Peralta Community College District
Retirement Board Meeting Minutes
June 14, 2012

Present:	Trustee Bill Withrow, Trustee Riley, Chancellor Wise Allen, Vice Chancellor Ron Gerhard, Michael Wirth, Tae-Soon Park, Jerry Herman, Odell Johnson, Joanna Bowes (KNN Public Finance) (phoned in) and Ed Berman (Neuberger Berman)
Absent:	Trustee Cy Gulassa, Vice Chancellor Trudy Largent, and Ava Lee-Pang
Guests:	Matt Rubin, Paul Dagget, Chris Frattaroli, and Jeff Majit

Agenda Item	**Discussion**	**Follow-up Action**
Meeting Called to Order	3:11 P.M.	
III. Approval of Agenda	Motion (Withrow, Riley) to approve the June 14, 2012 agenda. APPROVED	
IV. Approval of Minutes	Motion (Withrow, Gerhard) to approve the March 15, 2012 meeting minutes. APPROVED	Item #6 - Ed Berman to provide the percentage of subprime securities and schedule under the floating rate.
V. Correspondence VC Gerhard	none	
VI. Presentation by Neuberger Berman Ed Berman Matt Rubin Paul Dagget Chris Frattaroli Jeff Majit	Request was made by Trustee Withrow to upload the recording of this meeting online. Document provided *Peralta Community College District Retirement Board/Trustee Workshop* The three alternative asset classes are: 1. Private Equity 2. Hedge Funds 3. Commodities Note: the presentation is for informational purpose only. No action will be taken. **Background** In a traditional sense, when we were a lot younger we have a pool of funds with a target return yield of 7-8%, bonds yield of 5%, and equity yield historically of 9-10% over a long time frame. Asset allocation to equity and bonds consisted of doing the math, coming up with	

	a mix, and just let it happen. Those days are gone. Alternative asset classes are options available to Discretionary Trustees to achieve the goal of the trust. We like to think of it as our job to educate this group on the dynamics of what some of these asset classes are, the risks involved, and characteristics of these asset classes. Also, what are some of the options if we chose to utilize some of these asset classes? This is background information for future dialogue. **Private Equity Funds** Highlights: 1. Neuberger Berman manages $14 billion in alternative assets 2. Looking at asset allocation from a moderate perspective: 54% in Cash & Fixed Income, 44% in Equities, and 2% in Real & Alternative Assets. After a long period of time, the expected return of this portfolio is 6.2% with a 7.3% volatility (the volatility around the dispersion mean return is 7.3% in either direction assuming a normalized distribution). With alternative investment, we are able to achieve a slightly better return of 6.5% with a slight increased amount of risk at 7.5%. 3. The current allocation as of June 8, 2012 does not include Real & Alternative Assets. 4. Private equity refers to investments and assets (equity and/or debt) that are not tradable in the public exchange. 5. Fund Structure: Usually a limited partnership structure. Each fund would typically invest in 10-25 companies within that portfolio. If you invest in that fund, you have made a commitment to that fund for period of 4-5 years. Fund size can range from $1 mil to $20 billion. Life of the fund varies between 7-12 years (10 is the most common). It takes time to develop and then sell the company. Private equity tends to be illiquid. When you invest in that fund, you are in that fund for its entire life. One exception: you can sell the commitment in the secondary market for used private equity. 6. All of the private positions are valued using mostly comparable companies on a quarterly basis. There is a linkage to public markets with a correlation much below one. One advantage is	

that as private equity funds develop over time, the valuation tends to be steadier over the investment period.

7. Private equity funds are not SEC regulated, but registered investment advisors are usually subject to SEC regulation. Private equity funds have audits (December 31st) and follow Generally Accepted Accounting Principles (GAAP). A simplified version of the performance report will be provided 2-3 months after year end. 75% of the companies are in the US and some in Asia and Europe. For each fund, Neuberger does a vast background check and due diligence work before making an investment.
8. Fees: 20% profit share made on the investment after an 8% hurdle. Fund-of-fund charges a fee of 60-70 basis points plus 5% carry interest. For example, for a $1 million investment, the target amount of 2x the fund at $2 million. Neuberger will take $200,000 (20% of $1 million) and another $40,000 (5% of $800,000). Peralta gets around $760,000.
9. Types of Control: Depends on the strategy.
    a) Buyouts (most typical and prominent form) – buys almost 100% of the company using 50-60% of equity and the rest with debt. The goal is to own it and take it away from public markets. Smaller companies can benefit more from professional investors than larger companies. The focus is on mid cap buyout spectrum.
    b) Venture Capital – minority ownership with Board representation to guide entrepreneurs with ideas. This is mainly for young companies. Investors are looking to takeover 10-30% of the company. They usually invest in firms that are $3-5 million in size.
    c) Credit Investments:
        i. Mezzanine Debt – in between senior debt and equity with returns in the mid to high teens.
        ii. Distressed Securities – trading strategy: buy publicly traded debt that is subject to a leveraged

