THE BOARD OF PENSIONS AND RETIREMENT
INVESTMENT COMMITTEE MEETING
January 23, 2014

MEETING MINUTES

There being a quorum, Rob Dubow, Board Chair, called the Investment Committee Meeting to order at 9:55 a.m., in the Board Conference Room, 2 Penn Center Plaza, 16th Floor.

Present:

Rob Dubow, Finance Director
Paula Weiss, Esquire, Alternate, Deputy Director of Finance
Alan Butkovitz, Esquire, City Controller
William Rubin, Alternate, First Deputy City Controller
James Leonard, Esquire, Alternate, Chief Deputy City Solicitor
Brian Albert, Alternate, Deputy Human Resources Director
Celia O'Leary, Alternate, Deputy Director of Human Resources
Ronald Stagliano, Employee Trustee
Andrew P. Thomas, Employee Trustee
Veronica M. Pankey, Employee Trustee
Folasade Olanipekun-Lewis, City Council Designee

Francis X. Bielli, Esquire, Executive Director
Mark J. Murphy, Deputy Executive Director
Sumit Handa, Esquire, Chief Investment Officer
Brad Woolworth, Deputy Chief Investment Officer
Christopher DiFusco, Esquire, Director of Investment
Dominique A. Cherry, Investment Officer
Daniel Falkowski, Investment Officer

Also Attending:

Jo Rosenberger Altman, Esquire, Divisional Deputy City Solicitor
Katherine Mastrobuoni, Esquire, Assistant City Solicitor
Daina Stanford, Administrative Assistant
Carmen Heyward, Clerk Stenographer II
Donna Darby, Clerk Stenographer II
Steven Nesbitt, Cliffwater
Jacob Walthour, Cliffwater
Chris Rice-Shepherd, Cliffwater
Jean Feely, Cliffwater
Robert O'Donnell, Esquire, O'Donnell Associates
Raymond Jackson, Franklin Park

Gregory Kinczewski, Marco Consulting Group
Maureen O'Brien, Marco Consulting Group
Will Greene, Loop Capital
Charles Jones, COP

Agenda Item #1 – Approval of Minutes of December 5, 2013

Mr. Dubow called to order the Investment Committee meeting for January 23, 2014.

Mr. Dubow requested a motion to approve the Minutes of December 5, 2013.

Mr. Albert made the motion. Mr. Stagliano seconded it. All were in favor with the exception of one abstention by William Rubin. There were no oppositions. The motion passed.

Agenda Item #2 – Independence Fund Guidelines

Mr. Woolworth presented the proposed revisions to the Independence Fund guidelines to reflect current market conditions in light of the additional $100 million allocation to the Independence Fund in August of 2013. He said Staff wanted the ability to have increased diversification within the guidelines by allowing for a greater number of positions. The Independence Fund has both long and short positions. When the guidelines were originally written, the focus was more on the long positions. Staff would like to have the flexibility in the guidelines to have a range of 10 to 50 positions versus 10 to 25 positions.

The way the Independence Fund is structured, leverage is not allowed. This means that both the long and short positions can only add up to 100%. The typical hedge fund structure has “implied leverage” by having the ability to go up to 100% long and 100% short. As such, the Independence Fund is very conservatively invested.

Mr. Dubow asked Mr. Woolworth about the proposed change to increase the maximum sector allocation from 20% to 25%. He wanted to know if there would be a circumstance where they would go over 25%.

Mr. Woolworth stated that the largest current single sector concentration was approximately 17% when accounting for both the long and short positions. Staff would like to keep the sector concentration at or below 20%, but would need the flexibility for positions to move above the 20% level during times of market dislocation. Having the 25% single sector concentration limit allows Staff to keep single sector allocations in the 15% to 20% range on a normal basis with some headroom in the event that equity markets change value in other parts of the portfolio that then move a single sector allocation above the 20% mark. The higher allocation would be a good buffer to prevent forced selling during market dislocations because of concentration limits.

Mr. Dubow requested a motion to adopt the guidelines as amended. Mr. Rubin made a motion and Mr. Staglinao seconded it. All were in favor with the exception of one abstention by Veronica Pankey. There were no oppositions. The motion passed.

Agenda Item #3 – Performance Review – Kynikos Opportunity Fund

Mr. Handa stated that at a previous Board meeting Trustees had requested a review of hedge fund manager Kynikos. Kynikos is a short bias hedge fund. In 2011, at the Board's request, Staff began seeking out strategies that could provide a level of protection for the Plan during times of market stress. As a result, Staff and Cliffwater recommended the creation of the Independence Fund and hired Kynikos, both of which are strategies designed to act as a hedge during market downturns.

The performance of Kynikos has been challenged and some of the reasons are highlighted in Cliffwater's report. The primary detractor of performance for Kynikos has been the current macro-economic environment. The accommodative policies of the Fed have resulted in unprecedented low interest rates over the last five years. The Fed has only now started the process of pulling back on these policies by slowing tapering bond purchases. When you're a short biased fund, and your positions are in high beta stocks, some of which are trading at 300 to 400 times earnings and you short them, it can be very painful when the markets go the other way. Kynikos was involved in shorting two positions last year; both stock values were up 300% or more. Mr. Handa and Staff have studied both companies and believe there is a real possibility that the companies have significant accounting irregularities that will, at some point, likely cause the valuations to drop substantially. However, when the broader markets see appreciation of 30% or more during a single year, even companies with bad balance sheets can go up in value.

