduction. Mike circulated a chart describing the kind of reduction for the calculation for the actuarially neutral formula. Mike suggested that there were three options for the Board to consider: 1) do nothing and leave the calculation in place as written currently but is not widely used; 2) add the rule of 75 as an addition to flexibility with a higher reduction and is actuarially neutral to the system, or 3) use both the current age 55 with 20 years of service and the temporary rule of 75 that has no age requirement but a combination of age and service equals 75. Leslie commented that this question is being debated nationwide. She suggests that there are two policy pieces. The first is the opportunity to retire early and the second is if the Plan will pay a subsidy to people who choose to retire early. Mike revised his question to the Board to should the Rule of 75 (age 55 plus 20 years of service) be replaced with the revised Rule of 75 (any combination of age and service to equal 75). Gage Andrews **moved, seconded** by Paul Miner, to defer consideration of the actuarial neutral Rule of 75 until the experience study and the asset liability study is completed or to February, 2009 meeting. **Motion passed 7 to 0.**

f. Report on ASRS costs to transfer service credits to/from TSRS - Leslie reported that the study is not complete because of recent changes made by ASRS in the way they calculate costs. This become known just before the report was completed, causing a delay in the final analysis. Regardless of the report findings, the Board will ultimately have to consider how closely the equivalence of each plan will be to the other. Doris Rentschler remarked that the way the law reads that we can charge the actuarial cost to provide the benefit in our system. Leslie concluded that these discrepancies exist because ASRS uses different actuarial assumptions, from our Plan.

g. 3 year forecast of contribution rates, assuming lower investment returns, normal # of retirements - Leslie had provided a 10 year analysis, (topic was touched on earlier), using a 6% investment return for the first 3 years, returning to an assumed 7.75% return for the following 7 years. Gage asked if Leslie could return in December, adding 0%, -10% and -20% returns for this year followed by normal returns.

**4) PIMCO – Annual Investment manager review for StocksPlus, Custom Fixed Income Fund**

Jessie Price and John Miller thanked the Board for the opportunity to give their annual report. John Miller replaces Scott Roney as account manager. John is an Executive Vice President dedicated to Public Institutions.

Jessie reported that the third quarter was challenging, the worst September experienced in the last 20 years, with October performance not much better. Their performance was down 7%, underperforming the benchmark by 600 basis points. However, as of June 30, 2008, they outperformed the benchmark by 100 basis points, which is consistent with their performance annually. The StocksPlus portfolio had similar returns. The underperformance resulted from the poor market in September. The investment community was driven by panic overall. John commented that over the past ten years, if they experienced a quarter where they underperformed by 600 basis points and had to report to one of their clients why this occurred, they would be panicking themselves. Right now, there are numerous disconnects in the financial markets that are unprecedented. Inflation is anticipated over the next 30 years to be under 1%. John reported that high yield fixed income portfolios are yielding 13.5% over treasury bonds. This has gone beyond fundamentals, causing a de-leveraging effect.

Jessie commented that what they are seeing is a systemic, coordinated, massive de-leveraging of capital globally. That means companies are selling assets purchased with borrowed money to raise cash to meet margin calls. The companies are lowering their debt ratio, which of itself is not a bad thing, but when everyone does it simultaneously, it can create downward pressure on asset prices, causing massive dislocations to fundamentals. For example, there are three options open to homeowners to meet their liabilities: they can refinance, tapping into the equity of the home, to meet their needs – but this option is no longer available. The second option is to sell the asset, payoff their mortgage outright - but unfortunately, asset prices have declined now so they aren't getting the true value of their asset and thus are unable to payoff their liability. The third option is foreclosure - 750,000 households have gone into foreclosures in the third quarter, an annual rate of 3 million households. The same is true for financial institutions. An example of that is Bear & Stearns; they purchased their assets with borrowed capital and now need to raise money to pay their margin calls. Unfortunately, their assets are no longer worth what they paid for them so they have to raise more money elsewhere in order to meet the margin calls. If they aren't able to raise the necessary funds, they face bankruptcy, much like the homeowners are facing foreclosure. This phenomenon happened to Lehman Brothers, as well. John Miller commented that they are experiencing moving away from fundamentals and towards selling at all costs. He said that spreads and subsequent prices are difficult to assess given bankruptcies, bailouts and takeovers. The dramatic widening of GNMA spreads is a reflection of the market's lack of liquidity.