	buyout but the debt is still public. Buy low sell high strategy: buy distressed debt of a firm at a low value, as bankruptcy occurs, convert that debt into equity, take control of the company, fix/improve it and then sell it back to the public market or private owner. 10. Timeline: Capital Call Period – fund raised. Firm makes investments in 10-20 companies over a 3-5 year period. Large calls occur within the first 3 years; they don't call 100% upfront, just when they need money. Money starts to come back usually in the 4^{th} or 5^{th} year. It takes 4-6 years to call all the money back. 11. Cash Flow J Curve: the most money out the door is 70%. By the time all the money is out the door, it will begin to come back. Another tool is by vintage or by the year the fund was created. Rather than going to one vintage of private equity, Neuberger will go into multiple private equity fund-of-funds to stagger and diversify the funds. The recommendation is to put money into 5 years of vintage. 12. Target Internal Rate of Return (IRR) is 20%. Target return is twice the investment **(return)**. 13. From an asset allocation perspective, to be in this asset class, the best way to employ the capital is through a diversified vehicle. From a return perspective, putting money away for a 7-10 year period, Peralta should be compensated for the illiquidity of the money and fees paid. We should look at private equity funds as a return enhancer to the portfolio. Neuberger has netted 16.3% (entire life of the vehicle) for their customers over the last 25 years. 14. Advantages: Extensive and complete access to information. The goal is to build the company up, get more revenue, and then get IPO or sell to another strategic partner. Companies want to be taken over by successful equity firms. In 2-3 years, the company will increase in value. 15. Volatility: Money will be called in the next 5-6 years. We do not know when the money is going to come back.	

16. Liquidity (biggest risk): None. We heard a statistic in New York this week that it is estimated that 10% of all investments into private equity funds end up going into the secondary market. If true, that is a fundamental change in the last 2-3 years, which means there is a chance of getting out in some sort of discount. Within the portfolios that Neuberger is going to put together, there are primary investments and secondary investments where they will go out to distressed seller and buy an investment in a private equity fund on 80-90 cents on the dollar. CalPERS is a large seller of private equity funds in the secondary market. They are not selling for distressed reasons. They are selling because they are doing yearly asset allocation.
17. Manager Selection (most important): Huge spread between the 1st and 4th quartile (Buyouts at 1,750 basis points and Venture Capital at 1,300 basis points). You do not want median private equity return. You have to be compensated for the illiquidity. There is a strong correlation of successful funds being successful again within the private equity market. If you invest in a top quartile fund, you have 73% chance of being above median on a go-forward basis. About 87% of all previous funds invested by Neuberger are now above median. Winners continue to win in private equity.

Hedge Funds

Highlights:

1. Hedge fund is a more heterogeneous asset class. It invests in a variety of instruments. It can have a long bias or a short bias (bearish). It uses options to hedge positions and a collection of different strategies to allocate capital and improve leverage.
2. Common target: 400-500 basis points in a given portfolio. Returns are absolute in nature.
3. Short a security: You make money when it goes down. CalPERS is one of the largest hedge fund investor in the market. Institutions like CalPERS often go short on the market to offset risk. Per VC Gerhard, this Retirement Board is setup under the same Article 16 as CalPERS. Anything

Ms. Bowes will check to see if Peralta is precluded from going short on the market as a

	that CalPERS is doing is permissible to us. 4. Hedge funds are used as a risk mitigation tool by lowering the volatility of the overall portfolio. Most hedge funds are included in a client's portfolio to reduce risk, not to gain a return. 5. Equity Hedge tends to, at the net level, have more longs than they have short. 4-6 years ago, equity hedge dominated the hedge fund market. Managers invested in a long bias way as a substitute rather than a compliment. It is more akin to equity investments than hedge fund investments. 6. Strategies: a) Relative Value: Managers are looking for pricing dislocations to exploit mispricing among securities. It tends to offer liquidity on a monthly basis. Statistical Arbitrage is a market-neutral model-driven equity strategy. It captures short-term pricing arbitrations in the stocks being monitored. b) Event Driven: refers to investments in companies with corporate activity, i.e. mergers. When company A buys company B at an announced price, because of the way the market moves, the target company's value does not immediately rise to the bid price of that company. There is an opportunity to go long the target company, when the deal closes, take advantage of that price and go short. Other strategies are akin to private equity such as distressed debt, where managers are buying the debt of companies going through bankruptcy (usually Chapter 11). It is one of the most productive hedge fund strategies. Another example of the Chapter 11 process is where mutual funds or insurance have to sell the security once the company defaults in its interest payments. As a result, there tends to be a large supply of that paper in the market. Distress debt managers may ride through the bankruptcy process and sometimes 12-18 months recover those funds and the	governmental institution.