Mr. James Chanos, who runs Kynikos, has counseled Staff for the last two and a half years and has provided an unprecedented amount of research. When you look at the Plan's strategic allocations on the flash report, it is a result of this research and counsel. This has resulted in the Plan being overweight U.S. equities which was a very good decision for the portfolio in 2013. The reason why the Plan has been underweight strategies that underperformed, such as international and emerging equities, is a direct result of the research and counsel Staff has received from Kynikos.

Mr. Dubow expressed concern and asked Mr. Handa to talk about poor stock selection in the manager's short positions, a supposed strength of the firm that detracted from performance.

Mr. Handa stated there are three companies in the Kynikos portfolio that you can call poor stock selection that were up 300% or more last year when Kynikos was short. All three, in his opinion, are potentially accounting frauds.

Mr. Dubow asked Mr. Handa if those stock selections will play out in the long run.

Mr. Handa stated he believed they will play out.

Mr. Bielli asked Mr. Nesbitt does he concur with what Mr. Handa said concerning the poor stock selection and that inevitably they should turn around if they are encountering fraud situations.

Mr. Nesbitt replied he can't say the companies will inevitably turnaround, but in all likelihood they will. He said he would echo all of Mr. Handa's comments and Cliffwater believes it would be premature at this point to redeem from this manager.

Agenda Item #4 – Investment Policy Statement

Mr. Woolworth stated that the current Plan Investment Policy Statement ("IPS") was structured as a collection of memos written over several years and added to a single document. Staff believed it was time to refresh the document and have the IPS prepared in a more linear, streamlined, and cohesive way. One of the changes to the IPS includes a provision for an annual review. The Plan has been using a document that was based on policies from 2006 that was then moderately updated in 2012 to include the Independence Fund guidelines. However, the rest of the document needed to be fully refreshed to reflect the current portfolio and strategies.

As such, the revised guidelines now include provisions for investments in local managers that were missing from the old document. The prior IPS only provided guidance regarding diversity managers. Staff and Cliffwater updated parameters for diversity managers to reflect the $100 million minimum in asset under management for investment, and it adds the current asset allocation as part of the document. It also includes the asset class return assumptions.

Mr. Dubow asked Mr. Woolworth if he could talk about the status of the Performance Monitoring Procedures and the impact these procedures might have on the IPS in the section that discusses the review and monitoring of investment managers.

Mr. Woolworth indicated that the IPS does refer to the review and monitoring of managers in section 9.4. Staff had met with the Performance Monitoring Procedures subcommittee and attempted to incorporate the subcommittee's suggestions into a new document in conjunction with Cliffwater. However, the final document, in Staff's opinion, didn't fully incorporate all of the subcommittee's suggestions and it still needs to be revised.

Mr. Handa added they hope to have the document done by next month for the subcommittee to review it and have it for the Board for the February meeting.

Ms. Weiss also added that the Board needed to reconstitute the subcommittee since Harvey Rice has departed. Mr. Stagliano nominated Mr. Rubin to fill the subcommittee position and Mr. Rubin agreed.

Mr. Dubow asked if there were any other questions on the policy statement and asked if there was a motion.

Ms. Pankey asked Mr. Dubow if there are still aspects of the IPS that could be affected by changes in the Performance Monitoring Procedures.

Mr. Dubow asked Ms. Pankey if she thought the Board should wait until the monitoring policy was completed before voting on the IPS. Ms. Pankey replied yes and that she wanted to table agenda item #4 until all aspects have been addressed with the subcommittee.

The Board decided to move the IPS to the next Investment Committee Meeting in February.

Agenda Item #5A – Proxy Guideline Amendments

Presenting from the Marco Consulting Group were Vice President and Director, Gregory Kinczewski and Assistant Director, Maureen O'Brien.

Mr. Kinczewski stated they were there to suggest updates on the proxy voting policy, review the proposals that were filed last year with shareholders and run through the plans for the upcoming proxy season.

Ms. O'Brien stated the update they were suggesting is to add a section on pledging a company stock which is something that they consider when electing directors. Sometimes when executives or directors receive shares from the company, they use that as collateral for a loan. A small amount is okay, but if it becomes excessive, it can drive down the value of the stock if that executive or director is forced to meet a margin call. Their research provider is now giving them data on this so they can use it as one of the criteria they consider when electing directors. The other change to the policy this year is to adjust the page numbers.

Mr. Butkovitz inquired about the Citizens United issue and wanted to know if we are still intimidated by the potential corporate response or is that popping up anywhere; the idea of increasing shareholder vote requirements or disclosure requirements?

Mr. Kinczewski responded by saying that disclosure requirements are an increasingly important element and he stated when Ms. O'Brien talks about the plan 14, a number of proposals on political contribution disclosures are being suggested.

Mr. Butkovitz asked Mr. Kinczewski if there are any shareholder proposals from cities.