John remarked that the reason for the underperformance of our portfolio was due, in part, was in the first quarter of 2008, when they had a very defensive position, and began to allocate to sectors like the financials. They did this because valuations were very attractive, capital was flowing into that sector and they felt the government was a final backstop insuring that the banking system would not go under. Clearly, they were too early with their allocations, hurting the performance of the portfolio. The macro framework they use has helped the portfolio. However, their holdings in certain companies were not backed by the government, such as an allocation to Lehman brothers. Even still, they believe that the institutions they hold now are price impaired, not credit impaired. The turnaround will not happen overnight but they do believe there will be a rebound. John asked the Board to be patient for the recovery, because their performance is not normal for them and they don't expect their performance to remain below the benchmark. Allan Bentkowski asked Jessie and John what would have happened if the government hadn't bailed out the financial institutions. John answered if they hadn't stepped in to bailout those institutions, there would have been a total freezing of the capital markets, which almost occurred following the Lehman bankruptcy. By stepping in, they are doing things to help the liquidity of the market. John commented that the economy is not in a good shape from a growth perspective over the next six to eight quarters.

Kevin Larson asked John why their performance was so poor compared to the index which was basically flat. John replied that 70% of the index securities were agency mortgage backed securities. The major reason for underperformance was caused by the movement to financials back in the first quarter. Financials underperformed by 30%. Chairman Bjorndahl asked Jessie if it was a mistake getting into Lehman Brothers thinking that government would back them or was it something they couldn't foresee that they would have a liquidity problem. John answered that when they looked at financials as a whole, they were very attractive. Then they had to decide which financials they were going to get into. Lehman looked like a strong player with large capitalizations. They were definitely convinced that the government would back them even if they were wrong. Because Lehman failed, there is a lack of trust in all financials now. Mark Klimek asked how much of their portfolio was allocated to Lehman. Jessie replied about 200 basis points of the loss was due to Lehman Brothers. Mark asked what percentage of the portfolio is broken down into agency mortgage backed securities, credit and high yield securities. John replied that about 85% of the portfolio is agency mortgage backed securities, about 10% in investment grade credit and 5% in high yield.

**5) JP Morgan - Annual Investment Mgr. Reviews – Income & Growth Fund, Strategic Property Fund**

Chairman Bjorndahl turned the meeting over to Ann Cole from JP Morgan. Ann went over the various managers who control our investments. Anne Pfeiffer managers the Strategic Property Fund and Michael Giliberto manages the U.S. Real Estate Income and Growth Fund. She mentioned that Jim Walsh is in asset management and has 28 years of experience, mostly with JPMorgan. Ellie Kerr has 25 years of experience and has also gone through difficult times like we are going through currently. As of September 30th, TSRS had $36 million invested in the Strategic Property Fund. She reported that since inception, the total annualized return has been 12%. The three month total return (ending September 30th) was -1.2%. For the Income & Growth Fund, the Net Total Return as of 9/30/08 was -2.7%. Their return since inception was 9.5%. The Income & Growth Fund doesn't have a benchmark to which it can be compared. Their target return for this fund is 8 – 10% net.

