sdCERS
San Diego City Employees' Retirement System

INVESTMENT POLICY STATEMENT

The mission of the San Diego City Employees' Retirement System (SDCERS) is to deliver accurate and timely benefits to its members, retirees and beneficiaries and ensure the Trust Fund's safety, integrity and growth.

Current as of May 18, 2007

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SAN DIEGO CITY EMPLOYEES' RETIREMENT SYSTEM
INVESTMENT POLICY STATEMENT

INTRODUCTION

This Investment Policy Statement (IPS) is intended to serve as a reference tool and encompasses the investment goals, objectives and policies of the San Diego City Employees' Retirement System (SDCERS) Trust Fund. The purpose of the IPS is to assist the Board of Administration, the Investment Committee and staff in effectively supervising and monitoring SDCERS' Investment Program. This IPS addresses the following issues:

- The investment goals of the SDCERS investment program;
- The specific asset allocation and performance objectives by which SDCERS' assets shall be managed to achieve this goal;
- The general investment policies for the management of assets; and
- The responsible parties and their duties for the management of assets.

The Board has adopted the specific policies and guidelines incorporated herein. The Board has been and will continue to be guided by the Prudent Expert standard.

The Board may allocate investment responsibility of Trust Fund assets to multiple investment managers and/or the Retirement Administrator subject to both these guidelines, the provisions of Article IX, Section 144 of the City of San Diego Charter. The Board may delegate to the Investment Committee responsibility for appointing and supervising investment managers and consultants. Investment consultants are used to assist in asset allocation studies, investment manager performance monitoring and selection reviews, as well as to conduct other research. The Investment Committee is required to report to the Board at least quarterly.

The IPS is designed for sufficient flexibility in the management oversight process to capture investment opportunities as they may occur, while setting forth reasonable parameters to ensure prudence and care in the execution of the investment program

I. INVESTMENT PHILOSOPHY SUMMARY

The following is a summary of SDCERS' investment philosophy. For the complete philosophy statement, see Appendix A.

The Board believes that its investment policies, in aggregate, are the most important determinants of its investment success. Compliance with investment policies should, therefore, be monitored rigorously. The Board also believes that performance of the total portfolio, individual asset class, and managers should be monitored and compared to appropriate, predetermined benchmarks.

The Board believes that prudent management of risk is a central element of the investment function and that diversification among asset classes will reduce risk and enhance returns of the overall investment portfolio in the long term.

The Board believes that market efficiency and opportunities vary among asset classes and may change over extended periods of time. Therefore, the Board believes that SDCERS' portfolio management strategies should adapt over time to reflect the changing nature of capital markets.

The Board's primary goals in managing the Trust Fund are:

1. To ensure that sufficient funds will be available to provide participants and their beneficiaries with all benefits due as specified in SDCERS' plan documents;

2. To give precedence to the financial interests of participants and beneficiaries over all other financial interests;

3. To comply with all applicable fiduciary standards; and

4. To reduce the cost of funding benefits for both participating employers and the individual participants of SDCERS.

In order to achieve its goals, SDCERS must invest the necessary resources to build and maintain an appropriate organizational infrastructure.

II. INVESTMENT GOAL AND OBJECTIVES

In accordance with SDCERS' Mission Statement, the goal of SDCERS' investment program is to generate adequate long-term returns that, when combined with employer and employee contributions, will result in sufficient assets to pay the present and future obligations of SDCERS. The following objectives are intended to assist in achieving this goal:

- SDCERS should earn, on a long-term average basis, a total real rate of return in excess of SDCERS' actuarial assumed rate of real return (See Appendix B, "Actuarial Assumptions and Methods").

- SDCERS' assets will be managed on a total return basis, which takes into account the considerable importance of the preservation of capital. Additionally, SDCERS follows the principle that different degrees of investment risk exist and are generally rewarded with varying degrees of return over the long term.

- SDCERS will operate in an efficient manner that fulfills its fiduciary responsibility and contributes to the overall effectiveness of the organization.

It is the purpose of the SDCERS investment program to assure that sufficient financial assets are available to provide SDCERS participants and their beneficiaries with all benefits due as specified in the SDCERS Plans. Therefore, the participants' and beneficiaries' financial interests shall take precedence over all other financial interests.

To achieve these objectives, SDCERS allocates its assets (asset allocation) with a strategic, long-term perspective of the capital markets. Additionally, SDCERS also models and manages its investment program based on principals outlined under the Prudent Expert standard.

III. GENERAL INVESTMENT POLICIES

AUTHORITY TO INVEST AND DELEGATION THEREOF

The Board is authorized by Article IX, Section 144 of the San Diego City Charter to engage the services of one or more investment managers and independent Investment Consultants. Also, City of San Diego Council Resolution R-283578 (See Appendix C), adopted March 21, 1994, sets parameters with respect to the classes or types of investments permitted for investment of SDCERS funds.

The Board may delegate to the Retirement Administrator the investment of assets provided such investments are approved by an independent Investment Fiduciary. Once retained, an investment manager or consultant must acknowledge in writing their fiduciary responsibility to the Trust and agree that these objectives and policies will be observed. It is expected that investment managers and consultants will at all times conduct themselves as fiduciaries according to California law.

PERFORMANCE MEASUREMENT

Investment manager performance shall be measured and reported in accordance with Appendix D, "Performance Measurement and Reporting." Performance shall be measured against Trust Fund objectives and against individual manager objectives.

- The Trust Fund shall be measured against the actuarial assumed rate of return, inflation, a universe of other public funds, or other appropriate measurements.

- Investment managers will be measured against stated objectives, a broad universe of managed portfolios and against a smaller universe of portfolios managed by a similar investment style.

Performance shall be judged over at least a three to five period (e.g. market cycle), except as indicated under the "Investment Manager Deficient Performance" section. This performance time horizon is intended to be consistent with the long range investment goals of the Trust Fund. Additionally, this time horizon is adopted in order to improve the statistical reliability and validity of the performance evaluation process.

Performance objectives for active managers are based upon the expectation that the Trust Fund will achieve value added over and above the cost of active management.

CUSTODY OF TRUST ASSETS

SDCERS shall contract to utilize the services of a master custodian (custodian). The custodian shall transfer assets to and from the Trust Fund as directed by SDCERS' staff. Also, the custodian shall settle purchases and sales or securities, collect income, and disperse funds for approved expenditures. Other services provided by the custodian include, but are not limited to, cash management, portfolio transition services, securities lending services, compliance monitoring services and information/accounting services.

ASSET ALLOCATION AND RISK MANAGEMENT OF INVESTMENTS

Long-Term Strategic Planning for Asset Allocation

The Board, or the Investment Committee on behalf of the Board, shall review and determine the long-range asset allocation investment policy of SDCERS. In conjunction with this philosophy, the asset allocation policy shall be structured for at least a three-year period. The asset allocation policy shall be developed with the assistance of the Investment Consultant and address the following considerations:

- Historical and anticipated capital market performance (returns and risks) of various asset classes;
- The expected correlation of returns among various asset classes;
- Inflation, interest rates, and other economic assumptions;
- The difference between the current and the projected asset values of the Plan; and
- The projected actuarial cost of benefits due.

The asset allocation investment policy shall be reviewed annually. A more comprehensive asset/liability projection study shall be performed every three to five years. Through the annual review process, changes to the asset allocation policy and the any needed manager structure adjustments shall be decided. The long-term strategic planning process for asset allocation is detailed in Appendix E.

The Board shall review annually the overall asset allocation policy for the Trust Fund in order to provide a sound, fiduciary structure to the investment process. The asset allocation target exposures are established after thorough review and analysis of the Trust Fund's expected rates of available investment return and the associated risk of attempting to achieve the targeted return. These asset allocation guidelines identify the asset classes to be used by SDCERS. They designate the percentage exposure to each asset class of the total portfolio.

Additionally, at least every five years, the Board shall perform an asset/liability study that evaluates the asset allocation policy setting process in the additional context of projected actuarial liabilities and funding (contribution) practices. This is done in order to understand the impact of inevitable changes in capital market behavior upon both the risk/return structure of the asset allocation strategy and the ultimate net cost of funding the benefits owed to participants and retirees.

The asset allocation policy targets that are adopted as a result of the strategic planning process are specified in Appendix G, "Asset Allocation Target Weightings and Rebalancing Ranges."

Risk Management and Rebalancing

SDCERS seeks to maintain the Trust Fund tracking error to within +/- 2.5% of the total fund blended benchmark, as measured over a rolling 20-quarter time period. Tracking error is a measure of risk that indicates the amount of deviation in performance from that expected by passively investing in a benchmark.

In order to control Trust Fund risk, the Board has adopted an asset allocation re-balancing policy which stipulates that target allocations to asset categories or to asset managers within asset categories not be allowed to exceed certain tolerance or variance ranges specific to the expected volatility of each asset category and sub-category. This control process is detailed in Appendix F, "Risk Control and Rebalancing."

The target allocations will guide the designation as to which asset class(es) should receive contributions when available. Additionally, the allowable variance ranges shall guide the periodic determination as to which asset class(es) and/or investment manager(s) should be directed to adjust their respective holdings. This shall be done when necessary in order to cause the redistribution of assets to achieve the target allocations.

The control parameters used to rebalance, adjust and maintain the asset allocation structure in response to market fluctuations shall be reviewed at least every three years or in response to changes in the asset allocation strategy. Rebalancing is an effective tool used to control risk within the total fund and potentially enhance returns. This is accomplished by reducing funds to an over-allocated asset category and increasing the funds to an under-allocated asset category.

A specific asset class may become under allocated as a result of poor relative investment performance by an investment manager over one or more market cycles. Additionally, poor relative performance may result from a change in the manager's key investment personnel or a change in the manager's investment style. Should these situations occur, the Retirement Administrator is authorized to redistribute the assets to achieve the target allocations by selecting and utilizing appropriate, alternative, low transaction cost, interim investment vehicles, as approved by an independent Investment Fiduciary. This authorization shall also be utilized in situations where existing investment managers are unable, for non-performance related reasons, to accommodate redistributions of assets. This may occur due to an investment manager's decision to no longer accept additional funds for investment.

INVESTMENT MANAGER SELECTION PROCESS

The Investment Committee recommends to the Board the selection of outside investment managers to manage designated portions of the Trust Fund. The search and selection process used to identify and screen potential investment managers may utilize the services of the Investment Consultant to perform the initial and semi-final phases of the process. Also, the initial and semi-final phases of a search and selection process may be performed by Investment Staff through advertisement, through issuance of Request for Proposals (RFP), or through utilization of databases to screen firms for inclusion on a short list for issuance of Requests for Information (RFI).

Final investment manager selection decisions are performed by the Board or, if delegated thereto, the Investment Committee. This final review and selection procedure includes the prospective investment managers making presentations to the decision making body. Additionally, a sub-committee of the decision making body or the Retirement Administrator (or designee) shall physically visit the office of the investment manager selected to be hired and perform a due diligence review of the manager's operations.

The Board's delegation of investment authority to the Investment Committee or to staff is specified in Appendix M.

The Investment Committee shall administer the Trust Fund's investment program and oversee investment management and custodial fees, consulting fees, transaction costs and other administrative investment costs. No more than reasonable fees consistent with market rates for similar services shall be paid.

INVESTMENT MANAGER DEFICIENT PERFORMANCE

Criteria for evaluating the deficient performance of an investment manager include: underperformance relative to benchmarks and peer groups, investment style drift, significant organizational changes, compliance issues, and shortfalls in client service. Occurrences of deficient performance by investment managers shall be grouped in two categories.

> The "Watch List" category is for short-term or moderate levels of underperformance and for minor organizational or compliance issues. Managers on the Watch List will be subject to closer scrutiny and monitoring. A copy of the Watch List Criteria is found in Appendix H.
>
> The "Probation" category is for long-term or more extreme shortfalls in performance and for major organizational or compliance problems. An investment manager whose underperformance meets the criteria for placement in the "probation" category shall be subject to an Investment Committee formal review and reevaluation of their investment process no less than every six months. Probationary status that persists or worsens can result in the replacement of an investment manager.

INVESTMENT MANAGEMENT

The management of SDCERS' investments shall be conducted, as directed by the Board, under the following policies.

Pooled investment vehicles and funds for equity, fixed income and cash investments shall be subject to the limitations associated with their primary investment objective. In no case shall an investment in a pool, fund or separate account exceed 20% of the pool or of the total assets under management by a manager in a particular style allocation, at the time of entry.

All assets shall be transferred to the investment managers except those required for administrative expenses, benefit payments, and pending asset allocation commitments. All assets transferred to an investment manager should be fully invested. However, it may be necessary for investment managers to keep part of the assets under their management in cash or cash equivalents as they deem necessary. Security selections and maturities are the investment managers' prerogative.

Policies for each individual asset class are included separately in Appendix J, "Investment Guidelines and Performance Benchmarks." These policies detail both performance benchmarks and specific guidelines for each asset class. The following asset classes are those that SDCERS is eligible to invest in, either as an owner or as a lender:

EQUITIES – Equities generally provide higher returns than other asset classes over the long-term. SDCERS currently has allocations for publicly-traded domestic equity and international equity. Allocations to Private Equity are also eligible for consideration.

FIXED INCOME – Fixed Income generally provides steady, stable returns over the long-term. SDCERS currently has allocations for both domestic and international fixed income.

REAL ESTATE – Real Estate provides both a stable total return and cash income. Additionally, it provides a hedge against inflation. SDCERS currently has allocations to stable, enhanced, high-return private properties, and to publicly-traded real estate securities.

SECURITIES LENDING – To provide additional income to the Trust Fund, SDCERS employs a Securities Lending Program through its custodial bank. The Securities Lending policy is detailed in Appendix I.

The investment decisions within each managed portfolio shall be solely those of the investment manager, in accordance with the contractual agreement between SDCERS and the manager. The contractual specific investment guidelines for the managers of publicly-traded securities portfolios can be found in Appendix M. The investment actions and reporting of the investment manager's actions shall be performed within the bounds of the Board's overall asset allocation guidelines and investment policies for the Trust Fund. These policies are detailed in Appendices.

Additional investment management policies resulting from investment in the above asset categories include:

SECURITIES LITIGATION CLAIMS RECOVERY - When necessary, SDCERS files securities litigation claims to recover damages from companies. SDCERS Legal Division has established a policy detailing SDCERS involvement in potential lead plaintiff situations. This policy is included in Attachment K, "Securities Litigation."

CORPORATE GOVERNANCE – SDCERS believes that good corporate governance is essential for the long term financial performance of any company. Given this, SDCERS has developed its Proxy Voting Policy and Guidelines in order to facilitate voting on proxy issues. Each vote decision is made on the basis of providing greater shareholder wealth. This policy is included in Appendix L, "Proxy Voting."

ASSET TRANSITION MANAGEMENT

On occasion, SDCERS may have a need to restructure its portfolios as a result of asset allocation policy changes or as a result of replacing an underperforming investment manager. In order to monitor and control asset allocation exposure and minimize transaction costs associated with redeployment of large amounts of capital, the services of the custodial bank's trading operations, the services of any capable investment manager currently under contract, or the services of any other responsible transition management service provider may be utilized. A trading cost analysis shall be obtained on an asset transition restructuring in order to evaluate the results of the transition management and to satisfy SDCERS' fiduciary responsibility to monitor best execution.

IV. DUTIES OF RESPONSIBLE PARTIES

Duties of SDCERS' Board through SDCERS' Investment Committee

Trustee's Standard of Care in Administering Trust

The assets of the Trust Fund are to be managed and invested according to the provisions of the California State Constitution, Article 16, Sections 17(c) and 17(d). These state:

> (c) The members of the retirement board of a public pension or retirement system shall discharge their duties with respect to the system with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with these matters would use in the conduct of an enterprise of a like character and with like aims.
>
> (d) The members of the retirement board of a public pension or retirement system shall

diversify the investments of the system so as to minimize the risk of loss and to maximize the rate of return, unless under the circumstances it is clearly not prudent to do so.

The Board or its designee(s) will adhere to the following in fulfilling its fiduciary duty in managing the investment of SDCERS' Trust Fund:

- Annually review and establish the long range asset allocation strategy and manager structure of SDCERS in accordance with Appendix E.
- At least every three to five years, conduct an asset/liability study that will be used to establish asset allocation goals and objectives for a three year period.
- Review the investment performance of SDCERS total fund and the underlying portfolios, with the assistance of the general Investment Consultant, in accordance with Appendix E, on a quarterly basis. Performance will be evaluated by comparing investment returns to appropriate benchmarks and peer group rankings.
- Review quarterly real estate performance reports from SDCERS' real estate consultant.
- Review both monthly and quarterly statements from SDCERS' investment and real estate managers.
- Retain a general Investment Consultant to assist with performance measurement, asset allocation, manager reviews, investment research, manager searches and other projects as needed. Comments and recommendations from the Investment Consultant will be taken into account when making investment-related decisions.
- Retain a qualified custodian to safeguard SDCERS' assets.
- Monitor SDCERS' investment managers in ensure they adhere to policies and guidelines set forth in this document. The Board has the authority to initiate or terminate contractual relationships with SDCERS' investment managers.
- Monitor staff to ensure the administration of SDCERS' investments in a responsible, cost-effective, risk minimizing manner.
- Avoid any conflicts of interest.