Mr. Kinczewski stated he was not sure but that he could find out.

Mr. Butkovitz suggested doing outreach to New York.

Ms. O'Brien added she was not sure if New York City filed for proposals this year but that they have in the past.

Mr. Butkovitz said a closer relationship through Mr. Kinczewski would be convenient.

Mr. Kinczewski replied that they could easily do that.

<u>Agenda Item #5B – Shareholder 2013 Proposal Review and 2014 Proposal Recommendation</u>

Mr. Kinczewski reported that in 2013, the City filed five shareholder proposals. It did not refile one that got a 52% vote on in 2012. The reason for that is because Kindred Health Care indicated they were going to implement the proposal and were going to appoint the independent chairman to the Board.

There were five proposals that did go in. Two were withdrawn because the companies decided to implement the proposals or responded in a positive way so that the withdrawal was warranted. All five of those proposals were part of an informal coalition that the City has been participating in with 14 other Institutional Investors that are active in the National Conference of Public Employee Retirement Systems or the Council of Institutional Investors.

The idea has been in the last two years to target companies that received low advisory say on pay votes during the prior year and to engage them with a package of proposals that would encourage them to improve their compensation plans. The types of proposals that went in were independent chair, which the City filed successfully at Kindred Healthcare and no gross ups of excise taxes in change of control.

Mr. Dubow wanted to know how excessive is defined for purposes of limiting the ability to pledge company stock.

Mr. Kinczewski stated it is a judgment call.

Mr. Bielli asked how you would know before he or she has to sell stock whether it is excessive or not.

Mr. Kinczewski stated when the proxy statement comes out; the numbers are available as to what will happen as of that moment. Numbers can change as time goes on but what it is going to warrant are two things, how much of it is involved and what is the percentage of the shares outstanding. That is what you make the judgment call on.

In 2013 there was a new proposal that came in. The way most compensation plans work in the United States, shareholders approve a long laundry list of factors that can be used when making awards. When you sign off on the blank check, it is outside of the shareholders hands and in the hands of the compensation committee and you have no idea what they are going to do.

For these problem companies that were being targeted as part of the say on pay engagement, the proposal said you can use any factors you want but you have to tell us in advance when we are going to approve them and what the factor, metric, formula and outcome are going to be so that we know what we are approving.

Mr. Kinczewski read the company by company results of the system's shareholders advocacy in 2013.

Mr. Bielli asked Mr. Kinczewski for an example where executives were forced to sell through a margin call.

Ms. O'Brien answered with Green Mountain Coffee Roasters in 2012. During the financial crisis, there was also a rash of executives that had the same problem.

Mr. Bielli inquired about people who had been in that situation and had ample financial resources to cover that margin as opposed to the person who did not have the other independent ample financial resources to cover the margin and asked if this section was discriminating based on the amount of assets the individual would have.

Mr. Kinczewski answered it should be on the amount of assets the individual has but the danger to the company is on finances if a lot of stock suddenly gets shuffled around, that is the focus. Our focus is the company and shareholders, not the individual.

Mr. Bielli asked Mr. Kinczewski what if he wanted a Board member out for other reasons and decided to use the subjective analysis of an excessive amount of company stock as an excuse to do that. He said what guarantee or assurance do we have that is not being done? Mr. Bielli added that we read a lot about proxies in the news and that worries us. It worries him to put the power in someone's hands outside of this Board to make subjective determinations where the Board is going to be on the front page of the news since it is our shares that are going to be used as leverage to get whatever result you want.

Mr. Kinczewski explained we have a fiduciary duty to vote these shares and only take action in the best interests of you, your beneficiaries as your shareholders and we take that very seriously. The reality is, unless it was an odd case, your particular vault of shares should not be enough to drive out any director at any company. Normally, almost any institutional investor like yours is not going to have enough shares to throw out a director.

Ms. O'Brien recommended that the Board be engaged with the say on pay. Other institutional investors that have been involved are going forward. New York City and the New York State controller fund are also participating in the campaign. There is also the political disclosure effort which is coordinated by a non profit, non partisan group in Washington D.C. and The Center for Political Combinability. That effort is to encourage companies to disclose all of their political spending; both political spending that is direct and indirect through trade associations or third parties.

Mr. Bielli wanted to know when the non-profit started.

Mr. Kinczewski answered it goes back to the early 2000s and he said you've been active in it since 2006-2007.

Ms. O'Brien said the reason you did not file proposals on this last year is because the companies that were selected as targets for the campaign had no overlap with your holdings.

Mr. Butkovitz asked Ms. O'Brien how they were picked as targets.

Mr. Kinczewski said CPA is the coordinating body and they were selecting good targets.

Mr. Butkovitz stated the proposal he made was to select the targets. He stated the reason why the corporations we haven't invested in are not in the targets is because we haven't aggressively tried to link a corporation that we have holdings in with this practice.

Ms. O'Brien stated there are some companies that don't give political contributions. Second, if they're giving, they are then disclosing. Therefore, there is nothing to ask for. Mr. Butkovitz asked had they reviewed our portfolio and determined there is nobody in our portfolio that is giving [donations]. He said the question is whether you are the right people to implement this because it sounds like it's a lot easier to ride the momentum of something that somebody else is doing rather than something that was directly brought to your attention about two years ago.

