

San Mateo County Employees' Retirement Association
Minutes of the Investment Committee

September 28, 2004 – Investment Committee Agenda

PUBLIC SESSION – The Committee met in Public Session at 10:06 A.M.

- 1.0 Call to Order
- 2.0 Roll Call
- 3.0 Approval of the Minutes for the Investment Committee Meeting
- 4.0 Oral Communications From the Committee
- 5.0 Oral Communications From the Public
- 6.0 Investment Management Services of the Investment Committee
 - 6.1 Acceptance of Monthly Portfolio Performance Report
 - 6.2 Review, Revision & Reaffirmation of Investment Committee Charter
 - 6.3 Selection of *SamCERA's* Core Plus Fixed Income Manager
 - 6.4 Approval of Chadwick Saylor Capital Management's Independent Fiduciary Work
 - 6.4 A Approval of Chadwick Saylor's summary of its valuation conclusions and recommendations
 - 6.4 B Approval of Contribution Agreement
 - 6.4 C Acceptance of the Fairness Opinion
 - 6.5 Approval of INVESCO Core Real Estate-U.S.A., LLC Subscription Documents & Fee Side Letter
 - 6.6 Acceptance of Post Transition Report for the BGI Russell 1000 Alpha Tilts Fund
- 7.0 Other Business
- 8.0 Adjournment

MINUTES OF *SAMCERA's* Investment Committee

- 1.0 Call to Order:** Mr. Lewis called the Public Session of the Investment Committee of the Board of Retirement to order at 10:06 A.M September 28, 2004, in *SamCERA's* Board Room, Suite 125, 100 Marine Parkway, Redwood Shores, California.
- 2.0 Roll Call:** Mr. Bryan, Mr. Lewis, Ms. Salas, and Ms. Tashman *Board Members in Attendance:* Mr. McMahon, and Ms Stuart *Staff:* Mr. Clifton and Mr. McCausland. *Consultant:* Ms. Jadallah and Mr. Thomas of Strategic Investment Solutions and Mr. McClellan of Chadwick Saylor Capital Management, *Public:* One *Retirees:* One
- 3.0 Approval of the Minutes:** Mr. Lewis suggested that the August 24, 2004 Investment Committee Minutes were unanimously approved.

Action: Motion by Ms. Lewis, seconded by Ms. Tashman, carried unanimously to accept the Investment Committee Minutes.
- 4.0 Oral Communications From the Committee:** None
- 5.0 Oral Communications From the Public:** None
- 6.1 Acceptance of Monthly Portfolio Performance.** In August 2004, *SamCERA's* Total Fund Returns are 0.75%, which trailed the Total Plan Policy Benchmark by 7 basis points. During the month, *SamCERA* was slightly underweight equity and overweight fixed income which added slightly to performance. Security selection in the international equity portfolio detracted from value by 10 basis points. The Fiscal Year to Date Fund Return, which is a trailing two month period, is -1.62%. However, *SamCERA's* trailing twelve month return is still positive at 10.98%.

In his testimony to Congress, Federal Reserve Chairman, Alan Greenspan, did nothing to dissuade the belief that the Fed will continue its pattern of raising the overnight interest rate 3target another 25 basis points. The rate is expected to jump to 1.75% at the September 21st Federal Open Market Committee. Economic growth continued at a moderate pace in August. There is still concern that U.S. consumer spending will weaken, as the Core PCE deflator, the Fed's preferred measure of inflation, rose only 0.1%

on the month and only 1.5% over the year.