Duties of the Investment Staff

The Investment Staff, as designated by the Retirement Administrator and Board, plays a significant role in the management and oversight of the Fund. The Investment Staff is responsible for the following tasks:

- Maintain the target asset allocations of the fund in accordance with Board policy.

This requires an annual review of the asset allocation policy and an asset allocation and liability study to be done every three to five years.

- Rebalance investment portfolios, as necessary, in order to maintain the asset allocation or to make cash available for the payment of benefits.

- Initiate and monitor all wire transfers or movement of monies to or from all investment accounts.

- Monitor external investment managers, including real estate, for adherence to appropriate policies, guidelines and contract specifications. Report to the Board any significant violations found.

- Maintain relationship with custodian to ensure compliance with contract and all commitments.

- Maintain relationships with consultants (general investment, real estate and other asset class specialists) in order to obtain necessary assistance with assignments from staff and the Board in accordance with the contract requirements.

- Conduct manager searches or monitor the Investment Consultant in investment manager searches as assigned by the Board.

- Monitor the Manager's Watchlist, report on any changes, and recommend action to the Board, if necessary.

- Evaluate any changes in ownership structure of a financial vendor and, with the concurrence with the Investment Consultant, authorize the assignment of the firm's contract with SDCERS to the new ownership entity.

- Manage portfolio restructurings resulting from investment manager terminations with the assistance of consultants and managers, as needed.

- Conduct special research required to manage the Fund more effectively, as directed by the Board.

- Assist the Board in the development, implementation, and revision of the Investment Policy Statement.

- Report on investment activity and matters of significance at each Investment Committee and/or Board meeting.

- Monitor the Securities Lending Program in accordance with the Securities Lending Policy.

- Conduct research and vote proxies in accordance with SDCERS' Proxy Voting Policy and Guidelines.

- Administratively suspend the investment activity of managers (see Appendix M).

- Avoid any conflicts of interest.

Duties of the Investment Managers

The investment managers shall have designated discretion to direct and manage the investment and reinvestment of assets allocated to their accounts in accordance with this document; applicable Local, State and Federal statutes and regulations; and, the individual specific investment guidelines in their contracts. The Investment Managers shall be responsible for the following:

- Execution of a contractual agreement to invest within the guidelines established in the Investment Policy Statement.

- Provide SDCERS with annual proof of liability and fiduciary insurance coverage.

- Be a SEC-Registered Investment Advisor under the 1940 Act, an insurance company or a bank and be recognized as providing demonstrated expertise over a number of years in the management of institutional, tax-exempt assets within a defined investment specialty.

- Adhere to the investment management style concepts and principles for which they were retained, including, but not limited to, developing portfolio strategy, performing research, developing buy, hold and sell lists, and purchasing and selling securities.

- Execute all transactions for the benefit of SDCERS with brokers and dealers qualified to execute institutional orders on an ongoing basis at the best net cost to SDCERS, and where appropriate, facilitate the recapture of commissions on behalf of SDCERS.

- Reconcile monthly accounting, transaction and asset summary data with custodian valuations, and communicate and resolve any significant discrepancies with the custodian (excludes real estate and alternative assets).

- Maintain frequent and open communication with staff on all significant matters pertaining to the management of SDCERS assets, including, but not limited to, the following:

    1. Major changes in the Investment Manager's outlook, investment strategy and portfolio structure;

    2. Significant changes in ownership, organizational structure, financial condition or senior personnel;

3. Any changes in the Portfolio Manger or other key personnel assigned to the SDCERS account;

4. Each significant client which terminates its relationship with the Investment Manager, within 30 days of such termination;

5. All pertinent issues which the Investment Manager deems to be of significant interest or material importance; and

6. Meet with the Board or its designee(s) on an as-needed basis.

<u>Duties of the Custodian</u>

The Custodian shall be responsible for the following:

- Provide complete global custody and depository services for the designated account.
- Manage the cash and enhanced cash funds not invested by managers, and ensure that all available cash is invested. If SDCERS elects to manage cash externally, full cooperation must be provided to the external manager.
- Provide the Investment Consultant with portfolio information for performance measurement in a timely manner.
- Provide, in a timely and effective manner, a monthly report of the investment activities implemented by the investment managers.
- Calculate all income and principal realized and properly report the results in periodic statements.
- Provide monthly and fiscal year-end accounting statements for the portfolio, including all transactions; these should be based on accurate security values for both cost and market. These reports should be provided within acceptable time frames.
- Report to SDCERS situations where accurate security pricing, valuation and accrued income is either not possible or subject to considerable uncertainty.
- Provide assistance to SDCERS to complete such activities as the annual audit, transaction verification or unique issues as required by the Board.
- Manage a securities lending program to enhance income if directed by the Board. If the securities lending program is managed externally, full cooperation must be provided.
- Deliver all domestic and international proxy voting materials to SDCERS or its designated proxy voting agent, including meeting notices, voting instruction forms,

proxy statements, quarterly and annual shareholder reports and miscellaneous proxy voting materials.

Duties of the Consultants

The Board and staff will consider the comments and recommendations of consultants in conjunction with other available information to make informed, prudent decisions.

General Investment Consultant

The General Investment Consultant shall be responsible for the following:

- Assist staff in making recommendations to the Board regarding: investment policy, strategic asset allocation, asset liability modeling, asset class and manager structure strategies.
- Prepare a quarterly performance report including performance attributions on SDCERS' managers and total assets.
- Assist SDCERS in the selection of qualified investment managers, and assist in the oversight of existing managers, including monitoring changes in personnel, ownership and the investment process.
- Assist in the selection of a qualified custodian (including a securities lending agent and/or a cash manager) if necessary.
- Provide topical research and education on investment subjects that are relevant to SDCERS.

Real Estate Consultant

The Real Estate Consultant shall be responsible for the following:

- Assist staff in making recommendations to the Board regarding investment policy, strategic asset allocation and asset class strategy.
- Assist SDCERS in the selection of qualified real estate investment managers.
- Prepare a quarterly performance report including performance attributions on SDCERS' managers and total assets.
- Provide topical research and education on investment subjects that are relevant to SDCERS.

Private Equity or Alternative Investments Consultant

The Private Equity Consultant shall be responsible for the following:

- Assist staff in making recommendations to the Board regarding investment policy, strategic asset allocation and asset class strategy.
- Assist SDCERS in the selection of qualified private equity investment managers or fund-of-fund managers.
- Prepare a quarterly performance report including performance attributions on SDCERS' managers and total assets.
- Provide topical research and education on investment subjects that are relevant to SDCERS.

Proxy Voting Consultant

The Proxy Voting Consultant or Proxy Voting Agent shall be responsible for the following:

- Vote proxies in a timely manner per SDCERS' Proxy Voting Policy and Guidelines or per staff direction in the case of exceptions to the policy .
- Provide staff with on-going proxy voting research and analyses consistent with SDCERS' investment goals and in accordance with SDCERS' Proxy Voting Policy and Guidelines.
- Provide staff with company-specific corporate governance profiles, pertinent statistical reporting and yearly review of the results of corporate annual meetings.

APPENDIX A

INVESTMENT PHILOSOPHY

This section describes the Investment Philosophy (Philosophy) of the San Diego City Employees' Retirement System (SDCERS). Its purpose is to articulate the basic principles and beliefs that underlie SDCERS' investment policy and the overall management of the pension funds of the employees and retirees of the participating employers' retirement plans (Plans). The Philosophy is designed to complement rather than replace the investment policies of SDCERS. It is expected that SDCERS' approach to investments, as reflected in its policies and strategies, will be consistent with the Philosophy over time. Though the Philosophy allows significant flexibility, it also raises some constraints or implications. Where these are deemed to be significant, they have been explicitly identified and labeled as *Implications*.

SDCERS' Board should review the Investment Policy and the Philosophy at least every 3 to 5 years as experiences, circumstances and financial instruments and opportunities will change over time. This Philosophy statement and any changes will provide staff, advisors and Trustees with a frame of reference to understand how the investment program has evolved as well as the rationale behind its design. The Board may modify the Philosophy as experiences and circumstances suggest is prudent.

The Philosophy includes seven sections:

1. Mission
2. Risk Management
3. Diversification
4. Market Efficiency
5. Value-Added Managers
6. Organizational Infrastructure and Communications
7. Performance Monitoring and Time Horizon

1. Mission

a) The Board's primary goals in managing the investments are:

i) To ensure that sufficient funds will be available to provide participants and their beneficiaries with all benefits due as specified in SDCERS' Plan documents;

ii) To give precedence to the financial interests of participants and beneficiaries over all other financial interests;

iii) To comply with all applicable fiduciary standards; and

iv) To create value added, where feasible, that will help reduce the costs of funding the participating Plans.

2. Risk Management

a) The Board believes that prudent management of risk is a central element of the investment function.

b) Though there are numerous risks involved in the management of a pension investment program, SDCERS believes that the following warrant particular attention:

i) ***Funding-related Risk*** - The risk that the funds available in the participating Plans will be insufficient to pay both the promised defined benefits and any contingent or supplemental benefits; or, that contribution volatility will be unacceptably high. The primary methods for managing funding risk include periodically conducting integrated asset / liability studies, and establishing appropriate and prudent investment and funding policies.

0.1 In managing the relationship between assets and liabilities, the asset allocation strategy of the Fund should provide a minimum 90% level of probability of meeting the projected liabilities of the Plans over a 20-year time period, as determined by the actuary.

0.2 A Plan shall be considered fully funded so long as it maintains an average funded ratio of at least 120% during the rolling time period used for actuarially smoothing of investment returns (See Attachment A, Actuarial Assumptions and Methodologies).

0.3 A Plan shall be considered to be inadequately funded if it maintains an average funded ratio of less than 80% during the rolling time period used for actuarially smoothing of investment returns.

ii) ***Benchmark-related Risk*** – The risk that the investment benchmarks adopted by the Fund are inappropriate, or that the aggregate of the individual manager benchmarks within an asset class do not adequately reflect the benchmark for the asset class as a whole. The latter risk is a specific risk generally referred to as *benchmark misfit risk (i.e. style risk).* Inappropriate benchmarks or excessive benchmark misfit risk could result in investment performance different than expected and could adversely impact decisions concerning the hiring or firing of investment managers.

0.1 The primary methods for effectively managing benchmark-related risk are:

(a) regular review of the Fund's benchmarks; and

(b) regular measurement and monitoring of misfit risk using proper methodologies.

iii) ***Manager Risk*** - The risk of aberrant performance on the part of individual investment managers, and the related active management risk for asset classes as a whole.

0.1 The primary methods for mitigating manager risk are:

(a) Maintaining prudent processes for selecting and monitoring investment managers;

(b) Controlling the proportion of Fund assets assigned to individual investment managers;

(c) Employing competent internal investment staff to administer investment exposures;

(d) Employing effective investment consulting support; and

(e) Communicating clearly to investment managers the objectives, expectations, and investment time horizons of SDCERS.

0.2 The primary method for mitigating active management risk for asset classes include:

(a) Establishment of appropriate asset class benchmarks and the expected levels of deviation from the benchmarks;

(b) Careful monitoring of asset class performance relative to the benchmarks; and

(c) Appropriate use of passive investment management in more efficient markets, when the funded levels of the participating Plans are sufficient to permit foregoing value-added management.

iv) ***Fortitude Risk*** - The risk that the Board or staff will fail to exercise the patience, judgment, or fortitude required to support long-term policies and strategies for the investment and funding program.

0.1 The keys to managing fortitude risk are believed to include:

(a) Effective orientation and education with respect to institutional investing and actuarial science; and

(b) A commitment to continual refining, confirming, and communicating the investment philosophy and funding policy of the Retirement System.

3. DIVERSIFICATION

a) SDCERS accepts the basic tenets of modern portfolio theory, which suggest that diversification, or combining assets that are not perfectly correlated with each other, will reduce the long-term volatility of the overall portfolio.

b) It is generally desirable, however, to avoid overly complex asset structures, provided the allocations selected can reasonably be expected to meet the objectives of the Plan. The benefits of diversification must be weighed against a number of factors including costs, liquidity, complexity, communication, internal staff resources and expertise and trustee knowledge and effort.

c) The following asset classes are appropriate candidates for consideration of inclusion in the portfolio:
   i) Domestic equity;
   ii) International equity, including emerging markets;
   iii) Domestic fixed income, including high yield fixed income;
   iv) International fixed income, including high yield and emerging markets:
   v) Real estate; and
   vi) Alternative investments (private equity, currencies, timber, etc.).

Implications

- A systematic methodology for re-balancing the investment portfolio is required to ensure proper implementation, ongoing maintenance and adequate risk control of the asset allocation structure.
- Adding or deleting asset classes or investment managers should be considered in light of the impact such diversification decisions are likely to have on the general complexity and cost structure of the portfolio, as well as SDCERS' ability to prudently achieve its investment and funding goals over the long run.

4. Market Efficiency

SDCERS accepts that modern portfolio theory suggests that various asset classes or markets display different degrees of efficiency that may impact the ability of active managers to add value above appropriate market benchmarks, net of fees:

a) SDCERS believes that market efficiency varies among asset classes, creating greater and lesser opportunities for successful active management strategies based on securities selection.

b) SDCERS believes it is appropriate to employ value-added active management strategies in more efficient asset classes in order to achieve and/or maintain an adequate level of funding.

c) For less efficient asset classes, SDCERS believes that it has the ability and a duty to prudently exploit such inefficiencies through active securities selection strategies.

d) SDCERS believes it is appropriate to strategically overweight exposures to less efficient asset classes in order to capture the additional value-added opportunities they provide and thereby reduce the long-term funding cost to the participating Plans and their employees. As such, SDCERS maintains a capitalization bias to smaller companies in its equity exposures and uses other sources of diversification to control total fund volatility.

e) SDCERS does not believe in the viability of active management strategies that rely on market timing. As such, investment managers are expected to be fully invested in their respective asset classes; and, in accordance with their specific investment guidelines, maintain cash levels generally less than 5% of assets.

f) SDCERS does not believe in the viability of management strategies that call for over or under weighting investment styles (growth/value) or sectors (energy, finance, etc.) within an asset class; i.e., benchmark misfit risk will not generate long-term alpha. Accordingly, SDCERS generally believes that it should maintain overall asset class exposures on an aggregate investment style neutral or economic sector neutral basis that is consistent with broad or weighted benchmarks for an asset class as a whole.

g) When SDCERS has obtained full funding of its Plans, asset classes that can be demonstrated to be more efficient should be considered for passive management in order to reduce active management risk and lower the costs of managing the portfolio.

Implications

- SDCERS should be conscious of any subtle forms of market timing that may arise in the course of managing the Fund, or that may be implicit in investment strategies presented to SDCERS for inclusion in the investment program.
- SDCERS should determine appropriate methods for determining whether an asset class is efficient or presents appropriate opportunities, thus providing insight to the Board on the use of particular strategies.

5. VALUE-ADDED MANAGERS

a) SDCERS believes that the portfolio characteristics utilized to control risk in the broad portfolio, such as market capitalization, sector exposure, use of derivatives, leverage limitations, property type or deal structure may be modified for specific managers who control a limited portion of the portfolio and have demonstrated a proven capacity to consistently add value net of fees. Such strategies, which SDCERS refers to as Value-Added, may include the following elements:

   i) The use of active managers who employ more aggressive or esoteric investment strategies, such as concentrated portfolios, leveraged real estate purchases, value-added real estate investments, high-yield debt, absolute return market neutral strategies using collateralized short selling, etc.

   ii) The use of managers who employ tactical strategies to shift exposures between asset classes on either a domestic or global basis may also be retained to manage a portion of assets.

b) The primary benefits of including a Value-Added approach within the overall portfolio are:

   i) Prudent use of wealth generating opportunities to lower long-term funding costs;

ii) Improved risk adjusted performance of the Fund; and

iii) Concentration on opportunities where the likelihood of adding value is greatest.

c) The market efficiency and opportunities in asset classes may change over extended periods of time; therefore SDCERS believes that its portfolio management strategies should adapt over time to reflect the changing nature of capital markets.

6. Organizational Infrastructure and Communications

a) SDCERS believes that in order for the investment program to achieve its goals, SDCERS must invest the necessary resources to build and maintain an appropriate organizational infrastructure, key elements of which include:

i) A competent, internal investment staff comprised of a sufficient number of investment professionals possessing appropriate leadership, technical, and administrative skills.

0.1 SDCERS recognizes that it competes with the private sector in attempting to attract and retain competent staff. It must therefore continually strive to create a total work environment that is challenging, rewarding, and competitive.

ii) A strong relationship with outside general investment consultant(s) who are able to provide SDCERS with the following:

0.1 A high degree of investment expertise;

0.2 Innovative and proactive advise and counsel;

0.3 Strong research support; and

0.4 Strong reporting capabilities.

iii) A broad-based information gathering and reporting system to present well-researched, relevant and timely data in a manner that is easily understood, and that supports rigorous and consistent monitoring of critical investment activities.

iv) An open channel of communication between the Board, management, and the external investment professionals.

b) By providing the Board with timely, accurate, and thorough information, the organizational infrastructure will give the Board the high level of comfort it needs to set policy, make investment decisions, oversee the performance of the investment program, and maintain the fortitude necessary to support its investment philosophy, policies, and strategies.