Mr. Kinczewski explained what was brought to our attention was the idea of filing where shareholders would vote to approve political contributions, not disclose. That is what was reported back to you as having no support among other institutional investors. The issue reported back to you was approval of political contributions, not disclosure.

Mr. Bielli said Mr. Kinczewski should have come back to the Board or to the Controller specifically and say approval is not going to fly but maybe this will.

Mr. Kinczewski said he did have a meeting with Mr. Butkovitz.

Mr. Butkovitz said we had the initial meeting but you did not come back and tell us about these trends or opportunities, and you are reporting it to us now in a very passive way where Philadelphia wanted to take the leadership on this issue. You have lost my confidence.

Ms. O'Brien read the proposals for 2014.

Ms. Weiss asked Ms. O'Brien how do you determine which companies to go to for some of these specific proxies for access to political disclosures? Who chooses the companies?

Mr. Kinczewski said it's a screening process. We do a lot of coordinating of it amongst the various participants in that coalition. The typical way on the say on pay projects is to look at their low say on pay votes from the year before because those are the most likely targets to go after, the ones you would expect to be the most responsive. The Center for Political Accountability which has been coordinating the efforts of all of these people that filed that proposal go through the contribution records at the state level, at the federal level and compare them to what the disclosure levels are and come up with a list of target companies and then ask around, who is able to file and willing to file.

Mr. Dubow requested a motion. Mr. Butkovitz made the motion to table the recommendation and Mr. Stagliano seconded it. All were in favor with the exception of one opposition, Ms. Pankey. There were no abstentions. The motion passed.

Mr. Butkovitz believes these people [Marco] are in business for themselves. He said this is a movement to stop the 1% from propagandizing and monopolizing the discussion so they have changed the conversation from what the core of the concern is to something that it is easy for them to pass off.

Mr. Bielli stated his problem is that the proxy companies have control, they have the ability to vote our shares and other pension fund shares so they have x amount of shares and many times they will use their shares to sell their influence on particular votes. We have index funds everywhere.

Mr. Dubow requested a motion. Mr. Butkovitz made a motion to put out an rfp for a proxy consultant and Mr. Stagliano seconded it. All were in favor. There were no oppositions or abstentions. The motion passed.

<u>Agenda Item # 6A – Franklin Park LLC Second Quarter 2013 Private Markets Report</u>

Mr. Jackson reported the portfolio is doing well. The overall performance since inception is 9.7% IRR for all the investments into private markets since 1987; total committed capital has been $1.2 billion and the current value remaining as of June 30 is $521 million.

The bulk of the portfolio rose between 2006-2008 with 39% of the total committed capital and 64% of the current value in these three vintage years. The performance for the funds in those years has been solid. The net IRR versus the benchmark's top quartile in the median, in each case, the performance is above the median's benchmark.

The year 2006 was a tough year for private equity. In 2006 the Fund had a lot of exposure to a large segment where the funds made big investments in large companies, used a lot of debt and got caught when the economies and markets turned. We do think the performance will improve. There is upside in the funds for 2007 and 2008.

Mr. Dubow inquired about the later years. Mr. Dubow wanted to know if it was too soon to know how the more recent investments were performing.

Mr. Jackson replied yes. He stated the years 2008-2013 are still in their investment period, so performance is less meaningful in those years. Mr. Jackson stated there is an upside in the 2007 group - KPS III, Vista Equity III, Avenue V, Platinum Equity II, NGP IX, Carlyle Europe III, and Sterling III. With the 2008 funds there is upside potential in funds like Advent GPE VI-A, LLR III and Altaris II They have generated teens or higher returns so far which is pretty solid. Franklin Park thinks they will get better from here.

Mr. Woolworth mentioned the turnaround strategies in the portfolio have been the best performers. Platinum Equity II and KPS III have been excellent performers.

Mr. Jackson continued that the second best performing fund probably in the portfolio ever is Platinum I which generated a 60% return since the Fund invested in 2004. It produced 2.8 times the money invested, which is excellent.

In recent years the net cash coming back from the portfolio has been significantly positive. This is significant and common across private equity. Franklin Park is seeing that among other clients as well.

Public equity markets have been strong and the private managers are taking advantage of this. What it has also led to is an increase in fund raising for managers. Fund raising is up this year versus 2012. As of September 30, there has been $83 billion raised for buy-out funds for the year. The peak year (2008) was $156 billion; it is getting back to that 2007-2008 period in terms of fund raising for the private equity market. This may not be a good thing because the more capital managers have at their disposal; the more likely they are to increase prices on transactions.

Mr. Woolworth added that is why Franklin Park is being very selective about the managers they are making investments with rather than funding 4-8 managers per year. Staff wants to avoid a repeat of what happened in 2006.

Ms. Olanipeken-Lewis inquired about what happened in 2006 other than the market crash.