The table presented below shows the composite returns

August 31, 2004		One Month	Trailing Three Months	Trailing Six Months	Trailing Twelve Months
Equity Aggregate	\$957,799,643	0.25%	-1.71%	-3.83%	12.79%
Equity Composite Benchmark		0.41%	-1.30%	-3.26%	13.93%
Variance		-0.16%	-0.41%	-0.57%	-1.14%
Fixed Income Aggregate	\$450,953,331	1.87%	3.50%	1.39%	6.73%
Fixed Income Composite Benchmark		1.91%	3.51%	1.16%	6.14%
Variance		-0.04%	-0.01%	0.23%	0.59%
Real Estate Aggregate (1)	\$59,555,852	0.65%	2.46%	5.48%	8.55%
NCREIF (one quarter lag)		0.00%	3.13%	5.77%	10.83%
Variance		0.65%	-0.67%	-0.29%	-2.28%
Cash Aggregate	\$12,497,781	0.19%	0.55%	1.12%	2.26%
91 Day Treasury Bill		0.12%	0.31%	0.56%	1.08%
Variance		0.07%	0.24%	0.56%	1.18%
Total Fund Returns	\$1,480,806,607	0.75%	0.01%	-1.89%	10.98%
Total Plan Policy Benchmark		0.82%	0.37%	-1.43%	11.57%
Variance		-0.07%	-0.36%	-0.46%	-0.59%

Performance versus SamCERA's Actuarial Discount Rate

Total Fund Returns		0.75%	0.01%	-1.89%	10.98%
Actuarial Discount Rate		0.64%	1.94%	3.92%	8.00%
Variance		0.11%	-1.93%	-5.81%	2.98%

The table below shows portfolio market values and target weightings versus actual allocations.

Asset Allocation As of 08/31/2004	Market Value	Allocation Current	Allocation Target	Percentage Off Target	Rebalance Range
BGI Russell 1000	\$582,270,705	39.32%	40.00%	-0.68%	±5%
BGI Russell 2000	\$156,060,140	10.54%	10.00%	0.54%	±5%
BIAM	\$219,468,798	14.82%	15.00%	-0.18%	±5%
Total Equity	\$957,799,643	64.68%	65.00%	-0.32%	
BGI US Debt	\$249,430,849	16.84%	16.00%	0.84%	±3%
DAMI	\$201,522,481	13.61%	13.00%	0.61%	±3%
Total Fixed Income	\$450,953,331	30.45%	29.00%	1.45%	
Real Estate	\$59,555,852	4.02%	6.00%	-1.98%	±2%
Cash	\$12,497,781	0.84%	0.00%	0.84%	
Total	\$1,480,806,607	100.00%	100.00%		

Legacy Portfolio As of 08/31/2004	Current Market Value	New Mandated Target Portfolios Market Value %		Portfolio Manager
BGI Russell 1000	\$582,270,705	\$296,161,321	20.00%	Barclays Global Investors Russell 1000
Enhanced R1000		\$296,161,321	20.00%	Barclays Global Investors Enhanced R1000
BGI Russell 2000	\$156,060,140	\$0		
Enhanced R2000		\$74,040,330.36	5.00%	Goldman Sachs Asset Management
Active Value Mandate		\$37,020,165.18	2.50%	Brandes Investment Partners
Active Growth Mandate		\$37,020,165.18	2.50%	Chartwell Investment Management
Bank of Ireland Asset Management	\$219,468,798	\$0		
Active Core Mandate		\$111,060,496	7.50%	Delaware International Advisors, Ltd.
Active Core Mandate		\$111,060,496	7.50%	Julius Baer Investment Management
Total Equity	\$957,799,643	\$962,524,295	65.00%	
Barclays Global Investors US Debt	\$249,430,849	\$143,064,139	9.66%	Barclays Global Investors US Debt
Deutsche Asset Management, Inc.	\$201,522,481	\$143,064,139	9.66%	Deutsche Asset Management, Inc.
Core Plus Mandate		\$143,064,139	9.66%	To Be Announced
Total Fixed Income	\$450,953,330	\$429,192,416	28.98%	
Real Estate	\$59,555,852	\$59,241,450	4.00%	Proposed Open End Core Real Estate Fund
		\$29,848,446	2.02%	May Consider Manager Diversification (2)
Cash	\$12,497,782	\$0	100.00%	
Total	\$1,480,806,607	\$1,480,806,607		

Action: The Committee unanimously accepted the Monthly Performance Report. The Committee will recommend to the Board of Retirement that it accepts the report.