The Strategic Property Fund is a Core Real Estate Fund. They invest in office buildings, industrial buildings, retail facilities and warehouse industrial facilities. They do not invest in assisted living facilities, student housing or storage facilities. They buy the highest quality available, with strong demographics, holding facilities for 5 to 10 years. They focus on long-term financing with a fixed interest rate. The portfolio is widely diversified over the four main sectors. They are underweight in industrials which was good since industrials were soft in the first few quarters. Their retail holdings include fortress malls and grocery anchors. This portfolio is geographically diversified, as well. There is no one geographical sector that is weighted higher than others which is favorable to the portfolio. Over the past two years, they have generated over $1.8 billion in net sales proceeds. Mark Klimek asked Ann if there are any requests for redemption of assets due to liquidity issues. Ann replied that through the third quarter, they have a redemption queue that amounts to $650 million. Most of these requests are for rebalancing. 78% of the investors choose to re-invest their capital.

Ann reported that the Income and Growth Fund seeks to provide income and capital appreciation while preserving capital value by investing in a diversified portfolio of income-oriented U.S. real estate assets. The portfolio is diversified by investment type, geographic region, property type, borrower and tenant. They put their emphasis on current income with opportunity to achieve capital appreciation. This portfolio seeks moderate volatility and low correlation with financial assets. Kevin asked Ann if they expect to outperform the Strategic Property Fund. Ann replied they do indeed expect to outperform the Strategic Property Fund.

The third quarter return for this product was a -2.6%. Spreading economic weakness was reflected in lowered expectations about future cash flows. Discount and cap rates continued to rise, resulting in a negative return in direct property. Negative factors affecting private markets also affected values of securities, resulting in a -.65 return on REITS. Yields were relatively stable, but reduced asset values and debt service coverage produced write downs resulting in a return of -.9% for Mezzanine Debt.

Ann reported that debts maturing for 2008 are $0, $60.7 million in 2009 and $77.8 million in 2010. This strategy invests in high occupancy, low rollover and below market in place contract rents.

**6) LaSalle - Annual Investment manager Review – Fund IV - Income & Growth**

Jim Hutchinson gave a brief overview of the fund. He reminded the Board that the Income & Growth Fund IV is a closed fund. This fund invests in office, retail, industrial and apartment properties throughout the U.S. Approximately half of the portfolio is invested in apartment properties with good occupancy. Fund IV is nearing a fully funded status, lacking approximately $200,000. Returns for this portfolio are at -.2% for the quarter, but since inception, the returns are 9.6%. He said that depreciation will be slight over the next 12 months. Apartment properties generally meet or exceed their expectations except in Florida. Jim reported that industrial leasing has slowed. Their investment in a Central Florida Multifamily portfolio is their one underperforming property. The total return on this property since inception is -11% from the purchase price. For the current quarter, the total return was -20.3%. Since inception, occupancy has been down approximately 10%. An example of an outperforming property is the Gulf Coast Multifamily portfolio. Their total return since inception is 31.9% and for the current quarter the total return is .2%. Their occupancy is up to 97% as of June 30, 2008. This portfolio has no debt maturing until 2011. This portfolio financing is in good shape. Kevin asked if Jim had an estimate of what their return would be over the next year. Jim replied he expected no growth in value over the next 12 months. Duration of this investment is expected to be approximately 7 to 8 years.

**7) Disability Retirement Applications***

a. June Parks - John O'Hare **moved, seconded** by Gage Andrews, to move into Executive Session. **Motion passed 7 to 0.** Gage Andrews **moved, seconded** by John O'Hare, to move out of Executive Session. **Motion passed 7 to 0.** John O'Hare **moved, seconded by Gage Andrews,** to approve the disability retirement for Ms. Parks. **Motion passed 7 to 0.**

**8) JP Morgan / LaSalle Panel Discussion**

Ann Cole and Jim Hutchinson gave an overview of the Real Estate market. Ann remarked that we are in a mild market recession that has turned excessive leverage into a crisis. She said that property fundamentals are broadly holding up but will weaken sharply in coming quarters. She said that the market expects defaults and serious delinquencies to rise. Property yield spreads to Treasuries are up sharply. The spreads are expected to widen in the next 12 months.