Mr. Woolworth explained because of the way private equity works you make commitments and then the manager starts to deploy capital in later years. So, for example, in a 2006 vintage fund we would commit $20 million. The manager would start putting money out in parts, and the Board had just begun to deploy a lot of capital when the markets then collapsed. Some firms were able to manage through that, and some have struggled. Mr. Jackson said the Board made a lot of commitments to mega large buyout funds during that period. He indicated that the Board probably should not have done this and advised that the Board should not make allocations to those larger funds in the future.

Ms. Pankey asked Mr. Jackson what would be your recommended strategy given Franklin Park's concerns with increased fund raising.

Mr. Jackson said we think you should continue to invest. You should be very selective in the types of funds that you invest in particularly as the market gets high and as you get close to that peak.

Mrs. Pankey asked Mr. Jackson if he will come back shortly before that peak to make a recommendation.

Mr. Jackson replied absolutely.

Ms. Weiss expressed concern to Mr. Jackson about his report. She stated it is more than six months old and that staff seems to be able to roll forward as their report is a little more current. We are now six months down the line from when it happened and that is a really long time for some of these funds.

Mr. Jackson stated we are in the process of preparing the September 30 reports now. We have most of the September 30 statements from the managers and are in the later stages of having those reports ready.

Mr. Woolworth added it is a tough issue to solve because we receive all the managers' final statements on a 3 to 5 month lag and that is why staff does roll it forward. Staff takes the last valuation, subtracts contributions, adds distributions to it and then staff rolls it forward to come up with a number. Staff is doing the best it can with the information it has to use.

Mr. Jackson gave an example. He said in this report all of the fund values are as of June 30. The managers have 60 days to send out financial statements to the investors. For the December 31 statements because they have to get them audited it is an even longer period when they come back to us with the statements. What we have in here is more up to date market data, fund raising data, investment data and pricing. We can only do what we can do in terms of fund values; we have to wait for them to send us the statements.

Agenda Item #6B – Staff's 2nd Half 2013 Private Markets Update

Mr. Woolworth stated the portfolio performance was 9.6%. There was a partnership made back in 1998 called Keystone Venture V located in Philadelphia. By the beginning of 2000, there were some acts of fraud between one of the employees of Keystone, and one of the principals, Michael A. Liberty. A long court case ensued. Mr.

Liberty was ordered to pay damages. Recently, staff has been in contact with the courts to get those damages back to the limited partners that were damaged. The court has agreed to do that and they are sending all limited partners approximately $700,000. Staff is working with the SEC to give that money back to the investors. They require lots of documents from us as the liquidating trustee to make sure we are going to give the proper people the proper amounts.

Mr. Woolworth stated two Partners we invested in last year are closing. Levine Leichtman Capital Partners V, L.P. is closing up and will meet their $1.6 billion dollar cap. We invested in Vista Foundation Fund II, L.P. We requested $30 million; then requested $50 million at the table. They were a very good firm but were very oversubscribed. Some investors that requested $60 million were cut back $30 million. Mr. Woolworth said because Franklin Park and Staff had long relationships with Vista, our request was only cut 1/3. Today we have a $20 million commitment with the firm.

Mr. Dubow asked Mr. Woolworth what does that mean for the other $30 million [that was not provided to Vista].

Mr. Woolworth answered that means we were only able to commit $20 million versus $30 million for the year. This year we are planning to bring in several partnerships to the Board for approval.

Mr. Woolworth explained that last year we had invested $94 million, this year; on a net basis we invested $92.4 million. We've had a reduction in the amount of money going out the door, an increase in the amount of money coming in the door. Going forward our unfunded commitments are starting to drop, and that is why we are going to be bringing more partnerships to add.

Agenda Item #7A – Cliffwater LLC Second Quarter 2013 Real Estate Report

Mr. Rice-Shepherd commented on the timing of their report. He said the portfolio report is as of June 30; this is where we wait for the last company of the portfolio report before we can aggregate the data. Mr. Dubow wanted to know if there was one firm holding Mr. Rice-Shepherd up or a number of firms.

Mr. Rice-Shepherd stated as of today we probably have 80% to 90% of the September 30 reporting.

Mr. Nesbitt added the other problem is the data universe. We need the vendor to collect all their data on all of their funds.

Mr. Rice-Shepherd reported the expansion in commercial real estate has entered its 5th year from a trough that was reached in 2009. They have confidence that 2014 is going to be a strong year as well, both domestically and abroad. Commercial real estate has outperformed the major bond indices. The public real estate benchmarks have not done as well. The ten year treasury rate has risen towards 3%.

The market has become increasingly bifurcated between coastal markets and the rest of the country as well as by product type. The factor driving the growth is supply constraints. Capital markets are not back where they used to be.

He continued that starting in 2009, prices fell by 40% from the peak to that trough but most of the capital flows and the value appreciation have flowed into the office and apartment sectors. Multi family has benefitted from the downturn. We tend to look at laggards being industrial, retail and suburban office. They are laggards but with strong fundamentals as well. The industrial sector is very highly correlated with the housing sector due to the need for durable goods when housing is on a roll. We expect to see tremendous growth in industrial property. Retail is very correlated with GDP growth and with discretionary spending. We expect a turnaround.