6.2 Annual Review, Revision & Reaffirmation of Investment Committee Charter. The Board of Retirement created the Investment Committee with the adoption of Resolution 99-00-09 on January 25, 2000. The Board reviewed the Resolution on April 24, 2001. By consensus, it directed staff to provide amended language regarding the Committee's authority to direct the Board on its ongoing evaluation of both the Investment Consultant Structure & Performance and the Actuary's Economic & Asset Considerations. Sections 10.0 & 11.0 were amended into the Charter on May 22, 2001. Since then the Charter has been reviewed annually without any amendments until this meeting.

Mr. McCausland pointed out that the Regulations of the Board of retirement had been amended and the third and fourth Whereas Clauses no longer applied. The Investment Committee opined that the Third Whereas Clause should be removed in its entirety. The Fourth Whereas Clause would be amended as follows:

WHEREAS, *The Board of Retirement*, wishes to exercise these powers as follows:

EXERCISE OF POWERS: The Board shall exercise its investment, management and administrative authority and responsibility through the approval of motions recorded in public meeting

Action: By consensus, the Investment Committee will recommend to the Board of Retirement that it approve the amendments to Resolution 99-00-09, Investment Committee Charter.

6.3 Selection of Finalists for *SamCERA*'s Core Plus Fixed Income Manager The Board completed an Asset Liability Study in July 2003. As a result of that study the Board opined to maintain its existing Asset Allocation of 65% Equities (40% Large Cap Domestic, 10% Small Cap Domestic, and 15% International); 29% Domestic Fixed Income and 6% Real Estate. The Board then reviewed its manager structure. Several portfolio changes were recommended as a result of that study. An additional mandate, Core Plus, was added to *SamCERA*'s fixed income allocation. A Core Plus manager uses sectors outside of the Lehman Aggregate Index such as high yield on-US foreign debt and emerging market debt on an opportunistic basis as a source of added value. *SamCERA*'s fixed income allocation will be divided into thirds. One third will be passively invested in BGI's US Debt Index Fund, one third actively managed by Deutsche Asset Management in a core mandate and one third actively managed in a core plus mandate.

In July 2004, the Board approved criteria, to be utilized in a search for managers in a core plus mandate. Strategic Investment Solutions screened 329 products to assure a minimum three year track record, minimum performance standards, minimum amount of asset under management, return based style screens, open to new business and qualitative screens. The qualitative screens excluded managers where there are organizational concerns or noteworthy personnel turnover, retail or wrap business focus, very high tracking error, regulatory issues, asset mainly parent related, and poor relative performance/information ratios. The Investment Committee with the assistance of SIS, reviewed Deutsche Asset Management, Hartford Investment Management, Payden & Rygel, Pacific Investment Management Company, LLC (PIMCO), Trust Company of the West Group, Inc. (TCW), and Western Asset Management Company. The candidates were narrowed to three semi-finalists, Deutsche Asset Management, PIMCO and Western Asset Management who were asked to provide additional information on the cost of transitioning to their product from *SamCERA*'s legacy portfolio, BGI's US Debt Index Fund. Barclays Global Investors' transition team also provided estimates to compare against the manager generated data. The Board reviewed the estimated transition costs, management fees, and historical performance before selecting Deutsche Asset Management and Western Asset management as the two finalists.

Below is a review of the finalist's pros and cons:

Deutsche Asset Management

Pros

- Known entity to SamCERA
- Add value through investing in inefficient credits and structured product within the US as well as through extended sectors
- Largely stable team
- Strong returns

Cons

- Deutsche Asset Management and Deutsche Bank have had various regulatory issues in recent

- years (but none were associated with the Core Plus product)
- Firm has lost business across asset classes in the last year
- Significant non-index exposure within the US investment grade component of Core Plus
- Capacity constraints given niche bond exposure

Western Asset Management

Pros

- A bond powerhouse.
- High conviction approach has yielded tremendous alpha for its clients.
- Portfolio outlook and structure determined by experienced and stable Investment Strategy Group
- Successful sector rotation over many years.

Cons

- High tracking error
- Long term, value-oriented approach does require patience

Action: Motion by Mr. Bryan second by Mr. Lewis, carried unanimously to recommend to the Board of Retirement that Western Asset Management Company is selected for SamCERA's Core-Plus Fixed Income Mandate.