	company emerges from bankruptcy. Or they may take a more active role in driving the restructuring. It is an attractive strategy from a return standpoint but less liquid. Allocation to this strategy is modest. Distress debt has a 1-2 years initial commitment. Once the lockup is lift, it then turns into a quarterly liquidity and can be canceled with typically a 60 days notice. c) Long/Short: This area tends to be a net long bias. If they think the market is going to be strong, then they will long more than short. They will go short on stocks that they think are overvalued. It exploits fundamental and technically driven opportunities. d) Directional: We do not define the Macro strategy as a traditional hedge fund strategy but as a directional strategy. In 2008, most macro got the call right, went short and made money. It is an uncorrelated strategy with a correlation of zero over time. CTA stands for Commodity Trading Advisors. It only invests in futures contracts which are more liquid. 7. Benefits: Market-like returns with lower volatility (4-5%). You can preserve capital and compound it at a reasonable rate. Hedge funds have the flexibility to adjust their net market exposure by going long or short. Many strategies tend to be uncorrelated. 8. HFRX – fund weighted index. It is most cited in the hedge fund world. Annualized rates of return of HFRX are greater than Russell, S&P, and MSCI EAFE. 9. Manager Selection: Finding the best managers starts with the sourcing of funds. There are 10,000 hedge funds. Many of which are what we view are uninvestable; they have very low asset, do not have proper infrastructure, but are legal entities that are offering their services as hedge funds. A very high concentration of assets are held in the hands of the top 100-200 funds. Our job is to source those funds. Typically a group	

like us will see 1500+ hedge funds a year. After screening and due diligence, there may be 60 in our portfolio, and we pick a small number (10-25 per year) to invest in. We look for investment strategies that are robust. Is what they are doing significantly different from the other hedge funds that we've invested in? What is their risk management like? This occurs over several meetings. At the end of the conversations, our team debates their merits. There will be ongoing monitoring because hedge funds are dynamic. Hedge fund turnover is 15-20% per year.

10. Regulation Impact: As of now, hedge funds over $100 million need to register with the SEC. The hedge funds that we look at are SEC registered. There have not been any high profile cases where hedge funds have been tried for market manipulation. In 2008, in the commodity market, there were hedge funds manipulating oil. Prior to registering with the SEC, traditional equity funds did not have a need for big compliance structure. That cost tends to be a few hundred thousand dollars. It might be viewed as a barrier to entry. It makes cost of doing business more expensive for those hedge funds. Hedge funds are more transparent now. They provide full portfolio to their investors and will meet with investors whenever there is a request. SEC oversight does not replace the due diligence that we have done.
11. Hedge fund is a broad asset class. We can deliver attractive returns with low volatility. There are risks, but the simple rule is to avoid funds that use excessive leverage; make sure hedge funds are properly matching their own assets (securities) and liabilities (to investors). They cannot take liquidity to buy private equity that is illiquid. This is part of our ongoing screening criteria.

Commodities

Highlights

1. In many ways, we do not consider commodities as a separate asset class; we consider them a real asset class. It is an investment in hard asset as opposed to equities and bonds. The single most important reason to add commodities to a

	portfolio is because historically they have been the best hedge to inflation. The two best hedges against inflation are: 1) Equity with pricing power where the company has the ability to raise their prices in inflationary periods. 2) Treasury Inflation Protect Securities (TIPS) - The principal of a TIPS increases with inflation and decreases with deflation, as measured by the Consumer Price Index. 2. We set a strategic target of 3% right now to commodities because of the diversification benefit. Right now, given the growth expectation that we see in the world: 2.5% in the US, we think Europe will be in a recession, and emerging markets will continue to grow significantly. We think commodities will hold up. When inflation returns, it will be a good diversifier to the rest of the portfolio. 3. Correlation: Low correlation to other asset class. It does not move in tandem to stocks/bonds. There is no dedicated position to gold, crude, or pork belly. 4. Safe-haven Properties: Physical commodities generally do not default. 5. Liquidity: Very liquid investments. It is regulated and traded in an open market environment. 6. Risks: Total risk consists of systematic risk and idiosyncratic risk. Systematic risk is non-diversifiable risk which corresponds to movements of major markets. Idiosyncratic risk is risk specific to the security of the underlying instrument that you are investing. Commodities tend to help diversify characteristics of both risks from a portfolio perspective. Historically, commodities exhibited negative correlation to equity and bonds. It varies with stages of business cycles. Commodities have performed better than stocks and bonds during late expansion and early recession periods. One reason you have not seen any asset allocation in your portfolio yet is because the allocators in the asset allocation committee still believe we are in the earlier stages of a continued expansion in the US economy and we are not yet headed into a recession.	