Implications

- SDCERS must determine what constitutes an appropriate internal investment staff structure, given the current nature of the investment program and its anticipated evolution.

- SDCERS must, over time, take concrete steps towards creating and maintaining a work environment that will allow the Retirement System to attract and retain needed staff.

- SDCERS must recognize that developing the organizational infrastructure it needs (staffing, consulting support, information systems, and communication channels) cannot be achieved overnight, but rather will require an ongoing commitment of time and resources.

7. Performance Monitoring and Time Horizon

a) SDCERS holds the following basic beliefs concerning performance monitoring practices and methodologies:

i) The various investment policies of the Fund, in the aggregate, are the most important determinants of investment success so compliance with investment policies should be monitored rigorously;

ii) The performance of the total portfolio, individual asset classes, and investment managers should be compared to appropriate, predetermined benchmarks;

iii) Peer comparisons are an additional valid tool in assessing individual manager performance (supplementing the use of benchmarks), given that SDCERS aims to select superior managers within particular investment styles or mandates. Peer comparisons, or performance rankings, are also valid tools for measuring the performance of asset class portfolios; and

iv) Peer group comparisons are not an appropriate means of assessing the performance of the total Fund, given that other public fund sponsors have different objectives, risk tolerance levels and funded ratios and therefore may have different asset allocation policies.

v) Benchmark misfit risk, or the risk that the aggregate of individual investment manager benchmarks in an asset class do not adequately reflect the benchmark for the asset class as a whole, should be explicitly measured on a regular basis.

vi) Investment managers are generally hired to fulfill a specific role in a portfolio. Accordingly, SDCERS believes it is important that SDCERS monitor the extent to which managers comply with their stated styles and mandates.

b) SDCERS believes that successful funding and investment decisions require a long-term perspective on the part of the Board and management:

i) It is the intention of the Retirement Board that commitments to asset classes and investment strategies should involve long time horizons that may include more than one business cycle (3-5 years each). Relatively illiquid asset classes will require even longer time horizons.

ii) The Board acknowledges that commitments to individual investment managers also require a long time horizon of at least one business cycle (3-5 years).

iii) SDCERS believes that proper reporting and monitoring systems; and clear communication among consultants, management, investment managers and the Board will enable the Board to maintain the necessary long term perspective on all investment decisions.

Implications

- Assessing the investment performance relative to appropriate, pre-determined, benchmarks is as applicable to the total portfolio and to individual asset classes as it is for individual investment managers, and therefore warrants a commensurate share of the Board's time and attention.

- The Board will spend relatively little time assessing the performance of the Fund relative to that of other public pension funds.

- SDCERS will need to either develop in-house capabilities to regularly measure benchmark-related risk, or it will need to use such capabilities from external investment consultants.

- SDCERS will monitor all investment managers to ensure they are complying with their stated investment style, regardless of whether they are performing well or poorly. Strongly performing managers who are found to not be following their stated styles will be carefully scrutinized and may be subject to disciplinary action.

- SDCERS will monitor all investment providers to ensure compliance with the Investment Policy Statement.

8. Prohibited Investments

Asset managers shall exercise prudent expert standards in defining prohibited investments.

APPENDIX B

ACTUARIAL ASSUMPTIONS AND METHODS

1. Investment Return Assumption

System assets are assumed to earn an annualized total return of 8%, net of expenses.

2. Inflation Rate Assumption

An inflation assumption of 4.25% compounded annually is used for projecting the total annual payroll growth for amortization of any unfunded actuarial liability (UAL). It also represents the difference between the investment return rate and the assumed real rate of return.

3. Real Rate of Return Assumption

A real rate of return assumption of 3.75% compounded annually represents the difference between the assumed rate of total return, less the assumed rate of inflation.

4. Funding Method

The Projected Unit Credit Method is used to determine contribution costs, calculated as a rate applied to payroll. As of the June 30, 2007, actuarial valuation (for the FY2009 GASB ARC calculation) this will change to the Entry Age Norman Method. The total contribution rates consist of two parts: a normal cost rate and an employer UAL rate.

The UAL rate funds a UAL with annual payments as a level percentage of payroll amortized over a time period adopted by the Board upon advice from the Actuary. The amortization period for each participating employer can be found in the most current actuarial valuation report for that employer's pension plan.

5. Asset Valuation Smoothing Method

For purposes of determining annual contributions to the System, an actuarial value of assets is calculated using a smoothing process. This asset adjustment method dampens the volatility in asset values that occurs because of ongoing fluctuations in market conditions. The Board has adopted the Expected Asset Method of smoothing. This method adjusts the expected value of assets (prior year actuarial value of assets plus the assumed rate of total return) by ¼ of the difference between the market value of assets and the expected value of assets. At the potential extremes of this smoothing process, the actuarial value of assets will be capped at a maximum of 120% or a minimum of 80% of the market value of assets.

APPENDIX C

(R-94-1254)

RESOLUTION NUMBER R-283578
ADOPTED ON MARCH 21, 1994

WHEREAS, the San Diego City Employees' Retirement System Fund (Trust Fund) exists for the purpose of providing retirement income, disability income, and death benefits for the employees and family members of The City of San Diego and the Unified Port District; and

WHEREAS, the Board of Administration (Board) for the City Employees' Retirement System (Retirement System) has exclusive control over the administration and investment of the Trust Fund pursuant to section 144 of The Charter of the City of San Diego (Charter) and pursuant to California Constitution article XVI, section 17; and

WHEREAS, Charter section 144 permits the Board to invest in any bonds or securities which are authorized by general law for savings banks; and

WHEREAS, the Board is further permitted to invest in such additional classes or types of investments as are approved by resolution of the Council of the City of San Diego (Council); and WHEREAS, the Council has previously approved, by Resolution No. 259541, adopted on October 31, 1983, an investment policy; and

WHEREAS, the Board has developed an investment program based on this policy, the purpose of which is to ensure that sufficient financial assets are available to provide the benefits as specified in the Charter and the San Diego Municipal Code; and

WHEREAS, the Board is currently limited to investing in common and preferred stocks of corporations domiciled in the United States of America and the Dominion of Canada; and

WHEREAS, the Board is also limited to investing in fixed income security investments issued by the governments and corporations of the United States of America and the Dominion of Canada; and

WHEREAS, with the exception of Canadian investments, all other international investments are prohibited; and

WHEREAS, the Board is also restricted by percentage limitations, currently five percent (5%) in its investments in pooled vehicles; and

WHEREAS, the Board has been concerned with the Retirement System's investment returns in that they may become adversely affected by the current investment restrictions in the international arena and percentage limitations in pooled investment vehicles; and

WHEREAS, in the summer of 1993, the Board, with the assistance of its investment consulting firm, Callan Associates, reviewed the risk and return impacts which could result from updating the investment policy to remove the current restrictions on international investments, increase the percentage limitations in pooled investment vehicles and broaden the investment opportunities available to independent investment counsel; and

WHEREAS, the Board's independent investment consultant recommended a revision to the Council's investment policy to allow international investments and to increase the percentage limitation in pooled investment vehicles from five percent (5%) to twenty percent (20%) of the market value of the pools at the time of entry; and

WHEREAS, the Board approved the recommendation of its independent investment consultant on January 21, 1994; and

WHEREAS, the Board's current independent investment counsel, having knowledge of the global frontier of investment opportunity, also recommended a revision to the Council's investment policy to allow international investments; and

WHEREAS, revisions have been proposed to the investment policy set forth in Resolution No. 259541, adopted October 31, 1983, to permit international investments and to increase the percentage limitation for pooled investment vehicles from five percent (5%) to twenty percent (20%) of the market value of the pools at the time of entry; and

WHEREAS, the proposed revisions to the Council's investment policy have been reviewed by the Board's investment consultant and the Board's real estate consultant; and

WHEREAS, the proposed revisions to the Council's investment policy were submitted to and approved by the Investment Committee and the Board on February 17, 1994 and February 18, 1994, respectively; NOW, THEREFORE,

BE IT RESOLVED, by the Council of the City of San Diego, as follows:

1. That this Council hereby approves and adopts the following recommendation of the Board, supported by and based upon the recommendations and review of the Board's independent investment counsel and independent investment consultants, as the policy of this Council with respect to classes or types of investments permitted for investment of funds of the City's retirement system. All investments shall be restricted to those investments that are believed by independent investment counsel to be appropriate for investment by trust funds operating under the prudent man rule as formerly set forth in the California Civil Code section 2261 (repealed) and now detailed in the California Probate Code, section 16040 (b). (References to limitations based upon market values shall be interpreted to mean market value as of the month-end immediately prior to the time such a determination is required.) Percentages set forth herein as limitations on investments shall apply equally and separately to the existing assets of the City Employees' Retirement System and those funds to be collected and accrued under any subsequent ordinances establishing alternative or additional trust funds to be administered by the Board:

A. FIXED INCOME SECURITIES EXCLUDING REAL ESTATE LOANS

Investment in the bonds, notes or other obligations which are issued by:

i. The United States of America or any of its agencies or instrumentalities;

ii. Any sovereign nation or any of its provinces, cities or municipal corporations;

iii. Any state, and any county, town, school district or other municipal corporation of any state of the United States of America; and

iv. Any quasi-governmental agency or any solvent corporation created or existing under the laws of a sovereign nation which is not in default as to either principal or interest at the time of the purchase; and

v. Purchases of non-United States fixed income securities shall not exceed forty (40%) of the total assets of the fund invested in fixed income securities.

B. REAL ESTATE INVESTMENT

Investments in real estate may include every kind of real property or debt instrument with a security interest in real property including, but not limited to, the outright acquisition of land and/or improvements to the land, the origination or purchase of loans and equity including, but not limited to, loans with income and profit participation, combination loan and partnership financing, and straight partnership or joint venture interests where no loan is involved. The total amount of real estate investments shall not exceed forty percent (40%) of the total investments of the fund at cost at the time of commitment, except where it is necessary to exceed that percentage for limited periods of time to enable the Board to carry out a specific investment program, and such investments are approved by the Council by direct authorization or contractual relation. Purchases of first trust deeds that are insured by the Federal Housing Administration or that are guaranteed by the Veterans Administration should not be originated or serviced by the Retirement System.

C. COMMON STOCK

Investment in common stocks selected and recommended by investment counsel, subject to the following policies and limitations:

i. The total investment in equity-type securities is not to exceed seventy percent (70%) of total assets of the fund not invested in real estate oriented investments (specified in subsection B above) at market.

ii. Purchases of non-United States common stocks shall not exceed forty (40%) of the total assets of the fund invested in common stock investments.

iii. It is expected that common stock selection will place emphasis upon the likelihood of continuing satisfactory earnings.

iv. The amount invested in the common stock of any one company should not exceed at market six percent (6%) of total investment assets of the funds, and should not exceed three percent (3%) of the outstanding common stock of that company.

D. PREFERRED STOCKS

Investments in preferred stocks selected and recommended by investment counsel, subject to the following policies and limitations:

i. Total investment in preferred stocks is not to exceed ten percent (10%) of the equity portfolio at market;

ii. Purchases of non-United States preferred stocks shall not exceed forty (40%) of the total assets of the fund invested in preferred stock investments; and

iii. The amount invested in the preferred stock of any one company is not to exceed at market two percent (2%) of the equity portfolio and should not exceed five percent (5%) of the outstanding preferred stock of that company in that particular issue.

E. POOLED VEHICLE

Investments in pooled vehicles, which may be investment companies registered under the "Investment Company Act of 1940," such funds or other pooled funds offered by or through the custodian, or real estate pools of various types or other pooled vehicles which offer diversified investment management are authorized provided that the use of such pool must be approved by the Board of Administration upon recommendation by investment counsel and that the investment in such pool does not exceed twenty percent (20%) of the market value of said pool at time of entry. In addition, investments in such pools are subject to overall limits on equity and real estate investment stated in subsections B and C of this resolution. Pooled vehicles will be classified for the purpose of satisfying overall guidelines by the major sources of their expected investment return and not by the technical character of the investment vehicle itself. In case of uncertainty on this point, the Board of Administration is empowered to make such a determination.

F. MISCELLANEOUS INVESTMENTS

1. Investments which do not precisely fit within previously authorized categories are not specifically precluded for investment by the City's retirement system. Such forms of investment include, but are not specifically limited to, securities lending programs, covered call option writing programs, and use of financial futures. Forward currency contracts shall be permitted for use of hedging foreign currency exposure. Such investments must be approved by the Board of Administration upon recommendation by investment counsel and are to be judged upon the basis of their overall suitability for inclusion in the investment program.

2. That the Board of Administration is empowered to effect such purchases, sales, and exchanges as are desirable to accomplish the investment objectives of the Retirement System and to authorize investment counsel to effect such purchases, sales, and exchanges.

3. That the investment counsel is authorized to direct the custodian to invest all cash balances on a daily basis in certificates of deposit, bankers acceptances, commercial papers, master notes, savings deposits, United States Treasury or Federal agency obligations, or other investment vehicles, including pooled vehicles, appropriate for short-term.

4. That the investment counsel is authorized to direct the custodian to settle any and all transactions initiated by said investment counsel pursuant to its authority from the Board of Administration.

5. That Resolution No. 259541, adopted October 31, 1983, be and the same is hereby rescinded.

APPROVED: JOHN W. WITT, City Attorney
By
Loraine L. Etherington
Deputy City Attorney
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APPENDIX D

PERFORMANCE MEASUREMENT AND REPORTING

REPORTING OF TRUST FUND INVESTMENT STATUS

The Board believes timely reporting and communications concerning the status of investments and their performance is essential. This section defines the investment reporting requirements of SDCERS. In general, equity and fixed income managers shall provide monthly reports to the Investment Committee or the Board. Real estate managers or managers of other non-public market traded investment shall provide reports at least quarterly. These reports are to include:

- Composition of assets,
- Notice of the portfolio's largest industry or sector representations and holdings,
- Portfolio performance compared to the appropriate major index benchmark,
- Such other matters as investment managers feel are necessary.

Reports from the Investment Consultant shall be provided quarterly to the Investment Committee or the Board. These reports are to include:

- Performance of the total Fund,
- Performance of the individual managers,
- Equity performance,
- Fixed income performance,
- Real estate performance,
- Time-weighted rates of return and rankings,
- Such other matters as the Investment Consultant feels are necessary.

Additionally, SDCERS staff shall provide a monthly reconciliation of all invested assets at cost for the purpose of satisfying Municipal Code requirements. This reconciliation shall include a calculation of the realized gains and a list of asset values for use in preparing the monthly financial statements provided to the Board.

Investment Staff shall also report to the Board or its Investment Committee: on a monthly basis regarding the status of investments, including the asset allocation structure of the Fund and a list of managers on the Manager's Watch List; and, on a quarterly basis the status of securities lending activity.

PERFORMANCE REPORTING AND MONITORING

The Board of Administration has delegated to the Retirement Administrator the responsibility and discretion to implement the policies established by the Board for the investment of SDCERS' assets.

It is the responsibility of the Board to formulate policy but not the intent of the Board to become involved in either the active implementation of that policy or in the daily operations of SDCERS. It is the duty of the Trustees to review and monitor the implementation of the policy to assure that investment activities are being performed in a prudent manner consistent with the intent of the Board and consistent with the prudent expert rule.

Because the Board annually reviews and establishes its policy for investments in its asset allocation sessions, the Board shall exercise its fiduciary responsibility to be informed and to exercise oversight as to the general principles established and actions taken by the Retirement Administrator in the implementation of the investment policy,

Therefore, the following reporting requirement shall be followed to allow the Board to monitor SDCERS investment operations and ensure compliance with the Board's policy directives:

- within 30 days after the annual asset allocations have been established by the Board of Trustees, the Retirement Administrator will issue detailed letters of instruction to the staff of the San Diego City Employees' Retirement System setting forth the principles and procedures for implementing the investment policies and allocations set by the Board;

- no later than the second meeting after the asset allocations have been established by the Board, the Retirement Administrator will report to the Board on the general principles and procedures he has given the staff of the SDCERS for the strategic implementation of the investment policies and allocations set by the Board to the extent that such information can be reported in a public forum without damaging the interests of the Fund;

- no less than quarterly the Retirement Administrator shall, with the assistance of a professional investment consultant, report to the Board on the status of:

    (1) equity investments in a manner that

        (i) outlines the net amount of funds invested with each adviser during the quarter;

        (ii) compares equity investment performances with a nationally or generally recognized index; and

        (iii) contains such other information so that the Trustees are fully informed about the performance of the equity assets and allocations of the Fund in light of the policies established by the Trustees;

    (2) fixed income investments in a manner that

(i) outlines the net amount of funds invested with each adviser during the quarter;

(ii) compares fixed-income performances with a nationally or generally recognized index; and

(iii) contains such other information so that the Trustees are fully informed about the performance of the fixed-income assets and allocations of the Fund in light of the policies established by the Trustees;

(3) real estate or other non-publicly traded investments, commitments, and proposed acquisitions in light of the policies and allocation goals established by the Trustees.

- At each monthly meeting the Retirement Administrator shall report on the comparison of overall asset allocation policy with actual portfolio status. The monthly report shall indicate the existence of, and reasons for, any excessive deviations that may have arisen between asset allocation policy and the actual status of the portfolio. Additionally, the report shall indicate what corrective action has been taken to rebalance the portfolio to its target allocations.

