

**CITY OF PONTIAC, MICHIGAN
POLICE AND FIRE RETIREMENT SYSTEM
JANUARY 26, 2006**

A regular meeting of the Board of Trustees was held on Thursday, January 26, 2006 in the Shrine Room on the Main Level of City Hall, 47450 Woodward Avenue, Pontiac, MI 48342. The meeting was called to order at 9:03 a.m.

TRUSTEE PRESENT

Craig Storum, Chairman
Ed Hannan, Secretary
Brian Lee
Thomas Miller, Vice Chairman

TRUSTEES ABSENT

Mayor, Clarence Phillips (*absent*)

OTHERS PRESENT

Cynthia Billings, Sullivan, Ward, Asher & Patton, P.C.
Stuart Tompkins, Sullivan, Ward, Asher & Patton, P.C.
Andrew Kelsen, Gray & Company
Dave Duddles, PFOA
Ellen Zimmermann, Retirement Systems Administrator
Jane Arndt, M-Administrator Assistant

CONSENT AGENDA

- A. Minutes of Regular Meeting: December 1, 2005

- B. Communications:
 - 1. Correspondence from Morgan Stanley RE: Portfolio Commentary Nov., Dec. 2005 /President Named
 - 2. Correspondence from Lynch, Jones, Ryan RE: Recapture
 - 3. Correspondence from Montag & Caldwell RE: Portfolio Commentary
 - 4. Correspondence from Munder Capital RE: Portfolio Commentary Dec 2005
 - 5. Conferences:
 - a. In Search of Alpha – MAPERS – Feb. 16, 2006
 - b. Portfolio Management – Chicago GSB – Mar 13-17 or Sept 25-29, 2006
 - c. 5th Annual Stars & Stripes Public Funds Summit – April 2-4, 2006
 - d. NCPERS Annual Conference – NCPERS – April 30 – May 4, 2006

- C. Financial Reports:
 - 1. Financial Reports – November & December 2005
 - 2. Securities Lending Report – October & November 2005
 - 3. Commission Recapture Report – October & November 2005
 - 4. Accounts Payable – December 2005 & January 2006
 - 5. Due From GERS

- D. Final Pension Calculations:
- | | | |
|------------------|-------|------------|
| 1. Jane McLaurin | #2218 | \$3,768.22 |
|------------------|-------|------------|
- E. Application for Refund of Accumulated Contributions:
- | | | |
|-------------------------|--|-------------|
| 1. Derrick Lee – PPOA | | \$3,386.51 |
| 2. James Wilkins – PPOA | | \$ 3,764.88 |

Trustee Lee pointed out spelling error on page 3 of December 1, 2005 minutes (replace Andrew with Andrea).

RESOLUTION 06-001 By Lee, Supported by Hannan

Resolved, That the items of the consent agenda for January 26, 2006, be approved as presented.

Yeas: 4 - Nays: 0

RESOLUTION 06-002 By Hannan, Supported by Miller

Resolved, That the Board of Trustees approve Trustee Storum to attend the MAPERS “In Search of Alpha” Conference being held on February 16, 2006 in Ypsilanti, Michigan with the cost to be paid from the investment earnings of the Fund.

Yeas: 4 - Nays: 0

CONSULTANTS

Re: Gray & Company – Year-End Reporting

Mr. Kelsen discussed the year end performance numbers with the Board. He stated that the numbers were strong for December with the portfolio showing an increase. However, they are expecting a slide in January and numbers may fall back to where they started.

Mr. Kelsen disclosed information to the Board regarding Morgan Stanley and two of Gray & Company’s clients. Gray’s client City of New Haven Police & Fire has terminated Morgan Stanley for performance issues and MARTA currently has them on probation and is conducting a search for a new manager.

He provided Morgan Stanley’s 4th quarter and calendar year returns:

	4 th Qtr	CYR
Morgan Stanley	1.38	6.45
Benchmark	4.08	13.54

He also discussed that Morgan Stanley has \$35 billion in international funds. The index includes small, mid and large cap. Morgan Stanley can not invest in small cap with that amount of assets under management, so they do not see a full exposure to the benchmark.