Values have returned to peak in Boston, Chicago, Los Angeles, New York and San Francisco. This is not the case in the secondary markets: Denver, Dallas, Houston and Atlanta.

The lower employment growth but higher home appreciation growth markets are the larger markets: San Francisco, Los Angeles, Washington; due in part to capital flows. Housing is used as a substitute for other product types because of the trickle-down effect of that growth.

Mr. Dubow inquired about the crashes in Las Vegas and in Phoenix.

Mr. Rice-Shepherd replied Las Vegas was the market that saw the greatest correction. He stated Phoenix did not fall as quickly as Las Vegas. In Phoenix we saw office occupancies came back quickly and that is because it is a lower cost alternative to the bigger coastal market. Phoenix has some constraints but they are a little sounder.

Atlanta, Denver and Dallas have strong employment growth. Home price appreciation has not been as strong but you might expect it to be sustainable leading to trickle down positive effect in some of the other major product types.

Debt capital markets are driving the supply constraints and thus an increase in value. Rates remain near historical lows for borrowers which is good for the portfolio because managers are able to borrow at low rates. Cap rates are low. Opportunistic managers are earning great returns with very low leverage compared to 2005 & 2006 vintage funds. The availability of debt for refinancing rehabs or development is low in terms of value. There was significant maturity in 2013. Over the next five years you can expect to see $2 trillion in maturities. Values have recovered, and incomes are growing. When we say distressed, the opportunities are not distressed assets but distressed owners in capital sectors.

We remain bullish on real estate. Job growth appears to be moderate and consistent. December's job numbers were disappointing, around 70,000. There is a lack of debt for transitional opportunistic properties. There is also a lack of private capital available for investment and that is evident in the fund raising statistics through the third quarter of the year. Prior to the crisis, private fund raising outpaced public fund raising for REITS and core product by a factor of six to one; that has reversed. Through the third quarter of 2013, you have seen public equities in real estate accounting for the majority of the fund raising. Fund raising is up a bit for 2013 on the private side but still at half the peak. The lack of lending is leading to supply constraints - we do not see that ending in the near term in those markets.

Philadelphia's real estate portfolio, quarter over quarter, the performance was quite good. On a net basis the portfolio from the prior quarter was almost up 2%. That is a positive development. One number that is not reflected is the additional $10 million commitment made to LEM Capital toward the end of the year. This is a manager that has done well investing in private debt and preferred equity in the multi family space. They've seen significant write ups through the end of the year.

The Fund's current real estate allocation as of June 30 is 5%. That is a little above the 4% target but this reflects the investments in Invesco and the J.P. Morgan open ended core funds.

Total performance on an IRR basis is -1% since inception in 2005. Mr. Dubow asked Mr. Rice-Shepherd if this is something that would take us a long time to improve.

Mr. Rice-Shepherd responded if you're relying on the appreciation of the pre-crisis funds, yes. The reason for that is the pace of investment post 2009.

Mr. Bielli stated we don't have a choice as to whether we are relying on the pre-crisis investments because it is not very easy for us to get out of them.

Mr. Rice-Shepherd said that is correct. We've talked to staff about selective sales of some of those positions.

Agenda Item #7B - Staff 2nd Half 2013 Real Estate

Mr. Woolworth stated CIM Urban REIT has performed well. CIM Urban REIT has been approached to do a merger with a group called PMC Commercial Trust. Assuming that is successful, staff and other investors have recommended moving forward. That could be a significant win for the portfolio, as we would be delivered publicly traded shares, and we could liquidate that position.

In November we added an additional $10 million to LEM. That portfolio was written up before our investment so we benefitted quite a bit by coming in at the time we did.

Mr. Bielli said for Cliffwater's report in November of 2006 states the benchmark returned 6.3%. CIM is 6.21%. He said it is not a situation writing debt as a bad vintage year, it was bad in selection.

Mr. Woolworth stated it was both. CIM has done a good job.

Mr. Handa added CIM also walked away from deals. They stayed away; they were not invested so they avoided all of what happened in 2007 and 2008 that is one of the other reasons why they benefitted. When the markets corrected they were able to have capital to deploy while the other managers were fully invested. When they do sell themselves, we'll be getting a significant appreciation over that benchmark, 200 to 300 basis points above that benchmark in terms of returns.

Agenda Item #8 – Flash Report for the Period Ended December 2013

Mr. Handa reported the numbers on the flash report suggest that during the calendar year the Fund returned approximately 14%; the numbers don't include the final real estate marks for the last six months.

Private equity and the hedge fund portfolio are on a one month lag. His estimates are that it should be another 30-50 basis points of additional performance that is not reflected in the flash report. The flash report numbers understate performance.

Mr. Walthour reported it was a positive month in December for risk assets, with the exception of investment grade fixed income, that led to a positive return of over 1% for the plan in the month of December. It was a good close to the calendar year.

There was a strong performance from the domestic equity markets. There was difficult performance in Asia and emerging markets. There was a positive performance from Europe throughout the year and the month of December.

Fixed income materialized in the fourth quarter with a much more subdued tapering that was negative in general for fixed income asset classes. High yield did fairly well. Within Alternatives, hedge funds continue the consistent performance.