- Each month the Fund's investment advisors shall provide written reports on activities that occurred the previous month in equities and fixed-income portfolios. Reports on real estate investments or other non-publicly traded investment shall be provided quarterly. The reports shall include the composition of the investment advisors' portfolios, significant acquisitions or dispositions since the last report, and the current market value of the assets allocated to the investment advisors' portfolios.

- The Retirement Administrator, with the assistance of a professional investment consultant, shall report at least quarterly on the Fund's total performance, including the total return of the Fund for the last quarter, the last full year, the last three years, and the last five years.

APPENDIX E

LONG-TERM STRATEGIC PLANNING FOR ASSET ALLOCATION

Financial research has shown that over 90% of the variability in the performance of an investment fund is determined by its relative exposures to various asset classes. As such, the asset allocation decision is one of the most important decisions to be faced by SDCERS' Trustees. The Board of Administration of SDCERS has undertaken to engage in long-term investment strategy setting using asset allocation modeling to identify asset mixes expected to achieve, over the long-term, the actuarially expected rate of return with the least amount of risk as measured by variability (standard deviation) of returns.

The Board believes that an intermediate time horizon of three to five years is an appropriate period to strategically plan its asset allocation strategy and manager structure. In order to achieve this objective, the following procedures shall be performed.

- The Board of Administration or the Investment Committee, with the assistance of its Investment Consultant, will annually review forward looking capital market expectations delineating the expected return, risk and correlation characteristics of various asset classes.

- With the assistance of the Investment Consultant and staff, the Board will annually model the impact these capital market expectations have on various asset allocation mixes in order to establish an asset allocation policy strategy to be implemented and maintained over a three to five year period. This review process shall also include any manager structure adjustments necessary to implement the asset allocation policy.

- At lease every three to five years, the Board shall expand the asset allocation review process to include asset/liability modeling in order to evaluate the funding implications of the liability structure upon the both the risk profile of the asset allocation strategy and the ultimate net cost of funding the benefits.

- In conjunction with the annual review and adoption of policies for each asset class, the Board of Trustees will set asset allocation targets as well as rebalancing variance range limits around these target allocations. These targets and limits will serve to implement the three to five year goals.

APPENDIX F

RISK CONTROL AND REBALANCING OF THE ASSET ALLOCATION PLAN

In order to control the risk profile of the asset allocation strategy, the Board has adopted an asset allocation re-balancing process that stipulates the target allocations to asset categories or to asset managers within asset categories not be allowed to exceed certain tolerance ranges specific to the expected volatility of each asset category and sub-category. This process provides each allocation an equal probability of "selling high or buying low" in response to capital market volatility regardless of each category's relative volatility or size in the overall portfolio. The rebalancing variance bands are defined in terms of a multiple of the expected standard deviation of each asset category.

The allowed variance range factor is: **+/- 2.30 standard deviations.**

This standard deviation factor is translated into percentage variance ranges for each asset category. These control parameters used to rebalance, adjust and maintain the asset allocation structure in response to market fluctuations shall be reviewed at least every three years or whenever there is a change in the asset allocation strategy.

To control the risk of the investment strategy, the Board of Administration delegates to staff the responsibility and authority to:

(i) Monitor the Trust Fund periodically and/or in response to extraordinary situations impacting investment market volatility; and

(ii) Determine whether or not any asset category is out of balance with its target asset allocation in excess of the specified tolerance range; and

(iii) Determine whether or not any investment manager within each asset category is out of balance with their target allocation in excess of the specified tolerance range; and

(iv) Initiate the process of instructing the relevant investment managers to liquidate the appropriate dollar value of securities and reallocate the cash thus generated to the category(s) or investment manager(s) necessary to bring the Trust Fund back into balance with the adopted target allocations; or

(v) Initiate the process of instructing the relevant investment managers to redirect cash income (interest coupon and dividends), in concert with an evaluation of other cash flows (employer and employee contributions) and pending commitments, in order to redirect cash to the category(s) or investment manager(s) necessary to bring the Trust Fund back into balance with the adopted target allocations.

Progress made toward attaining these objectives will be reported to the Board by the Retirement Administrator each month.

APPENDIX G

ASSET ALLOCATION TARGET WEIGHTINGS AND REBALANCING RANGES

The asset allocation target percentages and allowable variance (rebalancing) ranges are detailed in the table below.

Asset Classes & Manager Structure	Target Allocations *	Allocation ** Rebalancing Ranges (Min/Max)
Domestic Equity:		
Large Cap Growth	7.60%	4.63% - 10.57%
Large Cap Core	7.60%	4.98% - 10.22%
Large Cap Value	7.60%	5.15% - 10.05%
Mid Cap Core Growth	3.80%	2.31% - 5.29%
Mid Cap Core Value	3.80%	2.40% - 5.20%
Small Cap Growth	1.90%	0.87% - 2.93%
Micro Cap Growth	1.90%	0.59% - 3.21%
Small Cap Value	3.80%	2.38% - 5.22%
Subtotal Domestic Equity:	38.00%	
International Equity:		
International Growth	6.80%	4.14% - 9.46%
International Value	6.80%	4.22% - 9.38%
International Small Cap	3.40%	2.04% - 4.76%
Subtotal Int'l Equity:	17.00%	
Fixed Income:		
Defensive – Market Neutral	9.00%	8.12% - 9.88%
Core Plus Bonds	18.00%	15.31% - 20.69%
Convertible Bonds	3.00%	2.15% - 3.85%
Subtotal Domestic Fixed Income:	30.00%	
International Fixed Income	4.00%	2.96% - 5.04%
Real Estate	11.00%	7.46% - 14.54%
Total Target Allocation	100.00%	

* Revised 7/21/06

** Updated 5/21/04

Appendix H

SDCERS Watch List / Probation Criteria (Adopted 12/16/1999; revised 2/18/05)

CRITERION	WATCH LIST	PROBATION
Performance	**Active Equity: Core or Diversified**; for cumulative 3-year or 5-year rolling return periods, respective performance which is 200 or 100 basis points below the benchmark and/or a peer group ranking which falls below the 66^{th} or 60^{th} percentiles. **Style or Concentrated**; for cumulative 3-year or 5-year rolling return periods, respective performance which is 300 or 150 basis points below the benchmark and/or a peer group ranking which falls below the 66^{th} or 60^{th} percentiles.	**Active Equity: Core or Diversified**; for cumulative 3-year or 5-year rolling return periods, respective performance which is 250 or 125 basis points below the benchmark and/or a peer group ranking which falls below the 75^{th}, or 66^{th} percentiles. **Style or Concentrated**; for cumulative 3-year or 5-year rolling return periods, respective performance which is 400 or 250 basis points below the benchmark and/or a peer group ranking which falls below the 75^{th} or 66^{th} percentiles.
	Active Fixed Income: Core or Diversified; for cumulative 3-year or 5-year rolling return periods, respective performance which is 50 or 25 basis points below the benchmark and/or a peer group ranking which falls below the 66^{th} or 60^{th} percentiles. **Style or Concentrated**; for cumulative 3-year or 5-year rolling return periods, respective performance which is 100 or 50 basis points below the benchmark and/or a peer group ranking which falls below the 66^{th} or 60^{th} percentiles.	**Active Fixed Income: Core or Diversified**; for cumulative 3-year or 5-year rolling return periods, respective performance which is 75 or 50 basis points below the benchmark and/or a peer group ranking which falls below the 75^{th} or 66^{th} percentiles. **Style or Concentrated**; for cumulative 3-year or 5-year rolling return periods, respective performance which is 150 or 75 basis points below the benchmark and/or a peer group ranking which falls below the 75^{th} or 66^{th} percentiles.
	Core Equity Index Funds (S&P 500, Russell 1000): tracking error exceeding 5 basis points on an annualized basis. **Other Index Funds** (small cap, fixed income, non-U.S.): tracking error exceeding 10 basis points on an annualized basis.	**Core Equity Index Funds (S&P 500, Russell 1000):** negative tracking error exceeding 5 basis points for 1-year or exceeding 10 basis points for 6 months. **Other Index Funds** (small cap, fixed income, non-U.S.): tracking error exceeding 20 basis points on an annualized basis.
	Enhanced Index Funds: Equity; negative tracking error exceeding 100 basis points on an annualized basis. **Fixed Income**; negative tracking error exceeding 25 basis points on an annualized basis.	**Enhanced Index Funds: Equity**; negative tracking error exceeding 200 basis points on an annualized basis. **Fixed Income**; negative tracking error exceeding 50 basis points on an annualized basis.
Style	--→	Manager deviates from style for 4 or more quarters.

Organizational Change	Firm is under new ownership but the team responsible for the account remains intact and autonomous. Reorganization or turnover in top management, portfolio managers, research or trading staff that does not directly involve the SDCERS portfolio team.	Changes in ownership, organizational assignments, or turnover in personnel that impacts the team responsible for the SDCERS account.
Compliance	Violating investment guidelines or contractual agreement; purchasing unauthorized securities; leveraging the portfolio. Market Value of the SDCERS account exceeds 40% of the manager's assets managed in the subject product. Failure to meet reporting requirements or deadlines. *Depending on circumstances and severity of the violation, higher level of contract review may be recommended.*	Violation of securities laws, industry regulations, or standards of professional conduct. Repeated violation of investment guidelines or contractual agreement evidencing inadequate compliance controls. Failure to correct reporting problems. *Depending on circumstances and severity of the violation, termination may be recommended.*
Client Service	Uncooperative or unprofessional conduct.	Failure to correct client service issues.
SDCERS Responses	For performance issues, manager will be monitored and reviewed more closely by staff and the investment consultant, including Investment Committee meetings with the manager at least every six months. Watch list status will end one year after the performance shortfall no longer exceeds the above criterion. Alternatively, continuing deterioration in performance will warrant review for placement on probationary status. Watch listing for operational issues shall remain in effect for one year from the date of occurrence.	For performance issues, probation shall last for at least one year. If deficient performance continues or worsens, alternative means of achieving the desired investment exposure will be researched and reported to the Board. A similar process will occur for repeated compliance problems. Probationary status will end when performance improves to watch list status or better or when the manager is replaced. Probationary status for operational issues shall remain in effect for one year from the date of occurrence.

APPENDIX I

SECURITIES LENDING

SDCERS' securities lending program provides the fund with an opportunity to earn incremental income and offset administrative expenses. The program may be managed by the Plan custodian, and/or qualified third-party securities lending agent(s). The lending program should remain transparent to SDCERS' external investment managers and should not impede their investment management process.

The securities lending program consists of two separate functions. The first function is the lending of SDCERS' eligible portfolio securities (domestic and international equities and bonds) to approved and qualified borrowers through an agent, subject to the terms and conditions specified in SDCERS' securities lending contract. Domestic loans must have a minimum initial collateralization level of 102% and international loans must have an initial collateralization level of at least 105%.

The second function is the reinvestment of cash proceeds generated by the lending of SDCERS' portfolio securities. This function is an investment management function, and as a result is governed by the same "prudent expert" rules employed by SDCERS' existing investment managers. Cash and non-cash collateral may be invested in commingled funds or in separately managed accounts. Non-U.S. dollar collateral for international loans may be invested in non-U.S. dollar assets.

Separately managed accounts will be managed in accordance with investment policies and guidelines adopted by the Board.

For separately managed accounts, Staff and the Investment Consultant shall monitor the securities lending program for compliance with contractual investment guidelines and policies pertaining to the reinvestment of cash proceeds. These guidelines and policies shall periodically be reviewed and, if needed, amended to incorporate any appropriate revisions. This will ensure that appropriate risk controls are maintained.

APPENDIX J

INVESTMENT GUIDELINES

AND PERFORMANCE BENCHMARKS

APPENDIX J-1

DOMESTIC EQUITY

Trust Fund assets may be invested in equity investments provided: 1) the equity is in a common or preferred stock and sold on a public or registered stock exchange of a country included in an index or benchmark used to measure an investment manager's performance, or is marketable because of the number of shares publicly held and traded; or (2) is in a diversified equity investment fund issued by an investment company registered with the SEC under the 1040 Act.

City of San Diego Council Resolution No. R-2835878 (Appendix C) states: **The total investment in equities shall not exceed 70% of total assets of that portion of the Trust Fund not invested in real estate oriented investments.**

SPECIFIC INVESTMENT LIMITATIONS

- Not more than 5% of the entire Trust Fund's equity portfolio shall be invested in the common stock of any one company nor shall any holding exceed 3% of the outstanding common stock of any one company, at the time of initial commitment.
- Not more than 10% of the equity portfolio, at market value, shall be invested in preferred stocks. Not more than 2% of the Trust Fund's equity portfolio shall be invested in the preferred stock of any one company nor shall any holding exceed 5% of the outstanding preferred stocks of any one company, in that particular issue, at market value.

PERFORMANCE

Performance will be evaluated by comparing SDCERS' Domestic Equity Portfolios against appropriate benchmarks as well as against relevant similar style peer groups. The following table illustrates the various benchmarks used for the Domestic Equity Portfolios:

Asset Class	Benchmark
Large Cap Core	S & P 500
Large Cap Growth	Russell 1000 Growth
Large Cap Value	Russell 1000 Value
Mid Cap Core Growth	Russell Mid Cap
Mid Cap Value	Russell Mid Cap Value
Small & Micro Cap Growth	Russell 2000 Growth
Small Cap Value	Russell 2000 Value

APPENDIX J-2

INTERNATIONAL EQUITY

Trust Fund assets may be invested in equity investments provided: 1) the equity is in a common or preferred stock and sold on a public or registered stock exchange of a country included in an index or benchmark used to measure an investment manager's performance, or is marketable because of the number of shares publicly held and traded; or (2) is in a diversified equity investment fund issued by an investment company registered with the SEC under the 1040 Act. The total investment in all equities shall not exceed 70% of total assets of that portion of the Trust Fund not invested in real estate oriented investments.

City of San Diego Council Resolution No. R-2835878 (Appendix C) states: **Purchases of non-U.S. equities shall not exceed 40% of the total assets invested in equities.**

APPROVED COUNTRIES FOR INVESTMENT

Any country which has an operative financial exchange or over-the-counter market, a convertible currency, and a political, economic and investment structure which facilitates the availability of securities to foreign investors without excessive taxation may be considered for investment by SDCERS. Based upon the above considerations, countries that are included in the appropriate benchmark(s) by which a manager's performance is evaluated are approved for investment. Also approved are companies legally domiciled in tax haven countries such as Bahamas, Bermuda, British Virgin Islands, Cayman Islands, Channel Islands, Liechtenstein, Luxembourg, Netherlands Antilles, Panama and the United States Virgin Islands.

Any limitations upon the relative exposures to the markets of approved countries shall be specified in the Specific Investment Guidelines of managers retained to invest on an international or global basis on behalf of SDCERS.

SPECIFIC INVESTMENT LIMITATIONS

- Not more than 5% of the entire Trust Fund's equity portfolio shall be invested in the common stock of any one company nor shall any holding exceed 3% of the outstanding common stock of any one company, at the time of initial commitment.

- Not more than 10% of the equity portfolio, at market value, shall be invested in preferred stocks. Not more than 2% of the Trust Fund's equity portfolio shall be invested in the preferred stock of any one company nor shall any holding exceed 5% of the outstanding preferred stocks of any one company, in that particular issue, at market value.

PERFORMANCE

Performance will be evaluated by comparing SDCERS' International Equity Portfolios against appropriate benchmarks as well as against relevant peer groups. The following table illustrates the various benchmarks used for the International Equity Portfolios:

Asset Class	**Benchmark**
International Core/Emerging	MSCI AC World Free ex-US Index
International Small Cap	Citigroup Extended Market Index ex-US*

* SDCERS was using the Goldman Sachs World Med-Small Cap exUS Index through December 31, 2001. After that date, SDCERS began using the current benchmark.

APPENDIX J-3

DOMESTIC FIXED INCOME

Not more than 10% of the Trust Fund's fixed income portfolio shall be invested in the debt security of any one issue at the time of initial commitment, except for U.S. Government obligations (or agencies and instruments of the U.S. Government).

The types of investments allowed for SDCERS' Fixed Income Portfolios are:

OPTIONS - Use of options is authorized on a selective basis so long as they are not used to leverage the Trust Funds' portfolios.

FINANCIAL FUTURES - Use of financial futures is authorized on a selective basis so long as they are not used to leverage the Trust Funds' portfolios.

INTEREST RATE AND CREDIT DEFAULT SWAPS (long and short) so long as they are not used to leverage the Trust Funds' portfolios.

CORPORATE FIXED INCOME SECURITIES - Trust Fund assets may be invested in debt securities, including convertible bonds and preferred stocks, provided the security is issued by a solvent corporation of a country included in an index or benchmark used to measure an investment manager's performance.

EQUITIES – Trust Fund assets in the fixed income category may be invested in long and short publicly traded equity securities in structured, absolute return oriented, market neutral investment processes, so long as the net equity market exposure is not more than +/- 4% of an account's market value. This type of portfolio structure is expected to function as a shorter duration fixed income diversifier within the Trust Fund's asset allocation structure. The cash component of a market neutral account may be securitized to extend the duration exposure of the cash to that of a bond market index. Also, in conjunction with a significant rebalancing of the asset allocation structure, the cash component of a market neutral account may be securitized with equity futures to convert an account's fixed income exposure to that of an equity account.