He told the Board that they could split their international equity keeping Morgan Stanley as their large-cap value manager where their performance is good and look for a small-cap product. He pointed out that Morgan Stanley has too much money to have exposure to small cap. He also commented that stocks with Morgan Stanley move through market cycles. He also told the Board that Morgan Stanley is currently in the process of moving their portfolio manager from London to New York. Again, he remarked that the Board could look for an international small-cap manager.

Trustee Hannan asked how much money the fund has invested with Morgan Stanley. Ms. Zimmermann replied \$35.7 million which is 14% of the portfolio.

Mr. Kelsen said that a small piece could be split off to another manager. Ms. Zimmermann commented that the asset allocation would not be affected. Trustee Miller asked if there is a minimum. Mr. Kelsen replied that he does not believe so, but the minimum is less for smaller products. Trustee Miller asked if he had any ideas for a new manager.

Trustee Storum asked if they could look at small-cap and at how it could increase risk to the portfolio. Mr. Kelsen replied that he will put together a model and bring alternatives to next meeting.

Re: Core Real Estate Manager Search

Mr. Kelsen brought the names of three of their best ideas for core real estate managers for the Board's review. Two of the managers run core open-ended funds (American Realty Advisors and Guggenheim Real Estate) and one is a closed-end product manager (Harbert Management.).

Mr. Kelsen briefly summarized the current core real estate market. He told the Board that there continues to be a large flow of capital into commercial real estate with \$100 billion being invested between 2002 and 2004. He explained to the Board that real estate numbers are reported a quarter behind. He commented that the numbers are strong stating the NCREIF Index Chart annualized numbers showed the following returns:

2005	17.76%
2004	14.5%
2003	9.3%
2002	6.75%

Mr. Kelsen gave a brief description of each manager starting with American Realty Advisors. Their product is the American Stable Value Fund which is an open-end fund offering. They are privately held with 100% ownership. They are well diversified and use a conservative strategy that is designed to be low risk. Their target leverage was 25% as of the 3rd quarter of 2005. Leverage was 25%. Their gross return was 8-10% over the market cycle (7-10 years) with a year-end net return of 18.1%. He stated that their 13.74% annualized 3-year return beat the benchmark. He concluded by saying that American Realty Advisors is a good core manager. Their fee structure is 110 basis points of committed capital. They have never lost a client.

The next manager, Guggenheim Real Estate, offers their product Guggenheim Real Estate Plus. They invest in more then core direct real estate (properties, REITS and commercial mortgages). The product is partially funded by the Bank of Ireland. They currently have \$1.1 billion assets under management. Mr. Kelsen told the board that they have a good analytics package and a good sense of where they are. The leverage was 41%. He said Guggenheim is diverse across various asset classes and that they manage sector exposures well.

Mr. Kelsen reported that Guggenheim's gross return was 13-15% over the market cycle. They are a strong, high character firm. They require a minimum investment of \$5 million. Their fee structure is a 60 basis points annual fee and a 20% incentive fee when the product exceeds the PLUS benchmark (70% NCREIF/30% NAREIT).

The last manager to be presented was Harbert Management. Mr. Kelsen stated that their product is closed end private real estate (Harbert Real Estate Fund III). Harbert is an old money family-run business with a significant portion of their own money invested. This is their 3rd fund since 1995 and they are looking to raise \$200 million with \$25 million of their own money currently invested. Their strategy is diverse with properties that return significant cash flow. He continued saying that their management style is sector oriented which is not the strongest against the benchmark. They have two strong portfolio managers on board.

Their combined gross internal rate of return was 25.7% on realized investments before fees as of June, 2005. Their return objective is 15%-18%. Their last fund's combined gross internal rate of return on realized investments was 32%. Leverage was 60-70%. They typically hold between ten and twelve properties with 4-6 year lives.

Mr. Kelsen pointed out that Harbert's fee schedule is 150 basis points annual management fee on committed capital during the acquisition phase with a 20% performance fee after capital is returned and a 9% preferred rate is achieved.

Mr. Kelsen concluded by again telling the Board that Harbert is a family-owned business of the highest character which is very important. They are the largest investor in the fund. They have two strong portfolio managers on board. They are scheduled to close September, 2006 with a soft close around June, 2006.