6.4 Approval of Chadwick Saylor Capital Management's Independent Fiduciary Work. On November 25, 2003, the Board of Retirement opined that an open-end commingled fund real estate mandate would allow *SamCERA* to achieve the diversity of property type, geographical location and range of market values that the Plan could not achieve with its separate property mandate. The Board found that moving SamCERA's separate properties into the INVESCO Core Real Estate – U.S.A., LLC Fund as a "Founding Investor" provided advantages not afforded by any other Core Real Estate Fund. In July 2004, the Board hired CS Capital Management as an Independent Fiduciary to represent and advise it with respect to the due diligence related to the INVESCO Core Real Estate - U.S.A, LLC Fund, including: (i) evaluating the value of all pre-closing portfolio transfers to the Fund and issuing a fairness opinion; (ii) negotiating, preparing, and delivering a Contribution Agreement; (iii) presenting a summary of its valuation conclusions and recommendation to the Board and (iv) such other assignments as set forth in the contract

On September 10, 2004, CS Capital Management (CSCM) delivered its Independent Fiduciary Report on INVESCO Core Real Estate – U.S.A., LLC to SamCERA. CSCM completed an independent valuation of SamCERA's Real Estate Portfolio for purpose of the transfer. CSCM represented SamCERA in the negotiation of a Contribution Agreement that reflects what they believe are appropriate terms, including price, and conditions for the transfer.

After completion of the valuation process and subsequent negotiation between INVESCO and CSCM, INVESCO agreed to the Contribution Price recommended by CSCM. The agreed upon contribution prices reflect individual assets. CSCM utilized a methodology, based on current industry practices, for marking existing debt to market. The Independent Fiduciary recommends that the final "mark to market" adjustments be calculated immediately prior to the Fund initial closing date. The report recommends a contribution value of \$59,795,000, prior to any adjustments for debt or marking the debt to market. The table below illustrates the recommended adjustments to that amount, for any outstanding loan balance expected on the estimated closing date of September 30, 2004, and for marking the debt to market. The

net contribution value, referred to as the “Agreed Value” in the Contribution Agreement, is \$52,512,015. Note that the Contribution Agreement provides for further adjustment to the Agreed Value for any prorations of real estate taxes, operating expenses and interest rate movements between September 14, 2004 and the closing date.

Property Name	Property type	CSCM Recommended Contribution Rate	Estimated Loan Balance as of 10/1/04	Mark to Market Adjustment	Net Contribution Value – Post Adjustment (Agreed Value)
Pacific Corporate Center	Office	\$ 14,000,000	(\$6,856,382)	(\$426,604)	\$ 6,717,015
Irving Warehouse	Industry	\$ 8,070,000			\$ 8,070,000
Boca Colony	Apartment	\$ 14,500,000			\$ 14,500,000
Matthews Township	Retail	\$ 16,815,000			\$ 16,815,000
Highland Bank Building	Office	\$ 6,410,000			\$ 6,410,000
Totals		\$ 59,795,000	(\$6,856,382)	(\$426,604)	\$ 52,512,015

Based on the work completed, which is described in the Independent Fiduciary Report on INVESCO Core Real Estate – U.S.A., LLC, CS Capital Management concluded and opined as follows:

- The recommended contribution price of the Real Estate Portfolio in order to complete the Transfer as of September 30, 2004 prior to any adjustment for marking debt to market is \$59,795,000.
- The recommended contribution price of the Other Transfers as of September 30, 2004 prior to any adjustment for marking debt to market is \$403,780,000.
- The Transfer when compared to the Other Transfers is fair and appropriate.

CS Capital Management’s, John McClelland provided the overview of the Independent Fiduciary process.

Action: By consensus the Investment Committee will recommend that the Board of Retirement approve the Independent Fiduciary work of CS Capital.