GOVERNMENT SECURITIES - Trust Fund assets may be invested in: a) securities issued by the U.S. Government, its agencies, and its instrumentalities; b) securities issued by a country included in an index or benchmark used to measure an investment manager's performance, and that country's provinces, cities, or municipal corporations; or, c) Brady bonds.

MORTGAGES - Trust Fund assets may be invested in mortgages offered by institutions or private parties. The mortgages, the properties and all other factors must satisfy the standards of the Investment Committee or a SDCERS Real Estate Investment Manager. Mortgages must be diversified both by area and usage. The combined value of mortgage debt with security interest and other real estate investments shall not exceed 40% of the total of the Trust Fund, at the time of initial commitment.

SHORT TERM, LIQUID INVESTMENTS - Short term cash investments shall be subject to credit quality standards and restrictions as identified in the investment manager's contract. Short term investments also must be diversified as to issuer and type, except for obligations of the U.S. Government or its agencies. Short term cash equivalent investments must be in one or more of the following:

- Certificates of Deposit
- U.S. Treasury Bills, Notes, and other obligations of the U.S. Government or its agencies
- Commercial paper rated A-1 by S&P or P1 by Moody's
- Demand notes of equivalent rating
- Money Market funds
- Bank and trust company short term investment funds (STIF)
- Repurchase and Reverse Repurchase Agreements
- Eurodollars Certificates of Deposit and time deposits of U.S. issuers
- Floating Rate Notes and Certificates of Deposit.

Additionally, the Board recognizes that pending asset allocation commitments may result in the periodic retention of cash reserves for the purpose of funding these approaching commitments. SDCERS may direct the investment of these periodic cash reserves by utilization of the above short term liquid investments and/or the utilization of actively managed enhanced cash investment vehicles. Actively managed cash vehicles shall be subject to duration or average maturity limitations of one year or less for investments which are priced to market, or three years or less for investments which are not priced to market.

PERFORMANCE

Performance will be evaluated by comparing SDCERS' Domestic Fixed Income Portfolios against appropriate benchmarks as well as against relevant peer groups. The following table illustrates the various benchmarks used for the Domestic Fixed Income Portfolios:

Asset Class	**Benchmark**
Core Plus	Lehman Aggregate
Shorter Duration & Market Neutral	Merrill Lynch 1-5 Year Government/Corporate, and 90 day T-Bills plus 3%
Convertibles	Merrill Lynch Convertible Index, All Qualities

APPENDIX J-4

INTERNATIONAL AND GLOBAL FIXED INCOME

Not more than 10% of the Trust Fund's fixed income portfolio shall be invested in the debt security of any one issue at the time of initial commitment, except for U.S. Government obligations (or agencies and instruments of the U.S. Government).

City of San Diego Council Resolution No. R-2835878 (Appendix C) states: **Purchases of non-U.S. fixed income investments shall not exceed 40% of the total amount invested in fixed income.**

The types of investments allowed for SDCERS' International or Global Fixed Income Portfolios are

OPTIONS - Use of options is authorized on a selective basis so long as they are not used to leverage the Trust Funds' portfolios.

FINANCIAL FUTURES - Use of financial futures is authorized on a selective basis so long as they are not used to leverage the Trust Funds' portfolios.

INTEREST RATE AND CREDIT DEFAULT SWAPS (long and short) so long as they are not used to leverage the Trust Funds' portfolios.

CORPORATE FIXED INCOME SECURITIES - Trust Fund assets may be invested in debt securities, including convertible bonds and preferred stocks, provided the security is issued by a solvent corporation of a country included in an index or benchmark used to measure an investment manager's performance.

GOVERNMENT SECURITIES - Trust Fund assets may be invested in: a) securities issued by the U.S. Government, its agencies, and its instrumentalities; b) securities issued by a country included in an index or benchmark used to measure an investment manager's performance, and that country's provinces, cities, or municipal corporations; c) Brady bonds; Supra-national agencies; or, d) Emerging Market debt instruments. The maximum exposure to Emerging Market debt shall not exceed 30% of the market value of the Trust Fund's fixed income portfolio.

SHORT TERM, LIQUID INVESTMENTS - Short term cash investments shall be subject to credit quality standards and restrictions as identified in the investment manager's contract. Short-term investments also must be diversified as to issuer and type, except for obligations of the U.S. Government or its agencies. Short term cash equivalent investments must be in one or more of the following:

- Certificates of Deposit
- U.S. Treasury Bills, Notes, and other obligations of the U.S. Government or its agencies
- Commercial paper rated A-1 by S&P or P1 by Moody's
- Demand notes of equivalent rating
- Money Market funds

- Bank and trust company short term investment funds (STIF)
- Repurchase and Reverse Repurchase Agreements
- Eurodollars Certificates of Deposit, Time Deposits and commercial paper
- Foreign government and supra-national agencies instruments
- Floating Rate Notes and Certificates of Deposit.

APPROVED COUNTRIES FOR INVESTMENT

Any country which has an operative financial exchange or over-the-counter market, a convertible currency, and a political, economic and investment structure which facilitates the availability of securities to foreign investors without excessive taxation may be considered for investment by SDCERS. Based upon the above considerations, countries that are included in the appropriate benchmark(s) by which a manager's performance is evaluated are approved for investment.

Any limitations upon or expansions to the relative exposures to the markets of approved countries shall be specified in the Specific Investment Guidelines of managers retained to invest on an international or global basis on behalf of SDCERS.

FOREIGN CURRENCY EXPOSURE

Foreign currency exposure will be based on the absolute value of all positions (long and short) versus the U.S. dollar. Both long and short foreign currency positions may be held without owning securities denominated in such currencies. Any minimum currency hedging requirements will be met through either hedged cash bond exposure or a combination of forward and derivative positions coupled with a long currency position in the same currency.

PERFORMANCE

Performance will be evaluated by comparing SDCERS International Fixed Income Portfolios against an appropriate benchmark, as well as against its relevant peer group. Following table illustrates the various benchmarks used for the International Fixed Income Portfolios:

Asset Class	**Benchmark**
International Fixed Income	S&P Citigroup Non-U.S. Government Bond
Global Fixed Income	Blended: 78% Lehman Aggregate, 21% JP Morgan U.S. hedged and 1% JP Morgan EMBI Global

APPENDIX J-5

REAL ESTATE

The Board has adopted specific policies and procedures concerning real estate investments. The Real Estate Strategic Plan Elements and Implementation Plan are attached as a separate section.

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APPENDIX J-6

PRIVATE EQUITY (under construction)

On February 16, 2007, the Board approved the addition of Private Equity as an eligible asset class, up to a maximum of 5% (at cost at time of purchase) of Trust Fund assets. The Board is in the process of reviewing and adopting specific policies and procedures concerning private equity investments. When adopted, these will be attached as a separate section.

APPENDIX K

LEGAL DIVISION SECURITIES LITIGATION POLICY

PURPOSE

The purpose of this policy is to establish procedures and guidelines for monitoring and participating in securities class actions when appropriate to protect SDCERS' interests.

PRINCIPLES

As a large institutional shareholder, SDCERS is frequently a class member in securities class actions that seek to recover damages resulting from alleged wrongful acts or omissions of others.

The enactment by Congress of the Private Securities Litigation Reform Act (PSLRA) in 1995 allows institutional investors and other large shareholders to seek lead plaintiff status in securities class actions. The lead plaintiff gains the right to supervise and control the prosecution of the case.

Since enactment of the PSLRA, it has been demonstrated that participation as lead plaintiff by large, sophisticated shareholders, particularly institutional shareholders, has resulted in lower attorney's fees and significantly larger recoveries on behalf of shareholders. The United States Securities and Exchange Commission and leaders in the legal community have commented that the governing board of a public pension system has a fiduciary duty to monitor securities class actions in which the system has an interest, and to participate as lead plaintiff where such participation is likely to enhance the recovery by members of the class.

STATEMENT OF FUNCTIONS AND RESPONSIBILITIES

1. Review of Class Action Filings

The Legal Services Division shall retain one or more law firms selected by an RFI process, to review the filing of class actions and, if SDCERS is a member of the class, to determine whether the case would be meritorious and worthy of further investigation. The firm shall report its findings to Legal Services with a recommendation as to whether SDCERS should actively monitor the case or seek lead plaintiff status. Retained counsel shall perform its monitoring services free of charge.

2. Active Case Monitoring

The Legal Services Division shall actively monitor each case in which it has determined the case has merit and SDCERS' estimated loss is $1 million or more. Active monitoring may include participation by Legal Services in significant motions prepared by one of the selected law firms and in settlement discussions when permitted by the parties or the court.

3. Participation as Lead Plaintiff

Legal Services shall recommend to the Investment Committee that SDCERS seek lead plaintiff status when (i) Legal Services, after consulting with outside counsel, has determined the case has merit and the best interests of SDCERS will be served, and; (ii) SDCERS' estimated loss is $2 million or more or SDCERS' estimated loss exceeds $1 million and lead plaintiff status will be sought jointly with one or more other public retirement funds.

4. Reports to the Board

The Legal Services Division shall provide the Investment Committee with annual reports covering its responsibilities under this policy.

5. Retention of Outside Counsel

The Legal Services Division shall select one or more firms to advise and/or represent SDCERS in class action matters. Firms will be selected based upon myriad factors including case analysis provided; representation of similarly situated entities; fee proposals; and history of advice to SDCERS. These factors must be evaluated on a case by case basis. Any agreements between SDCERS and a law firm shall be approved in advance by the Investment Committee and full Board.

CHANGES TO CURRENT PRACTICE

Currently, the Investments Division monitors class action lawsuits and files "claims" in those class action matters in which SDCERS has sold stock within the relevant class period. SDCERS regularly collects damages with this level of participation. At the present time, however, SDCERS is not estimating its losses in any particular matter. This Policy addresses this gap in information.

Under this Policy, the Investments Division will continue its claims monitoring procedure, which will be in addition to the free monitoring and case valuation provided by outside counsel.

This Policy formalizes the monitoring function being carried out by the Investments Division, and will create additional responsibilities for the Investment Committee and Legal Services Division.

No additional staffing requirements or significant expense will result from the implementation of this policy.

Adopted November 15, 2002

APPENDIX L

PROXY VOTING POLICY AND GUIDELINES

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APPENDIX M

INVESTMENT AUTHORITY DELEGATED BY THE BOARD OF ADMINISTRATION

Staff Authority

A. Administrative Termination of Investment Manager for Cause

The Board delegates to staff the authority to immediately suspend the trading activity of an investment manager and /or to administratively terminate an investment manager under the following circumstances:

1. Significant losses or departures of a firm's investment professionals responsible for the conduct and management of the investment process.
2. Significant violations of a firm's specific investment guidelines for SDCERS or significant sanctions imposed on a firm for breach of law or regulatory requirements and standards.
3. Discovery of material misrepresentations concerning a firm's expertise, experience, track record or other operational factors that call into question the firm's ability to consistently and reliability deliver the investment service desired by SDCERS.

Staff shall notify the Investment Committee Chairperson and Board President regarding the circumstances warranting the suspension of a firm's trading activity and obtain the concurrence of both of these Board Officers prior to exercising an administrative termination. The Board shall be informed by its next regularly scheduled meeting of the circumstances leading to staff's action and what interim fiduciary oversight has been arranged to manage the impacted portfolio.

APPENDIX N (Samples)

SPECIFIC INVESTMENT GUIDELINES FOR INVESTMENT MANAGERS

San Diego City
Employees' Retirement System

Strategic Plan
Objectives, Policies and Procedures

September 21, 2007

The Townsend Group
Institutional Real Estate Consultants
Cleveland, Ohio   San Francisco, CA   Denver, CO

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I. INTRODUCTION

The San Diego City Employees' Retirement System (the "Retirement System" or "SDCERS") has determined that, over the long term, inclusion of equity real estate investments will enhance the risk/return characteristics of the Retirement System's portfolio investment.

This document establishes the specific objectives, policies and procedures involved in the implementation and oversight of the Retirement System's real estate program. The objectives define the specific risk tolerance and return expectations for the program. The policies provide specifications for acceptable investment styles and management of the various risks associated with the asset class. The procedures provide guidelines for the implementation and oversight of said policies.

II. INVESTMENT OBJECTIVES

A. Asset Allocation

SDCERS has approved a long-term asset allocation target of eleven percent (11%) for investment in equity real estate investments.

B. Return Objectives

During the last twenty years, real estate has been an asset class that institutional investors typically include in their investment asset mix. The Board of San Diego City Employees' Retirement System ("Board") has determined that the objective of the Retirement System's real estate portfolio will be to provide returns superior to passive management strategies. Active management, value creation strategies and the prudent use of third party debt are approved methods for generating the expected excess return. The Board has approved a target return for the real estate portfolio of a net return equal to the NCREIF Property Index ("NPI") plus 250 basis points (or NPI plus 2.5%). A secondary objective for the asset class will be to improve the diversification of the overall investment portfolio. Shorter term performance and risk assessment will utilize a risk adjusted benchmark using return expectations by style in a customized, weighted benchmark to reflect the actual composition of the portfolio and expected return of the same.

III. INVESTMENT POLICIES

A. Portfolio Composition

The System divides the range of available real estate investment strategies ('styles') into three primary categories: (1) Stable, (2) Enhanced, and (3) High Return. The style groups are defined by their respective market risk/return characteristics:

Stable Characteristics

- Operating and substantially leased properties (80%);
- Property types include office, apartment, retail, industrial;
- Total return is primarily attributable to income ($\geq$ 65%).

Enhanced Characteristics

- Properties requiring lease-up, rehabilitation, repositioning, expansion or those acquired through forward purchase commitments;
- No property types are excluded.
- Total return is attributable to a balance between income and appreciation.

High Return Characteristics

- Properties or real estate companies offering recapitalization, turnaround, development, market arbitrage opportunities investments;
- No property types are excluded.
- Total return is primarily attributable to appreciation and generally recognized upon sale of the asset.

With respect to the three style groups, the Board has established the following portfolio composition target:

Style	Range of Expected Gross Returns
Minimum 30% Stable	Gross NPI + 25 bps
Maximum 70%	
Enhanced	Gross NPI + 225 bps
High Return	Gross NPI + 575 bps

B. Risk Management

The primary risks associated with equity real estate investments are investment manager risk, property market risk, asset and portfolio management risk, loss of principal and liquidity risks. The Retirement System will mitigate risk in a prudent manner. The following policies have been established to manage the risks involved in investing in real estate equity.

1. Defined Roles for Participants

The real estate program shall be planned, implemented, and monitored through the coordinated efforts of the Board, Investment Committee, Staff, Real Estate Consultant ("Consultant") and Investment Managers ("Manager" or "Managers"). Set forth below is the delegation of the major responsibilities of each participant.

Duties of the SDCERS Board

- Establishes the role of the real estate investment program in light of the total portfolio objectives.
- Approves the allocation to real estate and approves any adjustments to the allocation which may be necessary from time to time.
- Approves the Strategic Plan (Objectives, Policies and Procedures) and the Investment Plan for the real estate program.
- Approves Investment Committee recommendations for selection, retention and removal of Managers and selection and management of investments.
- Reviews the real estate portfolio on a quarterly basis to evaluate the investment performance and to ensure compliance with policy guidelines and approved Investment Plans.

Duties of the Investment Committee or the Full Board in the absence of an Investment Committee

- Reviews the Strategic Plan (Objectives, Policies and Procedures) and the Investment Plan for the real estate program. Presents and recommends the Plans to the Board for approval.
- Reviews and approves Requests for Information as developed by Staff and Consultant to be used in Individually Managed Account ("IMA") manager selection.
- Interviews Managers, Investment Partners or Ventures, and Commingled Fund Sponsors and recommends selections to the Board for approval.
- Reviews Staff and Consultant recommendations for removal of Managers and recommends termination to the Board for approval.

Duties of the SDCERS Staff

- Reports to the Investment Committee and Board on matters of policy.
- Oversees Consultant's preparation of the Strategic Plan and Investment Plan.
- Participates with the Consultant in the Annual Real Estate Portfolio Review, including Budget and Management Plans and Manager Investment Plans. Reports completion to the Investment Committee.
- Brings any non-conforming items or significant issues to the attention of the Investment Committee.
- Documents and monitors funding procedures.
- Completes any other activity as directed by the Committee and/or Board.

Individually Managed Account ("IMA") Duties:

- Conducts searches for professional services and investment managers and, with the assistance of the Consultant, recommends finalists to the Investment Committee and Board for approval.
- Oversees preparation of annual Manager Investment Plans and reports completion to the Investment Committee.
- Reviews the Budget and Management Plans prepared by IMA Managers and reports completion to the Investment Committee.

- Reviews Preliminary Investment Packages and compliance analysis prepared by IMA Managers and submits the results to the Investment Committee.
- Reviews fees for compliance and insures that Incentive Fees are processed appropriately.
- Performs other duties required to execute the IMA Investment Procedures.
- Monitors the closing process, and with legal counsel, reviews and executes any required documentation for acquisitions, refinancings and other capital transactions between IMA Managers and the Retirement System.

Commingled Fund ("CF") Duties

- With the assistance of the Consultant, conducts screening, review, and selection for recommendation of CF offerings.
- Oversees the commitment process, and with legal counsel, reviews and executes any required documentation.