Liquidity has not disappeared, she reports, but it is way down. Private real estate market trading volume is declining rapidly, near 0 transactions by September, 2008. It is expected to come back up to near 2004-2005 rate of transactions. Mike asked Ann if that thwarted their selling process where property values have devalued. Ann replied that they are receiving few or no bidders currently. Allan asked if there would be differences in strategies between a closed-end and open-end funds. Jim responded that the closed-end fund would be different because they don't have the flexibility of holding properties indefinitely. Jim said that he doesn't have queues of people wanting to get money out of their investment.

Ann pointed out that the difference between residential and commercial real estate was remarkable between March 2006 and September 2008. The residential real estate market bubble started to burst in

September 2007 and is now on a par with the commercial real estate. Commercial real estate has depreciated 20% over the past year.

One important takeaway is that the core price reset will be relatively modest due to ok fundamentals, worse than 2001 but better than 1991. Also, investors will ultimately prefer illiquid but transparent income producing properties to more liquid but opaque structured products. Retail center sales will soften most in discretionary retail in types/locations with few supply constraints. Multifamily rentals will face increasing pressure from empty for-sale homes and condos. Ann thinks property operating growth will turn negative in 2009 but not sharply so.

Mark asked what Ann or Jim saw in the commercial market because the dollar has strengthened. Jim answered that there is very little interest from foreign buyers. There is some interest in single family dwellings but nothing in the commercial market. Ann said that the U.S. will likely come out of the recession before the Europeans do. Rob asked where the most attractive investment is. Ann answered from a real estate perspective, distressed debt is a good place to invest. However, she believes there are opportunities across the board. Kevin asked about their forecast for the Arizona market, either Tucson or Phoenix. Ann replied that they have some properties in Phoenix but they don't expect much growth in that market.

**9) Fiduciary Responsibility Discussion – Jacinta Figueroa**

Jacinta Figueroa introduced herself to the Board. She formerly worked for a 401(k) plan and expressed a passion on the subject of fiduciary responsibilities. The Arizona Revised Statutes, Title 38 governs standard of conduct, conflicts of interest and prohibited acts. The Tucson City Code, Chapter 22 also provides guidelines for administration and membership, actuarial investigations and valuations, prohibited interest and powers and duties. Those trustees who are responsible for discretionary control over plan management or disposition of plan assets are fiduciaries. Also, those who have discretionary authority with respect to the administration of the plan are fiduciaries. An employee benefit plan must be operated for the exclusive purpose of providing benefits to the plan's participants and their beneficiaries, while avoiding prohibited transactions that are not for the exclusive benefit of the participants. Jacinta went on to explain that the prudent "person" standard is defined as a person who operates with care, skill, prudence and diligence under circumstances that a prudent "person" acting in a like capacity and familiar with such matters would use. Jacinta explained that a prudent investor has a duty to the beneficiaries to invest and manage the funds of the trust as a prudent investor would, in light of the purposes, terms, distribution requirements, and other circumstances of the trust. Finally, the fiduciaries act within the provisions of the plan document, ensuring that plan document reflects current legislation and operations are consistent.

Jacinta also outlined a checklist for the investment policy statement and items that need to be included in that statement. These items include statement and objectives, roles and responsibilities, fund selection criteria, ongoing monitoring standards, "watch list" criteria/procedures and a method of comparing actual funds compared to benchmarks and peer groups.

In order to be a qualified trust, there must be a plan document that is in accordance with the rules of the Internal Revenue Code. Jacinta is currently working with staff to ensure that any/all rewrites will be done before meeting with the outside counsel. Jacinta reported that any significant changes to plan document will require obtaining a determination letter. Jacinta commented that the summary plan description needs to be distributed to all participants and beneficiaries. This means that it should be available on the intranet, internet or by mail.

Another fiduciary responsibility is monitoring fees and expenses of the plan. The board needs to review and compare fee structures to ensure complete understanding of all cost and services. They also need to review incurred costs that are reasonable in amount and appropriate as to investment responsibilities. The board also needs to ensure proper and competent administration of the system in retaining consultants, attorneys, actuaries and technical advisors. Review of the budget for administrative operating cost, audits and provide education and training for staff and trustees.