6.5 Approval of INVESCO Core Real Estate-U.S.A., LLC Subscription Documents & Fee Side Letter. The Board of Retirement opined that an open-end commingled fund real estate mandate would allow *SamCERA* to achieve the diversity of property type, geographical location and range of market values that the Plan could not achieve with its separate property mandate. *SamCERA* began working with INVESCO on the development of the Core Real Estate Fund. In June 2004, the Board received a status report on INVESCO’s Core Real Estate-U.S., LLC Fund and reviewed alternate providers with a similar product. The Board found that moving SamCERA’s separate properties into the INVESCO Fund as a “Founding Investor” provided advantages not afforded by any other Core Real Estate Fund. In July the Board hired CS Capital Management as an Independent Fiduciary to represent and advise it with respect to the due diligence related to the INVESCO Core Real Estate - U.S.A, LLC Fund, including: (i) evaluating the value of all pre-closing portfolio transfers to the Fund and issuing a fairness opinion; (ii) negotiating, preparing, and delivering a Contribution Agreement; (iii) presenting a summary of its valuation conclusions and recommendation to the Board and (iv) such other assignments as set forth in the contract

Prospective investors to the INVESCO Core Real estate Fund are required to complete a Subscription Agreement and Investor Questionnaire, “Subscription Documents”. A complete set of documents, which includes a Subscription Agreement, Investor Questionnaire, Form W-9, Evidence of Authority, and

Privacy Notice, is attached to this item.

As a “Founding Investor”, *SamCERA* recognizes certain cost benefits expressed though Side Letters. Attached is an Investment Management Fee Side Letter, which stipulates that *SamCERA*’s fee will be seven percent (7.0%) of Net Operating Income. It also states, in essence, that no other investor will receive a more favorable fee arrangement.

SamCERA’s Investment & Finance Manager and County Counsel reviewed the Subscription Documentation and the Investment Management Fee Side Letter.

SAN MATEO COUNTY EMPLOYEES' RETIREMENT ASSOCIATION
Adoption of INVESCO Core Real Estate – U.S.A., LLC
Subscription Documents and Investment Management Fee Side letter
RESOLUTION 04-05-

THIS RESOLUTION, adopted by the Board of Retirement (Board)
of the San Mateo County Employees' Retirement Association (SamCERA), approves
the Subscription Documents and Investment Management Fee Side Letter
for the INVESCO Core Real Estate – U.S.A., LLC.

WHEREAS, Article XVI, §17 of the Constitution of the State of California vests the Board with "*plenary authority and fiduciary responsibility for the investment of moneys and the administration of the system*"; and

WHEREAS, Government Code §31595 vests in the Board “. . . *exclusive control of the investment of the employees retirement fund.*” and

WHEREAS, Government Code §31596.1 (d) authorizes the Board to retain investment managers “. . . *in connection with administration of the Board's investment program . . .*”; and

WHEREAS, The Board of Retirement opined that an open-end commingled fund real estate mandate would allow *SamCERA* to achieve the diversity of property type, geographical location and range of market values that the Plan could not achieve with its separate property mandate; and

WHEREAS, the Board reviewed several providers of core real estate funds before determining to invest in the INVESCO Core Real Estate – U.S.A., LLC as a “Founding Investor”; and

WHEREAS, “Founding Investor” in INVESCO Core Real Estate – U.S.A., LLC recognize certain cost benefits expressed though Side Letters; and

WHEREAS, the Board found it prudent to hire CS Capital management, Inc. as an Independent Fiduciary to represent and advise it with respect to the due diligence related to the INVESCO Core Real Estate - U.S.A, LLC Fund, including: (i) evaluating the value of all pre-closing portfolio transfers to the Fund and issuing a fairness opinion; (ii) negotiating, preparing, and delivering a Contribution Agreement; (iii) presenting a summary of its valuation conclusions and recommendation to the Board and (iv) such other assignments as set forth in the contract; and

WHEREAS, the Board approved CS Capital Management’s work product, a portion of which is incorporated into the INVESCO Core Real Estate – U.S.A., LLC Fund Subscription Documents; and

WHEREAS, County Counsel has approved the Subscription Documents and the Investment Management Fee Side Letter as to form and the Investment and Finance Manager has recommended approval of the documents. Therefore, be it