Duties of the Consultant

- Reports directly to the Board, Investment Committee and Staff on matters of policy.
- Brings any non-conforming items or significant issues to the attention of the Staff and/or Board.
- Monitors the performance of the real estate portfolio and compliance with approved policy.
- Prepares the Strategic Plan and Real Estate Investment Plan and, in conjunction with Staff, presents the Plans to the Investment Committee for review.
- Prepares a quarterly Performance Measurement Report (PMR) to evaluate investment performance and to ensure compliance with policy guidelines and approved Investment Plans. Presents portfolio PMR to the Investment Committee quarterly.
- Assists Staff in the Annual Real Estate Portfolio Review.
- Provides Staff and/or Board with topical research and education on investment subjects that are relevant to SDCERS.

Individually Managed Account ("IMA") Duties

- Assists Staff in conducting searches for investment managers and preparing recommendations for the Investment Committee.
- Oversees Manager preparation of annual Manager Investment Plans and, in conjunction with Staff, and reports completion to the Investment Committee.
- Reviews the Budget and Management Plans prepared by IMA Managers and, in conjunction with Staff, reports completion to the Investment Committee.
- Reviews Preliminary Investment Packages submitted by IMA Managers for compliance with approved Investment Plans.
- Performs other duties required to execute the IMA Investment Procedures.

Commingled Fund Duties

- Conducts, or assists Staff in conducting analysis of Commingled Fund offerings in accordance with the Commingled Fund selection process.
- Provides written analysis of Commingled Funds as requested by Staff.

<u>Duties of the Manager</u>

- Provides performance measurement data in form and substance as requested by the Retirement System.

Individually Managed Account Managers:

- Acquires, manages and disposes of assets on behalf of the Retirement System.
- Adheres to the most recent version of the Real Estate Information Standards established jointly by the National Council of Real Estate Investment Fiduciaries ("NCREIF"), the Pension Real Estate Association ("PREA") and the National Association of Real Estate Investment Managers ("NAREIM") ("Information Standards").
- Prepares Manager Investment Plans to be submitted to the Staff and Consultant.
- Prepares Preliminary Investment Packages to be submitted to the Staff and Consultant.

- Prepares Budget and Management Plans to be submitted to the Staff and Consultant.
- Meets with Staff and Consultant for the Annual Real Estate Portfolio Review.
- Provides Consultant, when requested, Annual Review information.
- Assists the Staff in preparing funding procedures.

Commingled Fund Managers:

- Adheres to reporting standards established by the CFA Institute and complies with generally accepted accounting principals ("GAAP").
- Executes and performs its duties under the terms of the investment vehicle documents.
- Provides timely requests for capital contributions.
- Provides quarterly financial statements and annual reports.
- Conducts no less frequently than annually meetings with Staff and Consultant to discuss important developments regarding portfolio, investment and management issues.

Duties of Legal Counsel

- Outside legal counsel, selected by the Retirement System as a representative for the Plan, will review upon request, all real estate related documents and/or provide advice for special investment situations as needed.

2. Investment Structures

The Retirement System recognizes that, regardless of investment structure, real estate is an illiquid asset class. Structures that maximize investor control of the assets are preferred, particularly in Stable investments. The Retirement System also recognizes that the Enhanced and High Return styles require the assumption of additional risks including diminished investor control. The risk associated with reduced investor control in higher return strategies will be mitigated by limiting exposure to any single investment strategy and/or manager.

The Stable investment style is considered to be less risky (thereby providing lower returns) than Enhanced and High Return investments. The lower risk assigned to Stable investments is due to three primary characteristics: (1) the level and predictability of the income generated, (2) the higher proportion of the total return attributable to income and (3) the limited use of debt usually associated with these styles.

The Enhanced and High Return investment styles seek to provide higher returns with higher risk than the Stable component of the portfolio. Enhanced investments are those assets capable of exhibiting Stable characteristics but in need of active management in order to regain or realize their Stable position. High Return investments seek to capitalize on market inefficiencies and opportunities (e.g. capital voids, market recovery, development, distressed sellers, financial engineering) and debt to provide excess returns. Because of the degree of reliance on active management necessary to capitalize on such market inefficiencies, investments will be accessed through structures that allow a high degree of manager discretion.

The Retirement System will utilize the following investment structures:

a) Individually Managed Accounts ("IMA")

For the Stable component, the Retirement System may purchase assets on a wholly owned basis through Individually Managed Account structures. The Retirement System may consider joint venture or co-investment ownership, as an equal or greater partner, within IMA structures.

b) Commingled Funds

For the Stable and Enhanced component, the Retirement System may also consider Open-End Commingled Funds (OECFs). OECFs are an infinite life pool of assets diversified by geography and property type. OECFs are complementary to smaller IMAs as they provide access to larger, stable, "trophy" properties that a smaller IMA would not be able to purchase. There are also OECFs that target Enhanced properties and provide similar diversification benefits.

For the Enhanced and High Return components, the Retirement System will purchase assets through the ownership of units or shares of Commingled Funds. Any legally permissible vehicle will be allowed including, but not limited to, joint ventures, limited partnerships, real estate investment trusts (private) and limited liability corporations.

3. *Diversification*

The Retirement System will seek to diversify its equity real estate portfolio by manager; property type; property location; investment style; and, within the High Return segment, by investment strategy. Investment property types must be consistent with the style groups as follows:

- Stable includes office, retail, apartments and industrial.
- Enhanced and High Return have no restrictions on property type.

It is expected that at various points in time, the portfolio may be more heavily exposed to a single property type or location by virtue of opportunities available in the market, which are projected to generate the superior returns targeted by the Retirement System. Exposure to any single property type (i.e. office, retail, apartment, industrial or other) or geographic region in excess of forty percent (40%) of the total real estate portfolio must be reviewed as an exception by the Investment Committee.

Real estate has become an institutionally accepted asset class and real estate investment programs have matured. The development of overseas markets and investment opportunities provide investors with alternatives to further diversify their programs. SDCERS will seek to optimize risk-adjusted returns by investing in opportunities located both domestically and internationally. International investments will be limited to no more than 40% of the total targeted real estate portfolio and may include stable, enhanced and high return investments. International real estate investments will be held in commingled fund structures or as REIT securities with aggregate exposure to multiple property types, regions and operators in order to reduce specific asset risk.

Individually Managed Accounts

The Retirement System's IMA management agreements, individually or as a group, will provide for diversification by property type, economic sector and location in order to minimize any such concentration which might, in turn, impact the stability of rental income over market cycles. The Retirement System will diversify its manager risk by utilizing multiple IMA managers.

Commingled Funds

Diversification by Strategy and Manager will be used to minimize sponsor or strategy concentration, which might, in turn, impact the performance of the Enhanced and High Return allocation and/or the total portfolio. The Commingled Funds will provide reporting which will allow the Retirement System to monitor its geographic and property type diversification.

4. *Leverage*

The use of leverage is a prudent tool for enhancing returns and diversifying equity investments. As such, the Retirement System has approved leverage targets in order to maximize returns to the total portfolio. The availability and cost of leverage will be factors considered in determining its use. For the Total real estate portfolio, the Retirement System has established a fifty percent (50%) leverage target. In all cases, leverage shall provide a return premium over the unleveraged IRR equal to three basis points (3 bps) of return for each one percent (1%) of leverage.

a) Stable

Stable assets generally provide an established stream of rental revenue. Because of the predictability of the income stream, third-party debt can be used at relatively low risk to enhance return. For Stable real estate investments, the Retirement System has established a fifty percent (50%) leverage maximum. For any single Stable asset, new third-party debt or debt placed after the close will be limited to fifty percent (50%) of the market value of the asset. For any single Stable asset, existing debt or assumed debt will be limited to fifty-five percent (55%) of the market value of the asset. The debt must provide sufficient net operating income ("NOI") for one hundred percent debt-service coverage and must be non-recourse. Property specific debt will be monitored through the Manager Investment Plans and Preliminary Investment Packages.

b) Enhanced and High Return

Investments classified as Enhanced and High Return generally provide returns with a higher proportion of appreciation, as compared to income, than do Stable assets. (The Retirement System has determined that leverage on these real estate investments should be determined based on strategy and opportunity). Third-party debt on Enhanced assets must expect to provide positive debt-service coverage over the life of the investment, and must be non-recourse. The use of up to sixty-five percent (65%) debt within the Enhanced style of investment is consistent with the expectations used in establishing return objectives for the style, managers and individual assets. Investments classified as High Return may utilize third-party debt up to one hundred percent (100%) of value as an integral part of their total return strategy. Such investments will be made through Commingled Funds and will therefore have a specified leverage target or maximum stated in the offering documents. Debt levels and structures will be evaluated when reviewing a specific offering.

5. Investment Size

There is no maximum investment size for equity real estate investments, however, at the time of purchase the net investment value of a single property within an IMA account shall not exceed eight percent (8%) or for a Commingled Fund exceed fifteen percent (15%) of the net equity investment value of the total targeted real estate portfolio.

6. Valuations

All investments in an IMA vehicle will be independently valued not less than every three years by a qualified expert (certified MAI). During interim years, valuations will be performed by the Investment Manager responsible for management of each investment no less than annually. Such interim valuations may be used for performance measurement purposes.

Investments held in Commingled Funds will be valued not less than annually, using the valuation methodology approved with the selection of the particular investment.

C. Discretionary Authority

The Board controls the delegation of discretion. The Policies and Procedures described herein are structured to control investment risk as well as to enhance the Retirement System's ability to execute transactions.

1. *Individual Managed Accounts*

The IMA Manger selection process, more fully described in Section IV.A.1 of this document, is structured to ensure prudent Manager selection, in order to allow Manager(s) to assume an appropriate level of discretion, balanced by controls established and monitored by the Board, Staff and Consultant. Preference will be given to those IMA vehicles allowing greater investor control.

2. *Commingled Funds*

CFs are structured to give the highest level of discretion to the Manager. The limited investor control of management decisions inherent in CF investments is appropriate given the flexibility required to achieve higher expected returns. Nonetheless, preference will be given to those CF vehicles extending greater investor control. Investments made in CFs are monitored for compliance with vehicle documents through quarterly performance measurement procedures and through documentation provided with capital calls and income distributions.

IV. INVESTMENT PROCEDURES

The Annual Investment Plan identifies the investment needs of the portfolio and establishes the parameters for the selection of appropriate investments. The particular needs for each Annual Investment Plan will be established in light of the structure, objectives and performance of the existing portfolio as well as current market opportunities. All Annual Investment Plans will be consistent with the policies detailed in Section III.A-C.

A. Individually Managed Accounts

IMA Managers will have discretionary authority over the selection of specific investments. However, certain controls will be maintained to ensure compliance with program objectives, policies and procedures. The following procedures will be utilized for selection of IMA Managers, as well as for investment and the subsequent control and monitoring of IMA allocations.

1. *Manager Selection Process*

a) Staff, assisted by Consultant, shall establish qualification criteria consistent with the purpose of the search. In all cases, the minimum criteria will comply with those approved in the San Diego City Employees' Retirement System Investment Policy Statement.

b) Consultant shall screen its database to identify Manager candidates exhibiting qualities consistent with the qualification criteria. Staff may identify additional candidates.

c) Staff, assisted by Consultant, shall establish evaluation areas, desired levels of competency and respective weightings for evaluation factors.

d) A Request for Information (RFI) shall be forwarded to qualified Manager candidates identified by Consultant and Staff.

e) Staff and Consultant shall review and evaluate RFI responses, identify material issues related to each candidate, including proposed fee structures, and compile numerical rankings for each respondent for each objective evaluation factor.

f) Staff and Consultant, shall prepare a report to the Investment Committee and Board that reviews the findings of interviews/on-sites.

g) Staff, with the assistance of Consultant, shall recommend manager(s) for selection to the Retirement Administrator and Investment Committee.

h) Staff, with the assistance of Consultant, shall coordinate final presentations when necessary that will be held at a noticed meeting.

i) The Board shall select a Manager based on review and evaluation of information presented in the steps listed above.

j) Staff and Consultant will negotiate and close manager agreements, including final fee structures.

2. *Investment*

a) Manager Investment Plan

Each IMA Manager shall prepare a Manager Investment Plan, which sets forth the investment criteria for said Manager's allocation including the reinvestment of proceeds from sales or refinancings.

The investment criteria shall be consistent with the Strategic Plan and Investment Plan. Plans will also set forth the IMA Manager's evaluation of current market opportunities and include a summary of the Annual Disposition Review (see Section IV.A.3b of this document) of each asset in the context of the market evaluation. Each plan shall be updated annually.

b) Preliminary Investment Package

Prior to making an investment, the Manager shall provide a Preliminary Investment Package to Staff and Consultant. The preliminary package shall include an analysis of the investment relative to the currently approved Manager Investment Plan and the Retirement System Strategic Plan and Investment Plan, including a projected hold/sell analysis for the proposed asset. Additional materials to be included are: a locator map, photograph, site plan, financial summary including cash flow projections, five year cash on cash return projections, no less than a five year lease expiration schedule, a list of major tenants and a metropolitan market overview.

c) Funding Procedures

The Manager and Staff will work together to prepare written funding procedures for each IMA which are compatible with the system of the particular Manager as well as with SDCERS' systems. All procedures will enable timely and accurate reporting and control of cash flows. The Manager shall provide the Staff and Consultant with a critical dates list with respect to an acquisition, including document execution and funding and closing dates, updating the list as necessary.

3. *Control and Monitoring*

a) Budget and Management Plan

Within 30 days after the end of the calendar year each IMA Manager shall submit a Budget and Management Plan for the current year for each direct investment and the aggregate IMA portfolio. The Budget and Management Plan must include a narrative strategy and an estimated income and cash flow statement for the current year. The statement will include gross revenues, expenses, percentage rent, additional interest, property management fees, net operating income, tenant improvements, leasing commissions, capital expenditures, cash flow before and after debt service and asset management, incentive and other fees along with quarterly or monthly distribution projections.

Within 45 to 60 days after the end of the calendar year, Staff and Consultant will meet with the Manager personnel directly responsible for portfolio and asset management for a review and evaluation of the reasonableness of the submitted Budget and Management Plan.

During the year, the Manager shall notify the Retirement System in writing within a reasonable time of the occurrence of any significant event relating to an investment, which was not projected in the submitted Budget and Management Plan.

b) Annual Disposition Review

IMA Managers shall provide an annual disposition analysis of each asset under management. The disposition analysis shall include hold/sell scenarios over long and short-term periods and incorporate an opportunity cost analysis. The analysis will also provide an evaluation of the asset in light of original investment objectives, the asset's compliance with the current Strategic Plan, Investment Plan and Manager Investment Plan and the reasonableness of the current valuation given market conditions for divestment.

The Annual Disposition Review shall be included in the Budget and Management Plan and the Manager Investment Plan.

B. Commingled Funds

The following procedures will be utilized in the selection, closing and monitoring of specific CF investments.

1. CF Selection Process

a) The Consultant will maintain an ongoing review of offerings within the institutional market place and, based on due diligence findings, refer appropriate CF investments to Staff.

b) Staff shall review the Consultant recommendations for compliance with agreed upon due diligence procedures for each fund recommendation.

c) Staff shall verify the compliance of each recommended fund with the approved Strategic and Investment Plans.

d) Staff and Consultant shall arrange presentations to the Investment Committee in order to allow the Committee to recommend a selection to the Board for approval.

2. CF Control and Monitoring

CF investments will be monitored quarterly by Staff, with Consultant's assistance, to evaluate investment performance and to ensure compliance with vehicle documents.

C. Performance Measurement Report

On a quarterly basis, the Consultant will prepare a comprehensive reporting and evaluation system addressing each investment and/or asset, IMA, and Manager. The evaluation system shall provide such information as may be required by the Retirement System to understand and administer its investments and Managers.

The content of the report shall include attributes for the assets individually (under IMAs), the investment managers and the total portfolio including: income, appreciation, gross and net returns, cash-flow, internal rate of return, diversification, comparisons to relevant industry performance indices and information reporting standards, and Strategic Plan and Investment Plan compliance. Each investment will be reviewed for significant events and projected performance and an opinion provided with respect to Manager performance. Budget and Management Plan variances, as reported by IMA Managers, will also be provided.

The Consultant shall prepare and forward to the Retirement System a Performance Measurement Report within ninety (90) days following the last day of each quarter.

The Townsend Group

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To:	San Diego City Employees Retirement System Investment Committee
CC:	Doug McCalla, CIO and Dawne Clark, Assistant CIO
From:	Matt Johnson, Consultant
Subject:	Asset Allocation Return Assumptions
Date:	June 15, 2006

Townsend recommends the use of Excess Return Assumptions when modeling a portfolio targeted to achieve returns in excess of the NPI. Excess Return Assumptions result in model portfolios most likely to provide alpha (excess return) above the index and at minimal risk profiles. When designing a real estate program targeting excess returns, the client will necessarily have to assume risk above the index. The following summarizes the analysis and methodology used to determine Excess Returns to be used in Asset Allocation.

The table below presents the Townsend approved Gross Excess Return Assumptions[1].