Mr. Kelsen told the Board that Trustee Hannan had recommended AMA, but they were not added to the list because they were not considered a core real estate manager. They primarily invest in single family structures.

Mr. Kelsen then asked if the Board had any further questions or comments. Trustee Miller asked how much was available for investing. Mr. Kelsen replied that the Fund is approximately \$7 million under the target allocation for real estate.

Trustee Storum asked about the closed fund and the significance of only managing 10-12 properties. Ms. Billings and Mr. Kelsen both explained that you can't get out of a closed-end fund. Closed-end is usually a long-term commitment. After the first year or 18 months, you can get out in approximately another 6 months with a 1-2% penalty.

Mr. Kelsen stated that legally stated the Board is looking at an 8-year partnership. Trustee Storum asked if expenses escalated would there be any controls. Mr. Kelsen explained that the Board would work within a limited partnership agreement clearly defining how the fee schedule would work.

Lastly, Mr. Kelsen commented that the three managers recommended by Gray & Company went through extensive screening and if agreed he will setup the interview process.

Trustee Hannan asked if the Fund is looking at the under-allocation. Trustee Storum replied that he sees funding the under-allocation and then using the new money as it becomes available. Trustee Lee commented that they could put current monies into closed and put new money into an open fund as it becomes available. Discussion followed by the Trustees.

RESOLUTION 06-003 By Lee, Supported by Hannan
Resolved, That the Board of Trustees approve American Realty Advisors, Guggenheim Real Estate and Harbert Management as finalists for Core Real Estate Manager interviews to be held at the March regular meeting

Yeas: 4 – Nays: 0

Re: Sullivan Ward Asher & Patton – CAPROC Update

RESOLUTION 06-004 By, Miller, Supported by Lee
Resolved, that the Board of Trustees go into closed session to discuss pending litigation/arbitration with CAPROC, LLC., et. al.

Lee– yea	Miller - yea
Storum – yea	Hannan – yea

Moved to Closed Session at 9:45 a.m.

Came out of Closed Session at 10:35 a.m.

Trustee Miller left at 10:45 a.m.

Meeting recessed at 10:45 a.m. for a short break

Meeting reconvened at 11:02 a.m.

RESOLUTION 06-005 By Hannan, Supported by Lee
Resolved, That the Board approve minutes from last closed session on December 1, 2005.

Yeas: 3 - Nays: 0

REPORTS

Police & Fire Regular Meeting
January 26, 2006

Re: Legal

Ferro Corporation Litigation

Ms. Cynthia Billings briefly stated that the fund had lost \$7,000 in the investment due to improper accounting practices. She also commented that no hearing date has been set.

United Rentals, Inc. Securities Class Action Litigation

The fund has lost \$73,000. SEC is currently investigating the manipulation of financial records. The PFRS was appointed lead plaintiff on November 8, 2005. No new action to report.

Boston Scientific Corporation Litigation

On November 20, 2005 Lerach Coughlin filed for lead plaintiff status on behalf of the City of Pontiac PFRS. The fund has experienced losses exceeding \$376,000. The SEC fined Boston Scientific \$75 million for insider trading. Motion for lead plaintiff status is still pending.

Fiduciary Liability Insurance Renewal Application

Ms. Billings stated that there is nothing unusual about this application. A list of investment managers will accompany application.

RESOLUTION 06-006 By Lee, Supported by Hannan

Resolved, That the Board approve the Chairman to sign fiduciary liability insurance renewal application.

Yeas: 3 - Nays: 0

Anthony Turner – Garnishment of Retirement Benefits

Ms. Billings referred to a letter sent to Attorney James N. Renfro, Esq. She explained that he is Anthony Turner's ex-wife's attorney and that he is attempting to garnish Mr. Turner's retirement benefits using an EDRO to recoup legal fees. Ms. Billings stated that she will continue to investigate, however, payment to an alternate payee under an EDRO may not commence prior to the participant's earliest retirement age.

Re: Chairman – None

Re: Secretary – None

Re: Trustees

Trustee Lee stated that a member has said that his wife did not like the language in a letter written to them regarding beneficiary compensation in the event of his death. Ms. Zimmermann asked that the member contact her and that she would either meet with him and his wife or rewrite the letter to address any concerns they have.