Kevin asked in there was insurance to cover the Board and their fiduciary responsibilities. Joel Peterson responded that the City insurance does not include those members of the Board whose job does not require them to be on the Board. Leslie suggested that a fiduciary liability insurance policy would be a good idea to pursue. The Board asked Joel to ask the City broker for a ball park figure for a policy.

Brandy Kadous asked what the timeline was for hiring an outside counsel. Jacinta responded that due to efforts required for rewriting the plan document, an outside attorney has already been retained. Her name is Cassie Langford and she does work on the City of Phoenix pension plan. She reported that there is a special meeting planned for November 10 to meet the outside attorney and to review the plan document rewrites. The contract to retain outside counsel was written by the City Attorney which is governed by Charter.

Finally, in light of what has been learned from our valuation report and from event occurring in the financial markets, Jacinta recommended that the Board reconsider the 13$^{th}$ check previously approved by the Board in August. Since, at the time the decision was made, there was no visibility to the actuarial valuation and other significant economic events. The ordinance has been drafted but it has not been scheduled for Mayor & Council approval. She recommended that this topic should be discussed at the next Board meeting.

**10) Investment Activity / Status Report**

a. TSRS portfolio composition, transactions and individual investments, securities lending summary thru 8/31/08 and performance by manager for the quarter ending 9/30/08 - Allan Bentkowski began reporting that the total fund balance was $577 million as of 9/30/08. To put this total in perspective, he provided a timeline: on 6/30/08 the total fund balance was $650 million, on 8/31/08 the total fund balance was $637 million, on 9/30/08 the total fund balance was $577 million and at 10/23/08 the total fund balance was $502 million. Allan reported that, due to the addition of the infrastructure accounts, some changes in investment policy target allocations were made. Alliance was changed from 13% to 11%, Fidelity (Pyramis) was changed from 6% to 5%, and the in-house Fixed income account was changed from 10% to 8%. Due to liquidity needs, on September 11$^{th}$, $2 million was moved from the in-house fixed income investments to the City's fund 72 (pension) account.

Allan reviewed the calendar year to date returns. The total return for September was -9.13% versus the benchmark of -7.07%. Calendar year to date returns were -16.41% versus -12.98% for the benchmark. Total fixed income was -4.64% versus .63% for the benchmark. Total equities had a calendar year-to-date return of -23.61% versus the composite return of -20.54%. Real estate had a total calendar year-to-date of -.90% versus the benchmark of 5.45%. Allan reported that net earnings for securities lending was a little over $30,000 and the custodial fees was nearly $47,000 through 8/31/08. Mike asked Allan if the Plan was taking any risk exposure on securities lending. Allan replied that we were taking some risk exposure, about $199,000 in realized losses due to one security with ties to Lehman Brothers. Mike asked if it might be a good idea to discontinue the securities lending, at least for a short time. John O'Hare asked how much did the plan realize in profits on the securities lending for this past year. Allan replied he thought it was around $173,000. John asked how much of the $199,000 would be recovered. Allan replied he was given an estimate between .10 and .15 on the dollar for this particular investment. Gage Andrews **moved, seconded** by John O'Hare to suspend the Securities Lending in terms of winding down with no new activity until further notice. **Motion passed 7 to 0.**