Commodities struggled throughout the year and were down -9.5% but did have a positive contribution in the month of December.

There was great performance from O'Shaughnessy Asset Management, Northern Trust, Tortoise Capital Advisors, Fisher Asset Management, and Emerald Advisors. We talked about what would happen to investment grade fixed income throughout the course of the year. Had we kept that original fixed grade income, results could have been a lot worse.

The year to date top contributions: Emerald Advisors, O'Shaughnessy Asset Management, Russell Growth Index, Fisher, Tortoise Capital. Kynikos was the bottom performer.

Emerging Markets Index Fund: Emerging markets debt and equity had a very bad year last year. While we did not expect the results for Stone Harbor Investment Partners to be this poor, they underperformed the index by about 600 basis points. The other performances are in line with what we expected.

December's flash report: the total fund outperformed the policy benchmark by about 31 basis points. Outperformance [of the benchmark] was achieved in every asset class except U.S. equity. U.S. equity was the top performer, up 2 ½%. Emerging markets equity was the worst performer, down 1%. Fixed income outperformed the indices. It was a tough month for the fixed income sector. Investment grade experienced its worst performance since 1994. Real assets had strong December returns, up over 1%. U.S. equity was the best performing asset class with significant contribution for the year, up 32%. That overweight to U.S. equity that we carried throughout the year was a positive development.

2013 was a year in which asset allocation mattered. The net result is that the fund as of the date of the report outperformed the policy benchmark by 9 basis points. The fund outperformed the actuarial assumption rate by 500 basis points. It was a good performance relative to the benchmark. The calendar year outperformed the benchmark. The one year and three year performance numbers are now outperforming the benchmark.

Calendar year 2012 and calendar year 2013 relative to the actuarial rate, showed significant outperformance, and made a positive contribution towards the funding rate of the pension plan.

There's been a lot of activity with hedge funds throughout the year. The Board approved a number of new relationships, and also added funds to existing managers. We now have a slight overweight relative to the benchmark. In regard to the underweight in private equity, Cliffwater has found as a firm is if you can't get in the top quartile fund, sometimes private equity does not make a lot of sense. Private equity performance was up 13% or 14%. The public equity portfolio was up 32%, that underweight to private equity did not hurt the plan at all; it is a net positive.

The U.S. economy throughout 2013 continues to gain traction with improvements in the labor and the housing sectors. There is an energy renaissance going on in the U.S. All of those sectors did well, particularly the energy sector where the Fund had good exposure through MLP's. The Russell 3000 had a terrific year, up over 30%, that was the single largest contributor to the portfolio's performance, being exposed to equities but also being overweight equities. Four of the active managers turned in solid results; three underperformed their indices. 46% of the U.S. equity allocation is passively invested. We removed a lot of the active manager execution risk from that particular part of the portfolio. We had significant exposure to the small caps; there was a wide performance gap between large caps and small caps. The Russell 1000 was up 33%, the Russell 2000 was up 43%. Having exposure within our U.S. equity portfolio to small caps was a great benefit to performance.

Europe came out of its recession, led by Germany. Japan had a rise of 56% during the course of 2013. Europe coming out of a recession and Japan's commitment to reviving its economy led to a MSCI EAFE performance of about 22%.

Non U.S. Equity Emerging Markets: this particular category delivered negative results. Managers were down 2.6% during 2013. The Non U.S. Emerging Markets portfolio for the fund was down 2%, outperforming the index by 53 basis points. ESG generated a positive 12% result while the index was down over 2%. That 14% of outperformance was the reason why the Fund was able to outperform the index.

Emerging markets: fifteen years ago outsourcing was being sent to a lot of Latin American countries. Everything is now being outsourced to China and lot of the production capacity in Latin America is no longer being used, therefore, their economies are shrinking. Foreign direct investment is reversing itself out of some markets and going into other cheaper labor markets. These economies have to adjust.

As the Fed tapers and interest rates begin to rise in developed markets, yields become less attractive given the risk associated. You are also seeing capital flow out of the fixed income markets in those economies as investors can access higher yields in the U.S. and other developed countries.

Opportunity Fund: both managers outperformed for the year.

PFM slightly outperformed their benchmark by six basis points. FIS beat their benchmark by 1.69%. PFM generated a 23% return for the year. FIS generated a 28% for the year. Both contributed significantly to the overall plan.

Board and staff previously discussed the fixed income portfolio being a source of potential risk once the Fed started talking about tapering. In March there was a $237 million overweight in fixed income. By June we were down to $193 million. By September we were down to $90 million. By December 31, 2013 the Fund was underweight in fixed income. The investment grade fixed income has been migrated into the opportunistic fixed income which has exposure to managers that can go both long and short.

The opportunistic fixed income portfolio is a new asset class for the fund, and its performance in 2013 was up 4.7%. Had these funds remained in investment grade fixed income, the performance would have been -2.68%. This portfolio outperformed the index by 150 basis points. At the start, this portfolio was almost 100% emerging markets bonds. Emerging markets bonds had a difficult year, down 6.6%. In the last round of asset allocation, the Board approved cuts to the emerging markets bonds portion of the portfolio. Those assets are being rotated into the opportunistic credit partnerships being--- developed. The portfolio is now more closely aligned with its benchmark. It is not an emerging markets benchmark. It is 50% high yield and 50% leverage loan benchmark.