	7. Commodities index: Two major ones are S&P Goldman Sachs Commodity Index (S&P GSCI) and Dow Jones - UBS Commodity Index (DJ-UBSCI). S&P GSCI tends to have a higher weight towards energy. DJ-UBSCI tends to have a more neutral weight towards energy. 8. Historically, commodities are a very good hedge against inflation and the erosion against returns in fixed income portfolios and also in elements of equity portfolio that does not have pricing powers as described earlier. It is a less complicated asset class and a much more straight forward asset class than private equity and hedge funds. **Monte Carlo Simulation:** A system that runs many mathematical calculations on the probability of occurrences happening over long time frames. We ran our current asset allocation in scenario A and 20% alternatives in scenario B. Returns increased from 7.2% to 7.7%. The standard deviation/risk decreases from 10.6% to 10.4% over a 25 year period. It is adjusted for 2.5% expected inflation. At the 50th percentile, the return is $294,998,624 in scenario A and $355,611,014 in scenario B. Per VC Gerhard, the goal is to put a plan in place to fund the OPEB liability. The last figure from our actuarial study was $221 million in today's dollars. The key is to look at the 50th percentile (average) and see in the period of 20-25 years if we are funding that actuarial liability; we are in both alternative asset class scenarios and in the non-alternative asset class scenario as well.	
VII. Review Updated Investment Policy Statement VC Gerhard	• No action taken • Full document provided with the inclusion of the SWAP policy language	
VIII. Investment Portfolio Review Ed Berman	Since we assumed responsibility as the Discretionary Trustee in April, we have been busy transitioning assets. We have executed on the wishes of this group and the template of the policy statement. We have allocated 20% of the funds to the external managers. Page 9 shows who we took money away from and who we gave money to.	

	Trustee Withrow asked about the exposure we have to emerging markets. Per Matt Rubin, Peralta has exposure to emerging markets in different ways: dedicated right now, we have exposure of 6.3% in the portfolio with a long-term target of 7%. Peralta also has emerging market exposure in Large Cap US space, 9 points above the long-term target. From a valuation perspective, much today's US Large Cap market is exposed to the emerging market where 40% of revenue/profit comes from sales and business from emerging markets. Request was made by Trustee Withrow to modify the report template to include the percentage of emerging markets under Large Cap portfolio. Net Change: -$11,107,607, a vast majority of that was during the month of May due to the flow of funds in the program. Per VC Gerhard, we had expenditures to pay CoreSource and Kaiser. As we close our books, we expect to get reimbursed from this fund to the general fund. Then when we are done with the audit, we will add money back to the OPEB fund. The assumption is an annual negative cash flow of $3 million deducted from the portfolio. Of the $11.1 million, $9.8 was reimbursement to the general fund. The $1.3 million was because May was a bad month. Page 11 shows the report from the old reporting system. This will be the last time we will see this form. As of April 30, 2012, the fund's Year-to-Date performance is up 8.24% versus it benchmark of 7.75%. Page 13 shows the new reporting format which is by asset class and investment manager. Page 14 is the key page that is not fully populated right now but will be in the future. It is provided every quarter. 3 measures of accountability: a) How well they have set the policy b) How well did they provide tactical allocation c) Manager selection – ability to hire and fire managers (internal to Neuberger and	

	external) on Peralta's behalf. We will report back how well they've done relative to their peers.	
IX. Information Reports	• None	
X. Agenda Items for Next Meeting	1. Follow up on Neuberger Berman Presentation on Alternative Asset Classes 2. Investment Portfolio Review 3. Irrevocable Trust	
Adjournment:	4:56 PM	
Next meeting:	September 13, 2012 from 4:00 to 6:00 PM	

Minutes taken: Sui Song
Attachments: All handouts for this meeting can be found at
http://web.peralta.edu/trustees/board-committees/retirement-board/