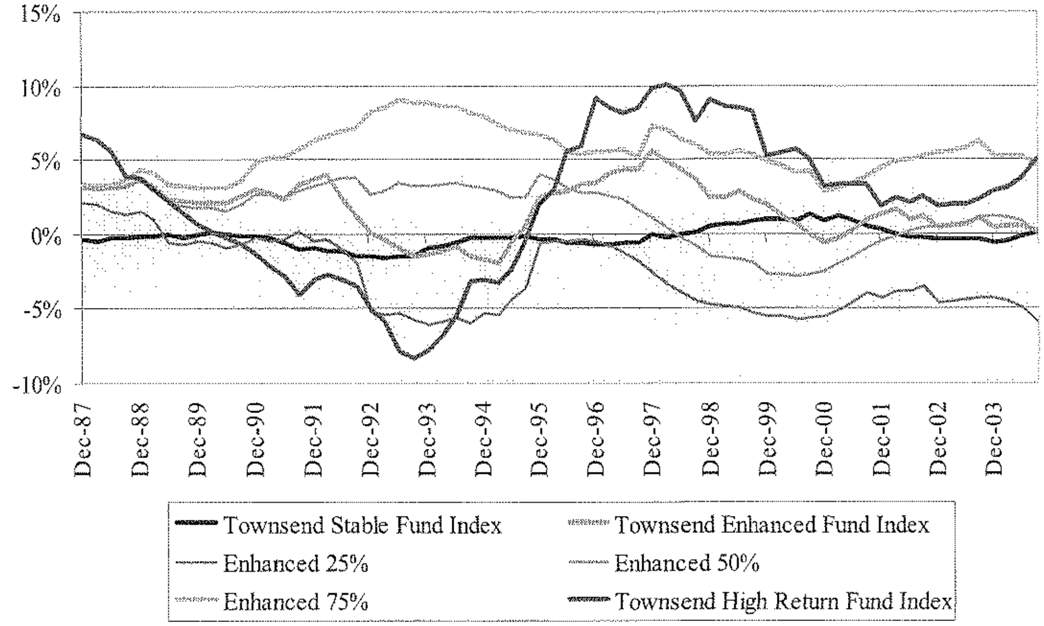
Excess Return Assumptions

NPI	Stable	Enhanced	High Return	International
Gross Excess Expected Return	0.25%	2.25%	5.75%	6.00%
Standard Deviation	1.50%	2.50%	6.00%	7.00%

The recommended excess return assumptions were derived from a blend of quantitative analysis from the Research Department using our TTG Indices as well as qualitative market analysis suggested from manager interviews. A collaborative effort was used to arrive at assumptions that were justifiable from both perspectives. *Please note that International represents High Return strategies only.*

[1] Please note this analysis was completed and presented to our internal Investment Committee in February 2005; as such, the historical data utilized was as of the end of the 3rd quarter 2004.

Excess Returns



Recommended gross assumptions are provided for use consistent with SDCERS' objectives:

- *Gross Expected Return Assumptions* – Clients with objectives to outperform the NPI on a Gross basis

Research: The following data series were evaluated using the TTG indices by sector (See Appendix A).

- Historical excess returns on an annualized and calendar year basis
- Rolling 3 and 5 year returns and rolling excess returns
- Up and down year performance by sector
- Bootstrap analysis at 25%, 50% and 75% percentiles for Enhanced

The process also involved creating a separate International Index by separating out any funds with 50%+ international from the existing High Return Index, reviewing performance of the new International database in comparison to the existing High Return Index with and without international, and evaluating our existing domestic databases for reasonableness. For example, the Enhanced Index was evaluated to determine whether historical performance is skewed due to its high percentage of open-end funds, particularly PRISA II. Analytics prepared on market value versus equal value weightings of the funds within the Enhanced Index, as well as performance with and without the open-end funds, showed there was no impact on Index analytics from the open-end fund overweight.

The historical annualized data initially suggested that lower excess returns may be appropriate for the three domestic sectors. For example, Enhanced excess returns as of September 30, 2004 never exceeded the NPI by more than 169 bps for any period. Rolling excess return data, however, justified the recommended higher projections and was considered more reliable. This time series indicated that the excess returns for the Enhanced sector ranged from 250 bps and 550 bps over certain periods. It is noted that historical data for the Enhanced sector appeared the most anomalous in that there are many periods of under performance relative to the NPI. The correlations of the Enhanced Index to NPI are also lower than the High Return Index, which is counterintuitive. We believe this is primarily a function of the wide range of funds in the Enhanced Index – from TA V having a 5-year return of 13.38% to Koll Bren V at -

1.1%. Thus, quartile data was relied on most heavily in this analysis as a means of eliminating the effect of those Enhanced funds that significantly underperformed their targets, while making the assumptions that we will be investing in top quartile funds going forward. As indicated, Enhanced funds in the 50% to 75% quartiles had excess returns of 207 bps 312 bps over the NPI.

Market Analysis: Excess return assumptions derived from historical data were reviewed in the context of current market expectations. Going-forward total return projections -- 5 year, nominal -- were discussed with several managers (SSR, ING, Principal, Morgan Stanley, UBS) and summarized as follows:

- **NPI:** 7.5%-8% gross (unlevered core)
- **Enhanced:** 11%-12% gross levered
- **High Return:** 14%-16% gross levered for strategies that include the four main property types, 16% to 20% for specialty types, development or secondary/tertiary markets
- **International:** +150 to 200 bps over high return for opportunistic international, depending upon the country and strategy

Managers' going forward return projections are consistent with those suggested in our database of new fund opportunities. Thus, excess returns over NPI *based on managers' projections* would therefore range from 350 to 400 bps for enhanced, 650 to 850 for general high return funds and approximately 1000 bps for niche and high return international strategies.

Managers agreed that return expectations were dropping across all real estate sectors. As previous Townsend research has suggested, lower expected returns are being supported by more disciplined, efficient and transparent real estate markets. Two-thirds of the returns in 2004 can be attributed to the cap rate shift. Based on capital flows to the asset class, cap rates continued to provide a positive effect in 2005, in addition to the fact that appraisers will still be "catching up" on valuations. Any positive impact from cap rate shifts, however, is expected to be gone by 2006, with a potential negative effect in 2007/2008. (Inflation is projected to be in the 2.5% and no one is anticipating any substantial movement in interest rates over the near term.)

There is unanimous agreement that the NPI will revert to its longer term average over the next five years. There is a consensus that the Index will be harder to beat going forward because the Index will likely produce total returns over the next one to two years that are higher than current core acquisition pricing:

- There is a higher component of value-add in the Index today than in the past, which will add alpha.
- Portfolios underweight in retail could continue to be negatively impacted. The Index historically has been driven by its largest market weights: the 50 largest retail properties (out of 4,500) drove up the Index by 150 bps last year. Conversely, in 4Q95, Equitable wrote down 27 malls and the Index dropped 100 bps. It is also believed that the NPI mall component is overstated relative to the institutional universe due to the Joint Venture effect (i.e., JV properties are contributed at 100% of their value despite their actual institutional ownership).
- There are a greater percentage of properties entering the Index in the 60% occupancy range versus 80% as in previous periods. Office occupancy is currently at one of the Index's all

time lows. This could suggest that properties normally considered "value-add" are entering the Index at their 60% occupancy market values, and then will be written up at some point in the future as the leasing/rental rates recover. Thus the Index will get the benefit of the "pop" in value. Given office's large percentile of the Index, portfolios underweight to office may find difficulty beating the benchmark.

- $8.6 billion or 5.7% of Index properties was sold in 4Q04. Thus, in addition to appraisal lag, the Index is benefiting from current spot market transaction pricing reflected on sold assets.

In light of the consensus that return expectations are dropping, actual projected returns from both our open fund list (which do not suggest any across the board decrease in expectations from a year ago) as well as the manager stated expectations appear to be aggressive for the 5-year going forward time period. Additionally, given that the NPI is expected to be more difficult to beat, excess returns over the Index will be reduced going forward. For example, the open-end core funds ability to outperform by their targeted 100 bps could be unachievable. Thus, the final recommended excess returns assumed that the managers' return projections were overstated by at least 100 bps. This would suggest excess returns in the range of 250 to 300 bps for Enhanced, 550 to 750 bps for general high return strategies and 750 to 1000 + for niche and high return international strategies over the Gross NPI. The final recommended assumptions attempted to reconcile the historical data with the market assumption while erring on the conservative.

APPENDIX A

Historical Returns by Sector

Return	NPI + 100	NPI + 200	TTG Stable Index	TTG Enhanced Index	TTG High Return with International	TTG High Return without International	TTG International Index
One Year	13.54%	14.66%	12.65%	11.56%	22.54%	20.03%	30.79%
Three Year	9.70%	10.79%	8.65%	8.15%	13.89%	12.20%	19.04%
Five Year	10.63%	11.73%	9.70%	10.01%	13.72%	12.48%	16.46%
Seven Year	12.12%	13.23%	11.43%	11.30%	15.78%	14.88%	14.29%
Ten Year	11.68%	12.78%	10.69%	12.23%	17.85%	17.22%	n/a
Fifteen Year	7.97%	9.04%	6.71%	8.02%	9.96%	9.56%	n/a
Nineteen Year	8.40%	9.47%	7.13%	8.90%	10.37%	10.05%	n/a

September 30, 2004

Excess Returns

Alpha	TTG Stable Index	TTG Enhanced Index	TTG High Return Index	TTG High Return without International	TTG International Index
One Year	0.24%	-0.86%	10.12%	7.61%	18.37%
Three Year	0.06%	-0.47%	5.39%	3.68%	10.68%
Five Year	0.19%	0.48%	4.25%	3.01%	7.26%
Seven Year	0.45%	0.30%	4.85%	3.96%	3.53%
Ten Year	0.15%	1.69%	7.53%	6.92%	n/a
Fifteen Year	-0.13%	1.24%	3.75%	3.34%	n/a
Nineteen Year	-0.16%	1.68%	3.59%	3.27%	n/a

September 30, 2004

Up Years

Period	12/31/1996	12/31/2000					
	NPI	NPI + 100	NPI + 200	TTG Stable Index	TTG Enhanced Index	TTG High Return with International	TTG High Return without International
Geometric Mean	12.79%	13.92%	15.05%	13.70%	15.18%	22.15%	22.10%
Standard Deviation	2.33%	2.35%	2.38%	2.40%	6.00%	10.20%	10.25%
Alpha	0.00%	1.13%	2.26%	0.91%	2.48%	9.67%	9.61%
Tracking Error	0.00%	0.02%	0.05%	0.90%	6.13%	9.67%	9.72%

Down Years

Period	12/31/1990	12/31/1994					
	NPI	NPI + 100	NPI + 200	TTG Stable Index	TTG Enhanced Index	TTG High Return with International	TTG High Return without International
Geometric Mean	-0.06%	0.94%	1.94%	-0.87%	0.00%	-3.49%	-3.49%
Standard Deviation	4.93%	4.98%	5.03%	5.67%	8.08%	11.38%	11.38%
Alpha	0.00%	1.00%	2.00%	-0.78%	0.23%	-3.03%	-3.03%
Tracking Error	0.00%	0.05%	0.10%	1.11%	4.90%	7.35%	7.35%

Rolling Arithmetic Mean by Sector with Enhanced Quartiles

	Townsend Stable Fund Index	Townsend Enhanced Fund Index	Enhanced 25%	Enhanced 50%	Enhanced 75%	Townsend High Return Fund Index
5%	-1.45%	-1.47%	-5.80%	-2.61%	3.13%	-6.42%
10%	-1.07%	-0.84%	-5.64%	-1.79%	3.29%	-4.34%
15%	-0.77%	-0.36%	-5.52%	-1.45%	3.50%	-3.15%
20%	-0.57%	0.12%	-5.33%	-0.39%	4.00%	-2.93%
25%	-0.53%	0.43%	-5.10%	0.16%	4.32%	-2.22%
30%	-0.45%	0.55%	-4.82%	0.52%	4.65%	-0.33%
35%	-0.39%	0.82%	-4.55%	0.99%	4.94%	0.97%
40%	-0.33%	1.17%	-4.42%	1.22%	5.18%	1.93%
45%	-0.29%	1.38%	-4.27%	1.73%	5.26%	2.10%
50%	-0.24%	2.11%	-3.91%	2.07%	5.39%	2.49%
55%	-0.21%	2.34%	-3.56%	2.44%	5.53%	2.99%
60%	-0.18%	2.43%	-1.85%	2.67%	5.56%	3.29%
65%	-0.11%	2.55%	-0.94%	2.82%	5.76%	3.77%
70%	-0.03%	2.84%	-0.65%	2.93%	6.25%	5.02%
75%	0.01%	3.09%	-0.53%	3.12%	6.62%	5.60%
80%	0.11%	3.25%	-0.48%	3.20%	6.98%	6.18%
85%	0.58%	3.50%	-0.36%	3.25%	7.30%	8.18%
90%	0.83%	3.81%	-0.14%	3.42%	8.23%	8.54%
95%	0.95%	4.34%	1.47%	3.61%	8.62%	9.10%
100%	1.27%	5.56%	2.10%	4.00%	9.07%	10.06%
Point Estimate						
Average	-0.22%	1.69%	-2.91%	1.42%	5.53%	2.05%
Median	-0.24%	2.11%	-3.91%	2.07%	5.39%	2.49%

Discretionary Compliance Checklist

PROPERTY CLASSIFICATION

Core Investment:

- Operating and substantially leased (80%) ____
- Office/Apartment/Retail/Industrial ____
- Total return primarily attributable to income (65%) ____
- Wholly owned or joint venture/co-investment as an equal or greater partner ____

RETURN EXPECTATIONS

NPI + 25 bps ____

LEVERAGE

- $\leq$ 50% for new debt or debt placed after the close ____
- $\leq$ 55% for assumed or existing debt ____
- Leveraged IRR must be $\geq$ to unleveraged IRR + 3 bps for each one percent (1%) of leverage ____

INVESTMENT SIZE

$\leq$ 8% of targeted real estate portfolio value ____

MANAGER INVESTMENT PLAN

Primary Investment Regions (TBD by MIP) ______

Secondary Investment Region (TBD by MIP) ______

Primary Property Type (TBD by MIP) ______

Secondary Property Type (TBD by MIP) ______

$XX - $XX million per property (TBD by MIP) ______

Ownership:
- Wholly Owned ______
- Controlled JV/Co-investment ______

Holding Period:
- Core holding period 5-7 years ______

PRELIMINARY INVESTMENT PACKAGE

Manager Investment Plan Analysis ______

Strategic Plan/Investment Plan Analysis ______

Projected Hold/Sell Analysis ______

Supplemental Materials:
- Locator Map ______
- Photograph ______
- Site Plan ______
- Market Overview ______
- Financial Summary ______
  - (Proj. Cash Flow, 5 Year Lease Exp Schedule, Major Tenancy)

SAN DIEGO CITY EMPLOYEES' RETIREMENT SYSTEM

PROXY VOTING POLICY AND GUIDELINES

Authority:

The San Diego City Employees' Retirement System ("SDCERS") was created by ordinance pursuant to San Diego City Charter section 141. The plan operates by the authority of the charter for The City of San Diego, with benefits and administration defined in Charter sections 141 et seq., and San Diego Municipal Code sections 24.0100 et seq. Under the Charter, management of the City employees' retirement fund is vested in the Board of Administration for SDCERS ("Board").

Fiduciary Responsibility:

Under state law, the trustees of the Board shall be held to the standard of conduct of a fiduciary in discharging their responsibilities. Article XVI, S17 of the California Constitution provides in relevant part:

> Notwithstanding any other provisions of law or this Constitution to the contrary, the retirement Board of a public Pension or retirement system shall have plenty [sic] [plenary] authority and fiduciary responsibility for investment of moneys and administration of the system, subject to all of the following:
>
> (a) The retirement Board of a public pension or Retirement system shall have the sole and exclusive Fiduciary responsibility over the assets of the public pension or retirement system. The retirement Board shall also have sole and exclusive responsibility to administer the system in a manner that will assure prompt delivery of benefits and related services to the participants and their beneficiaries. The assets of a public pension or retirement system are trust funds and shall be held for the exclusive purposes of providing benefits to participants in the pension or retirement system and their beneficiaries and defraying reasonable expenses of administering the system.
>
> (b) The members of the retirement Board of a public pension or retirement system shall discharge their duties with respect to the system solely in the interest of, and for the exclusive purposes of providing benefits to participants and their beneficiaries, minimizing employer contributions thereto, and defraying reasonable expenses of administering the system. A retirement Board's duty to its participants and their beneficiaries shall take precedence over any other duty.

> (c) The members of the retirement Board of a public pension or retirement system shall discharge their duties with respect to the system with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with these matters would use in the conduct of an enterprise of a like character and with like aims.
>
> (d) The members of the retirement Board of a public pension or retirement system shall diversify the investments of the system so as to minimize the risk of loss and to maximize the rate of return, unless under the circumstances it is clearly not prudent to do so.
>
> (e) . . . .
>
> (f) . . . .
>
> (g) . . . .
>
> (h) . . . .

Other Fiduciary Responsibility:

Although SDCERS is not subject to Employee Retirement Income Security Act of 1974 (ERISA"), it is attempting to comply with the spirit of the position taken by the U.S. Department of Labor in February 1988. The Department of Labor has stated that the right to vote shares of stock owned by a pension plan is, in itself, an asset of the plan, and therefore the fiduciary's responsibility to manage the assets includes proxy voting. Fiduciaries are required to develop and maintain a written proxy policy, vote in accordance with the written policy, and maintain accurate records of the proxy voting activities.