b. Hewitt Associates – TSRS performance update for 3$^{rd}$ Qtr. of 2008 - Mark Klimek presented the 3$^{rd}$ quarter update on the fund's position currently. The only "place to hide" was in Treasuries, which in recent history is totally unprecedented. Mark reported that all of the class allocations were hurt by the market. The S&P was down to 37%, the international markets are down 57%. Sometimes referred to as the "fear index", the Volatility Index (VIX) measures the implied volatility of the S&P 500 Index. Mark remarked that a crucial cause of the current crisis is the very easy monetary policy adopted following the turmoil of 2000-2001. Real U.S. short term interest rates were maintained at negative levels for several years. This caused borrowing to soar and created enormous leverage in the system, much of it relating to U.S. mortgages with a meaningful portion considered to be of dubious quality. The search for yield by investors led to loans being repacked into opaque products, and the lending boom went well beyond the banking sector. When the excess of the U.S. housing market and private equity boom started to unwind, it was exceptionally difficult to establish the value of the assets underlying the debt and also who owned the underlying assets. The ensuring collapse in confidence meant that banks would only lend to each other at very high rates, if at all, as illustrated by the difference between this rate and the rates available on government paper. This led to the inability of huge and previously respected financial organizations (e.g. Lehman and AIG) to maintain adequate liquidity, which lead to doubts over the solvency of some of these institutions.

There remains a tremendous amount of uncertainty in the markets. Market participants and observers are closely watching whether the concerted efforts of governments and central banks will help alleviate the tensions evident in asset markets worldwide. Mark remarked that the current period ranks with the 1973-74 period and the depression (1929-1931) as having the worst financial stock returns.

c. Comments on investment manager performance - Mark reported that PIMCO StocksPlus and Barclays Alpha Tilts trailed their benchmarks. Friess Large Cap was down -28.46% versus -12.33% for the benchmark. This was because of their exposure to Information technology. The worst place to be was oil and the best place to be in the 3rd quarter was financials. Bottom line, the plan composite reported a return year to date through 10/17/08 of -10.86% versus the custom index of -6.93%.

11) **Investment Policy – follow-up from Special Meeting / Approval** - Cindy Bezaury **moved, seconded** by Kevin Larson to accept the investment policy as presented. **Motion passed 7 to 0.**

12) **Asset Liability Study – follow-up from Special Meeting / Approval** - Rob followed up on the meeting of 10/23/08 where he asked the Board members to complete a survey so that they can a good idea about how the Board feels about their degree of risk acceptance. Mike suggested that the Board members return their survey responses back to Allan to compile and send back to Hewitt.

13) **Actuarial Experience Study - Planning Discussion** - Leslie stated that the Experience Study is both art and science. She also wanted to determine which asset valuation method should be used. This will be discussed at the February, 2009 meeting.

14) **Status of Congressional Legislative Activity - Jacinta Figueroa** - Jacinta remarked that there is a listing included in the Board packet, showing the number of issues affecting retirement benefits that the Internal Revenue Service is currently working on. The list is quite extensive.

15) **Investment Advisory Council - consideration of ordinance change** - Gage gave an overview of what is being discussed currently. Gage would like to see outside people brought in to advise the Board regarding investment information. Jacinta advised the Board that revisions are being made to the Plan document that include a draft of this section, simplifying the code to made it easy to administer. Making this section overly descriptive is not recommended, since the board can be held to all the standards written. This will be discussed at a later date in more detail.

16) **Recommended Practices written during 2008** – A new recommended practice (RP) written by the CORBA committee that Mike works on at the GFOA was included in the board booklets. This RP entitled: Funding of Public Employee Retirement Systems was provided for the Board's information.

17) **Call to Audience** - none heard.

18) **Future Agenda Items**
    - Actuary projections on sensitivity of contribution rates, assuming investment returns of 0%, -10% and -20% - for December
    - ASRS / TSRS service purchase study report to be discussed in December
    - Actuarial neutral Rule of 75 – February, 2009 meeting, or when the Experience study is complete
    - Additional discussion of the 13th check previously approved – November meeting
    - Types of asset valuation methods to be considered at February, 2009

19) **Adjournment** - Gage Andrews **moved, seconded** by Cindy Bezaury to adjourn the meeting. **Motion passed 7 to 0.** Meeting adjourned 4:45 p.m.

Approved:

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| Brian Bjorndahl, Chairman | Date | Michael Hermanson,<br>Retirement Manager | Date |