Trustee Lee also mentioned that the Donnell Reed, President of the Union would like to know how former Mayor, Willie Payne's retirement was calculated. Ms. Billings stated that if an FOIA was received she believes that the benefit calculation information would have to be

provided. She will look over the FOIA. Ms. Zimmermann said she would talk with Donnell Reed to find out what specific information they're looking to receive.

1. **Real Estate Committee** – None
2. **Personnel Committee** - None

Re: Union Representatitves

Dave Duddles said that the Union had a question regarding the actuarial assumption being changed from 40 years to 25 years. Ms. Billings stated that the Board has the authorization to change the actuarial assumptions per Public Act 314. She also stated that the maximum amortization period is 30 years and to set it at 40 would be illegal per Public Act 728 in 2001.

Ms. Billings suggested that the Ordinance should be cleaned up in order to be compliant with PA 728. She also told Mr. Duddles that the union has no authority to set actuarial assumptions such as the amortization period. Mr. Duddles replied that he thought it was an accounting practice.

Trustee Storum commented that the change was made as a standard. Ms. Zimmermann explained that in 1981 the amortization started at 40 years and reduced by one year each year until there were 25 years left.

The Board directed legal counsel to respond to the Union regarding the amortization question.

Ms. Billings left the meeting at 11:19 a.m.

Re: Staff

Ms. Zimmermann passed out a notice of the CAPROC Annual Shareholders Meeting to be held on March 2, 2006. Ms. Zimmermann was directed to send an email advising that someone from each fund will attend.

2006 Valuation Fee Quote - Gabriel Roeder Smith & Company

Ms. Zimmermann presented the Board with the 2006 quote for valuation fees from Gabriel Roeder Smith & Company. The quote said the fee for 2006 would be approximately \$16,600 - \$20,600.00. Ms. Zimmerman told the Board that the actual fee for 2005 was \$18,000.00.

RESOLUTION 06-007 By Hannan, Supported by Lee

Resolved, That the Board of Trustees approve the 2006 Valuation Fee Quote from Gabriel, Roeder, Smith & Company.

Yeas: 3 – Nays: 0

Ms. Zimmermann also told the Board that she had information from Gray & Company on the CAPROC investment. However, she preferred to distribute the information when Larry Gray is in attendance and able to explain and answer questions.

NEW BUSINESS

Re: Rebalancing Plan

Ms. Zimmermann stated that the Board of Trustees has not yet approved the cash flow rebalancing plan per consultant recommendations.

Resolution 06-008 By Hannan, Supported by Lee

Resolved, That the Board of Trustees approve the transfer of \$600,000 from the Morgan Stanley international equity account to the cash manager account for the funding of benefits and operating expenses.

Yeas: 3 – Nays: 0

Re: Amortization Period Inquiry from Fire Union – Covered under Union Representative

UNFINISHED BUSINESS

Re: Ordinance Clean up - None

Re: Inter-Fund Transfers

Ms. Zimmermann pointed out that the Board of Trustees has not approved the most recent inter-fund transfers for health insurance and City-owed Medicare payments. The amount due to the City Of Pontiac was for rider deductions withheld from retiree checks as a courtesy.

Resolution 06-009 By Lee, Supported by Hannan

Resolved, That the inter-fund transactions to reimburse the City of Pontiac be approved.

Yeas: 3 – Nays: 0

Re: Annual Committee Review

The Board of Trustees reviewed the committee listing and no changes were made.

SCHEDULING OF NEXT MEETING – Regular Meeting February 23, 2006 at 9:00 a.m. in the Shrine Room at City Hall

ADJOURNMENT

RESOLUTION 06-010 By Hannan, Supported by Lee

Police & Fire Regular Meeting
January 26, 2006

Resolved, That the meeting be adjourned at 11:30 a.m.

Yeas: 3 – Nays: 0

I certify that the foregoing are the true and correct minutes of the meeting of the Police and Fire Retirement System held on January 26, 2006.

J. Edward Hannan, Secretary
As recorded by Jane Arndt