RESOLVED that the Board hereby approves the INVESCO Core Real Estate – U.S.A., LLC Fund Subscription Documents and Investment Management Side Letter. Be it further

RESOLVED that the Board hereby delegates full discretionary authority to the INVESCO Core Real Estate – U.S.A., LLC Fund to manage the assets of the Retirement Fund as allocated by the Board in accordance with the terms of the amended and restated limited Liability Company Agreement (the “Operating Agreement”) of INVESCO Core Real Estate – U.S.A., LLC. Be it further

RESOLVED that the Board hereby approves the fees as specified in the Investment Management Fee Side Letter and authorizes the disbursement of funds as provided for in GC §31596.1 in accordance with *SamCERA*’s internal controls. Be it further

RESOLVED that the Board hereby authorizes the Chair, to execute the Subscription Documents and the Investment Management Fee Side Letter on behalf of the Board. Be it further

RESOLVED that the Board hereby designates the Investment & Finance Manager as its designee to perform those functions so identified in the Fund documentation and hereby authorizes the Investment & Finance Manager to take all actions necessary to initiate, implement and monitor assignments, approve payments and provide the Board with timely reports regarding the progress and satisfactory completion of the assignments authorized pursuant to the Fund Documents.

Action: Motion by Ms. Tashman, second by Ms. Lewis that the Investment Committee recommend to the Board of Retirement that it adopt the above Resolution, which authorizes the Board Chair to execute the INVESCO Core Real Estate – U.S.A., LLC Subscription Documents and Investment Management Fee Side letter.

6.6 Acceptance of Post Transition Report for the BGI Russell 1000 Alpha Tilts Fund. On June 22, 2004, the Board of Retirement selected Barclays Global Investors’ Russell 1000 Alpha Tilts for *SamCERA*’s first venture into an enhanced equity product. After conducting an onsite due diligence visit the Association passed Resolution 04-05-05, which authorized the Chair to execute an amendment to *SamCERA*/Barclays Global Investors’ Investment Management & Custody Agreement (IMCA). The amendment authorizing *SamCERA* to invest in BGI’s Russell 1000 Alpha Tilts Fund. Also in August 2004, the Board accepted Barclays Global Investors’ analysis for the transition of assets from the Russell 1000 Index to the Russell 1000 Alpha Tilts and authorized the Chair to execute a Letter of Authorization, directing BGI to restructure one half of *SamCERA*’s investment in the BGI Russell 1000 Index Fund into units of the BGI Russell 1000 Alpha Tilts Fund. The Letter of Authorization detailed the transition process, including certain disclosures and authorizations.

BGI restructured a domestic equity portfolio worth approximately \$291 million on *SamCERA*’s behalf. The legacy portfolio was the BGI Russell 1000 Index Fund and the target portfolio was the Russell 1000 Alpha Tilts fund.

On August 27, 2004, BGI redeemed 50% of *SamCERA*’s units, via securities, of the Russell 1000 Index Fund and transferred the securities to a restructuring account. Trading in the restructuring account from the index portfolio to the active portfolio was completed in one day (August 31, 2004). Upon completion, the restructured portfolio was contributed into the Russell 1000 Alpha Tilts Fund. The restructured portfolio consisted of approximately \$288.9

million of securities and approximately \$2.1 million in cash.