Mr. Bielli asked Mr. Walthour if fiscal year to date figures were representative of the excess return we would have had in absolute emerging markets, if the change had occurred earlier.

Mr. Walthour answered yes; the portfolio for the fiscal year would have been much more heavily weighted towards credit partnerships and probably would have been better.

Mr. Walthour continued: the absolute return portfolio was up 8.46%. LIBOR + 400 bps were up 4.2%. The portfolio outperformed that by 4 percentage points.

There was strong performance for the fund. U.S. markets hit highs. You now have thirty-one active managers, 2/3 outperformed.

Mr. Nesbitt announced that Mr. Walthour would be parting ways with the Cliffwater organization. Mr. Walthour will be joining another firm.

Agenda Item #9 – Flash Report for the Opportunity Managers for the Periods Ended November 2013 and December

Ms. Cherry reported for the domestic equity search, staff completed conference calls with selected managers; they will be ready to meet with the subcommittee within a week or so. We are waiting to get a date from the subcommittee.

Staff is in the due diligence phase with the fixed income search and will be ready for calls and contacting managers over the next two weeks.

The international search was just completed. There were twenty firms that responded. Some of them submitted multiple products for their response. Staff is going through the RFPs over the next couple of weeks

In December, PFM's performance was down 22 basis points. FIS was up 13 basis points. One manager for PFM, Philadelphia Trust was down 70 basis points for the month. For FIS, BRC was one of the managers discussed, down 24 basis points. Two names affected their performance. Together they attracted 50 basis points of relative performance.

Ms. Pankey inquired about Herndon Capital Management. Ms. Cherry said Herndon had been transitioned out of both portfolios.

Agenda Item #10 – Third Quarter 2013 Directed Commissions Report

Mr. Falkowski reported the funds equity and MLP managers directed 23 % of their trades to Local, Minority, and Women-Owned brokerage firms and that number is 27% year to date.

The Commission Recapture Program: the fund recaptured a little over $20,000 during the third quarter, and this was a decrease of 44% from the prior quarter. The decrease was due to a decrease in overall commissions as well as the percentage directed.

On a percentage basis for the third quarter, the fund's equity MLP managers directed 17% of their trades to ConvergeEx and 23% year to date.

Mr. Bielli added the Law Department is looking at ConvergeEx concerning certain allegations.

Ms. Rosenberger-Altman stated we have reached out to counsel for ConvergeEx and asked for a statement from them. We have not heard back. We are monitoring the situation and have been in touch with the SEC.

Agenda Item #11 – Chief Investment Officer's Report

Mr. Woolworth stated at the end of the year he reconciles the securities lending reports with JP Morgan. He discovered some of the accounts were not linked and that we were understating some of our securities lending income. We had been underreporting securities lending for the year. We finished out the year at $3.1 million in securities lending income. Last year was approximately $2.3 million. Mr. Woolworth had access to the securities lending platform, and access was spread out amongst the rest of the staff. This will be used as a cross-check to insure correct reporting throughout the year.

Quality D was at approximately $500,000, having moved up slightly.

In December, women, minority and local firms held 27% of the fund's AUM. The breakdown for women and minority firms only was 17%.For Philadelphia and suburban firms it was 13%.

Mr. Handa added we've allocated $100 million to diversity and local managers since the beginning of the fiscal year. Our expectations are we will have a $100 million coming to the Board by June 30 for approval. Mr. Leonard inquired about the nature of the allocations.

Mr. Handa said the managers are in private equity, real estate and traditional long only strategies. When the Board updated the Opportunity Fund guidelines, alternative managers were included.

Mr. Bielli added the fees the alternative managers are deriving are larger than from a fund of funds.

Mr. Handa informed the Board that last year the Independence Fund was up 10.54%.

Mr. Handa said the Financial Times had an article in December and thought everyone would be interested in reading about all of our partners and what they are doing in Europe and why we align ourselves with them.

Ms. Weiss asked if there was any other business for the Investment Committee Meeting. There was none.

At 12:33 p.m., Ms. Weiss requested a motion to adjourn the Investment Committee Meeting. Mr. Stagliano made the motion and Mr. Albert seconded it. All were in favor. There were no oppositions or abstentions. The motion passed.

At 12:34 p.m., Ms. Weiss convened the Board of Pensions and Retirement Meeting to affirm the actions taken at the Deferred Compensation Plan Committee

Meeting and the Investment Meeting. Mr. Stagliano made the motion, and Mr. Albert seconded it. All were in favor. There were no oppositions or abstentions. The motion passed.

At 12:35 p.m., Ms. Weiss requested a motion to adjourn the Board of Pensions and Retirement Meeting. Mr. Albert made the motion, and Mr. Leonard seconded it. All were in favor. There were no oppositions or abstentions. The motion passed.

The Investment Committee of the Board of Pensions and Retirement approved the Minutes on _______________________________.

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Rob Dubow, Finance Director
Board Chair