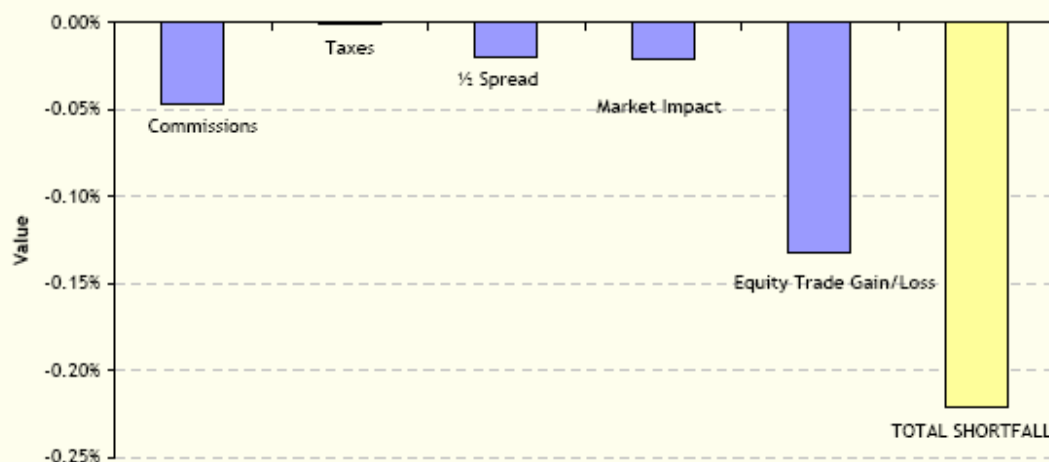
Approximately 42% of the legacy portfolio overlapped with the target portfolio and therefore did not require trading. on a roundtrip basis this overlap accounted for \$240 million of securities. Approximately 28% of the portfolio was crossed. The remaining 31% was traded in the open market.

The potential cost of the transition as measured by implementation shortfall (based upon 100% sell and buy in the open market) was estimated to fall between –3.4 bps and –22.7 bps. The realized implementation shortfall was –22 bps or approximately -\$645,000. A full attribution may be found in the attached report.

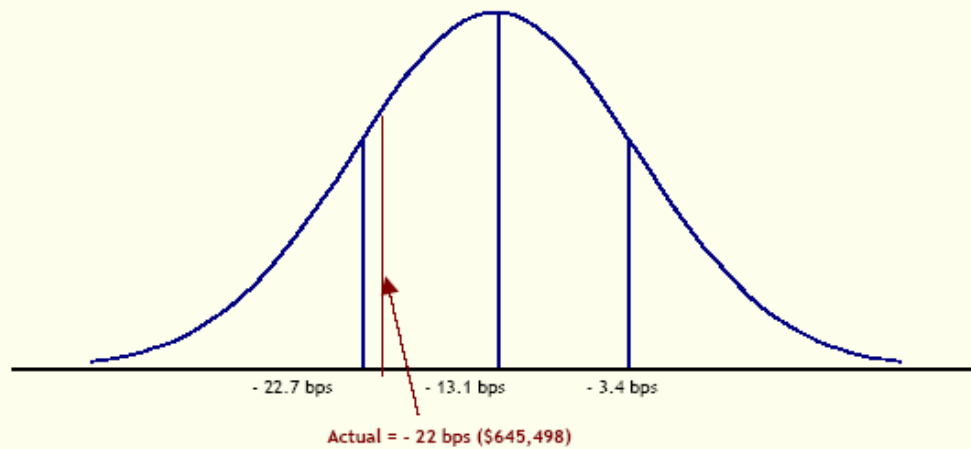
In summary the short fall on the lower end of the expectation range may be attributed to market movement. During the transition, Barclays crossed a greater amount of securities than estimated. While the increased crossing reduced explicit costs, it increased opportunity risk, or exposure to the market. Since the target portfolio outperformed the legacy portfolio, and crossing trades are priced at market close, the increased market exposure resulted in an implementation shortfall on the lower end of expectations.

A portion of the transition analysis appears on the following page.

	Dollars	Bps of \$291.9 m
Commissions	(138,006)	-0.05%
Taxes	(3,528)	0.00%
Explicit Costs	(141,534)	-0.05%
½ Spread	(57,764)	-0.02%
Market Impact	(61,028)	-0.02%
Implicit Costs	(118,792)	-0.04%
Equity Trade Gain/Loss	(385,172)	-0.13%
Opportunity P&L	(385,172)	-0.13%
Total Shortfall	(645,498)	-0.22%



Pre-transition estimate versus actual shortfall



Action: By consensus the Investment Committee will recommend that the Board of Retirement accept the Post Transition Report for the restructure from the BGI Russell 1000 Index Fund to the BGI Russell 1000 Alpha Tilts Fund.

7.0 Other Business: None

8.0 Adjournment: There being no further business Mr. Lewis adjourned the Committee at 11:52 A.M.