Finally, effective January 1, 1990, new reporting and recordkeeping requirements on employee benefit plans that invest in corporate stock were established. (California Corporation Code Section 711.) SDCERS has instituted recordkeeping requirements in compliance with this state law.

Proxy Voting Responsibilities:

To assist the Board in carrying out its fiduciary responsibilities in voting proxies, the Board has the authority to both set proxy voting policy and to vote proxies on behalf of SDCERS. The Board may choose to delegate the responsibility of the development of proxy voting policy and guidelines and the voting of all proxies to the Investment Committee and to the Retirement Administrator. In this case, the Board's General Counsel would serve as advisor to the Investment Committee for proxy issues.

Pursuant to the recommendation of the Investment Committee, the Board may also delegate the responsibility of voting all proxies to a contractual voting agent. If retained, the voting agent would be responsible for voting proxies in accordance with the SDCERS' Proxy Voting Policies and Guidelines.

If a voting agent is utilized, the Board, through the Investment Committee and the Retirement Administrator and staff, shall exercise general supervision over the agent to ensure that the SDCERS' Proxy Voting Policies and Guidelines are being followed and that the appropriate records are being kept.

The Retirement Administrator or designated staff is assigned the responsibility of ensuring that the proxy ballots are voted in accordance with the proxy voting guidelines established by the Investment Committee and adopted by the Board. The Retirement Administrator is also responsible for the maintenance of proxy voting records which reflect the manner in which all votes were cast.

The Investment Committee shall meet regarding proxy issues as necessary throughout the year. In March, the Investment Committee shall make its annual proxy-related report to the Board.

The attached Proxy Voting Policy and Guidelines were adopted on March 21,2003, by the Board. Item 24 of the Domestic Proxy Voting Guidelines was added on July 9,2003. Items 2, 18, 25 and 26 of the Domestic Proxy Voting Guidelines were added on March 19, 2004. Item 1 was modified on March 18,2005. Item 1 was modified and Item 26 was added on March 17,2006. The Proxy Voting Policy language was updated on August 18,2006. Items 1, 2, 14, 25 and 27 were modified and Item 28 was added on April 20,2037.

Thomas C Hebrank

Thomas C. Hebrank
President of the Board

Mark Sullivan
Vice-President of the Board

March 21,2003
Revised July 9,2003
Revised March 19,2004
Revised March 18,2005
Revised March 17,2006
Revised August 18,2006
Revised April 20,2007

DOMESTIC PROXY VOTING GUIDELINES

The Board has delegated the authority to vote all proxies to the Investment Committee and to the Retirement Administrator consistent with the Board's policies. Pursuant to the recommendation of the Investment Committee, the Board may also delegate the authority to vote proxies to a contractual voting agent. If retained, the voting agent shall be responsible for voting proxies in accordance with the SDCERS' Proxy Voting Policies and Guidelines.

The following guidelines are intended to assist in performing the proxy voting task. These are, however, merely guidelines. The Board recognizes that specific situations may call for unique responses. For this reason, the Investment Committee and Retirement Administrator are authorized, on a case-by-case basis to vote proxies which differ from these guidelines. A Glossary of Proxy Terms can be found as Appendix B.

When the guidelines require a case-by-case analysis by the Investment Committee or the Retirement Administrator on an issue, the contractual voting agent shall provide the Retirement Administrator, or designated staff, with a recommendation for the vote of the proxy. The Retirement Administrator, or designated staff, shall then request the recommendation of the individual investment manager. If the recommendations of the voting agent and the investment manager are the same, the Retirement Administrator, or designated staff, shall direct the voting agent to vote the proxy as originally recommended. However, if the two recommendations differ, the matter will be researched and evaluated by staff. The Retirement Administrator, or designated staff, shall then vote the proxy on behalf of SDCERS based on their best judgment. All voting activity conducted by the voting agent and designated staff shall be reported monthly to the Investment Committee and Board.

The Board also recognizes that some matters may be presented to shareholders in a combined form, in which the guidelines described below would call for inconsistent votes. The Investment Committee and Retirement Administrator are authorized to vote on such combined proposals on a case-by-case basis and in a manner that is consistent with the goal of protecting, preserving and maximizing the long-term interests of shareholders.

ISSUES

1. ELECTION OF DIRECTORS
(See related items #5, 10, 18, 25 & 27)

CASE-BY-CASE SDCERS believes that votes on Director nominees should be made on a CASE-BY-CASE basis, while examining the following factors:

- Composition of the Board and key Board Committees;
- Attendance at Board and Committee meetings;
- Corporate governance provisions and takeover activity;
- Disclosures under Section 404 of Sarbanes-Oxley Act;
- Long-term company performance relative to a market and peer index;
- Extent of the Director's investment in the company;
- Existence of related-party transactions;
- Whether the chairman is also serving as CEO;
- Whether a retired CEO sits on the Board;
- Number of outside Boards at which a Director serves;
- Majority vote standard for Director elections without a provision to allow for plurality voting when there are more nominees than seats.

WITHHOLD In the following situations, SDCERS may WITHHOLD votes from individual Directors, the entire Board of Directors, or members of certain Committees:

WITHHOLD votes from individual Directors who;

- Attend less than 75 percent of the Board and Committee meetings without a valid excuse (such as illness, service to the nation, work on behalf of the company);
- Sit on more than six public company Boards;
- Are CEOs of public companies who sit on the Boards of more than two public companies besides their own -- withhold only at their outside Boards.

WITHHOLD from the entire Board of Directors, (except new nominees, who should be considered on a CASE-BY-CASE basis) if:

- The company's proxy indicates that not all Directors attended 75 percent of the aggregate Board and Committee meetings, but fails to provide the required disclosure of the names of the Director(s) involved. If this information cannot be obtained, withhold from all incumbent Directors.
- The company's poison pill has a dead-hand or modified dead-hand feature. Withhold every year until this feature is removed;
- The Board adopts or renews a poison pill without shareholder approval since January 2005, does not commit to putting it to shareholder vote within 12 months of adoption or reneges on a commitment to put the pill to a vote and has not yet been withheld from for this issue;
- The Board failed to act on a shareholder proposal that received approval by a majority of the shares outstanding the previous year;
- The Board failed to act on a shareholder proposal that received approval of the majority of shares cast for the previous two consecutive years;

- The Board failed to act on takeover offers where the majority of the shareholders tendered their shares;
- At the previous Board election, any Director received more than 50 percent withhold votes of the shares cast and the company has failed to address the issue(s) that caused the high withhold rate;
- The company is a Russell 3000 company that underperformed its industry group (GICS group).

WITHHOLD from Inside Directors and Affiliated Outside Directors when:
- The inside or affiliated outside Director serves on any of the three key Committees: Audit, Compensation, or Nominating;
- The company lacks an Audit, Compensation, or Nominating Committee so that the full Board functions as that Committee;
- The company lacks a formal Nominating Committee, even if the Board attests that the independent Directors fulfill the functions of such a Committee.
- The full Board is less than majority independent.

WITHHOLD from the members of the Audit Committee if:
- The non-Audit fees paid to the Auditor are excessive (see discussion under Auditor Ratification);
- A material weakness identified in Section 404 disclosures rises to a level of serious concern; there are chronic internal control issues and an absence of established effective control mechanisms;
- There is persuasive evidence that the Audit Committee entered into an inappropriate indemnification agreement with its Auditor that limits the ability of the company, or its shareholders, to pursue legitimate legal recourse against the Audit firm.

WITHHOLD from the members of the Compensation Committee if:
- There is a negative correlation between CEO pay and company performance;
- The company reprices underwater options for stock, cash or other consideration without prior shareholder approval, even if allowed in the firm's equity plan;
- The company fails to submit one-time transfers of stock options to a shareholder vote;
- The company fails to fulfill the terms of a burn rate commitment made to shareholders;
- The company has backdated options;
- The company has poor Compensation practices. Poor pay practices may warrant withholding votes from the CEO and potentially the entire Board as well.

WITHHOLD from Directors, individually or the entire Board, for egregious actions or failure to replace management as appropriate.

EXPLANATION: Electing Directors is the most important stock ownership right that shareholders can exercise. By electing Directors who represent their interests, shareholders can help to define performance standards by which management can be held accountable. SDCERS believes the above criteria will assist in supporting responsible Director nominees who will add value for shareholders.

Continued ...

2. SELECTION OF AUDITORS

FOR SDCERS will vote FOR proposals to ratify auditors, <u>unless:</u>

- An auditor has a financial interest in or association with the company, and is therefore not independent;
- Fees for non-audit services are excessive; or
- There is reason to believe the independent auditor has rendered an opinion which is neither accurate nor indicative of the company's financial position.

If any of these cases occur, SDCERS will vote AGAINST the proposal.

CASE-BY-CASE SDCERS will vote shareholder proposals dealing with the issue of auditor rotation on a CASE-BY-CASE basis. Decisions will take the following into account: the tenure of the firm, length of the rotation period advocated in the proposal, the establishment and renewal process where the auditor is regularly reviewed, any significant audit-related issues, the number of annual Audit Committee meetings held, and the number of financial experts that serve on the Audit Committee.

The majority of an auditor's work/fees should be based on audit services and not on consulting or non-audit services. In the event of shareholder proposals suggesting a prohibition or cap level to non-audit services, SDCERS will decide these on a CASE-BY-CASE basis.

3. INCREASE AUTHORIZED COMMON STOCK

CASE-BY-CASE SDCERS will vote on a CASE-BY-CASE basis on proposals to increase the number of shares of common stock authorized for issuance after analyzing the company's industry and performance in terms of shareholder returns. This analysis shall be based upon input from both the proxy voting agent and the asset manager in a manner similar to other case-by-case proxy items.

4. BLANK CHECK PREFERRED STOCK

AGAINST SDCERS opposes blank check preferred stock unless management provides an explanation of the financial purpose and benefit of the issuance, and details all voting rights that are associated with the preferred stock.

Continued ...

5. CLASSIFIED BOARD
(See related items #1, 10, 18, 25 & 27)

AGAINST SDCERS will vote AGAINST proposals to classify the Board.

FOR In the event of a proposal to declassify the Board, SDCERS will generally vote FOR such a proposal so that all Directors may be elected annually.

6. FAIR PRICE PROVISIONS

FOR Fair price provisions require a bidder to pay the same "fair" price for all shares purchased. Fair price is defined as the highest price paid by the bidder for shares acquired before the start of a tender offer. Most fair price proposals are intended to discourage two-tier tender offers to purchase fewer than all of a target company's shares at a premium above market price and then later, after gaining control of the target, offer less for the remaining shares outstanding.

7. LIMITING SHAREHOLDERS' RIGHT TO CALL SPECIAL MEETINGS

AGAINST Votes will be cast against management proposals to restrict or prohibit shareholders' ability to call special meetings. In addition, votes will be cast for shareholder proposals to allow or make easier the shareholders' ability to call for special meetings.

8. LIMITING SHAREHOLDERS' RIGHT TO ACT BY WRITTEN CONSENT

AGAINST Votes will be cast against management proposals to restrict or prohibit shareholders' ability to take action by written consent. In addition, votes will be cast for shareholder proposals to allow or make easier shareholder action by written consent.

9. SUPERMAJORITY VOTE REQUIREMENTS

AGAINST Votes will be cast against management proposals to require a supermajority vote to amend any bylaw or Charter provision. In addition, votes will be cast FOR shareholder proposals to lower supermajority requirements to amend any charter or bylaw provision. Votes will also be cast AGAINST any supermajority requirement to approve mergers and other business combinations. In addition, votes will be cast FOR shareholder proposals to lower supermajority vote requirements for mergers and other business combinations.

EXPLANATION: SDCERS believes that supermajority voting requirements set a level of approval for specified actions that is higher than the minimum set by state law. These requirements often exceed the level of shareholder participation at a meeting, making action that requires supermajority approval all but impossible.

Continued ...

10. DIRECTOR LIABILITY AND INDEMNIFICATION
(See related items #1, 5, 18, 25 & 27)

AGAINST Votes will be cast against company proposals that request the elimination or limitation of Director's liability for acts involving gross negligence, or their violations of the duty of care that go beyond reasonable standards.

11. STOCK OPTION PLANS
(See related items # 21, 22 & 28)

CASE-BY-CASE SDCERS will vote each stock option plan on a CASE-BY-CASE basis using cost and dilution analysis provided by the voting agent.

EXPLANATION: SDCERS generally supports stock option plans on the grounds that they help attract, hold and motivate corporate personnel and tie their interests more closely to those of the shareholders. However, since each plan is different, it is necessary to look at the terms and coverage of each plan. As a result, SDCERS takes different positions depending on the terms and coverage of the stock option plan at issue.

12. REINCORPORATION

CASE-BY-CASE SDCERS believes that proposals to change a company's state of incorporation should be evaluated on a CASE-BY-CASE basis.

EXPLANATION: Corporations may wish to reincorporate in another state to take advantage of favorable corporate law, while providing maximized shareholder values and operational flexibility. Recognizing, however, the high degree of variance possible in the types and forms of other issues possible in the proposals, SDCERS will evaluate each proposal on a CASE-BY-CASE basis.

In the case of shareholder proposals dealing with companies incorporated in offshore tax havens, SDCERS will weigh each proposal on a CASE-BY-CASE basis to determine the value added to shareholders and whether the proposal will positively impact the company or negatively impact subsequent shareholder governance.

13. MERGERS, RESTRUCTURINGS AND SPINOFFS

CASE-BY-CASE Given the unique qualities of each merger, SDCERS will make a determination about each merger on a CASE-BY-CASE basis. (See the attached Appendix A for additional guidance in evaluating mergers.)

Continued ...

14. POISON PILLS

CASE-BY-CASE SDCERS believes that both Management and shareholder proposals regarding poison pills should be decided on a CASE-BY-CASE basis. Strong consideration will be given to the economic impact of the proposal and its impact on the company's value.

EXPLANATION: Because of both their positive and negative effects, SDCERS believes that shareholder proposals to redeem a company's poison pill should be examined on a case-by-case basis. Likewise, management proposals to ratify a poison pill should be examined on a case-by-case basis.

15. CONFIDENTIAL VOTING

FOR SDCERS supports confidential voting, independent tabulations and inspections because proxy voting should have the same safeguards as voting in any other election, and be free of any potential for coercion. It is SDCERS' preference that corporation by-laws be amended to include confidential voting.

16. ANTI-GREENMAIL

FOR Votes are to be cast in favor of shareholder proposals to adopt anti-greenmail charter or bylaw amendments or otherwise restrict a company's ability to make greenmail payments.

EXPLANATION: Greenmail is the payment a raider receives from a company in exchange for his shares and a guarantee to terminate a takeover bid. This payment is usually a premium above the market price, so while greenmail can ensure the continued independence of a company, it discriminates against other stockholders. The payment of greenmail may also have an adverse effect on corporate image, among both business associates and consumer.

Anti-greenmail proposals may be offered by either shareholders or management. When offered by management, they are frequently coupled with anti-takeover provisions that by themselves are less popular with shareholders.

17. OPT OUT OF STATE ANTI-TAKEOVER LAW

FOR SDCERS favors shareholder proposals to opt out of state anti-takeover laws.

Continued ...

18. OPEN/EQUAL ACCESS TO THE PROXY
(See related items #1, 5, 10, 25 & 27)

CASE-BY-CASE SDCERS will evaluate shareholder proposals for open or equal access to the proxy statement on a CASE-BY-CASE basis. Open or equal access to the proxy encourages shareholder involvement in evaluating the performance of the Board by allowing shareholder nominees for Director positions on the proxy. Decisions on these shareholder proposals will take into account the ownership threshold in the proposed resolution and the proponent's rationale for the proposal.

19. GOLDEN PARACHUTES

FOR SDCERS supports and will vote FOR proposals to have golden parachutes evaluated by shareholders.

AGAINST SDCERS is opposed to and will vote AGAINST any severance agreements that give more than three times the base salary (the Internal Revenue Service limit for excessive compensation) during the five years prior to the triggering of the protection, to key individuals.

20. CUMULATIVE VOTING

FOR SDCERS is required by state law (California Government Code Section 6900) to vote its shares to permit or authorize cumulative voting.

21. EXECUTIVE COMPENSATION
(See related items #11, 22 & 28)

CASE-BY-CASE SDCERS will review all proposals that attempt to grant excessive executive and Director salary and non-salary benefits (i.e. SERPs) on a CASE-BY-CASE basis.

FOR SDCERS will vote FOR any shareholder proposal that seeks additional disclosure of executive and Director pay and retirement benefit information.

22. EXPENSING OF STOCK OPTIONS
(See related items #11, 21 & 28)

FOR SDCERS will generally support shareholder proposals to expense options.

AGAINST SDCERS would not support such a shareholder resolution if the company has already committed to expensing options by a specific date.

Continued ...

23. SOCIAL AND ENVIRONMENTAL PROPOSALS

ABSTAIN SDCERS will abstain from voting on social and environmental shareholder proposals unless the proposals have a clear and beneficial impact on the finances or operations of the company.

24. ANTI-DISCRIMINATION AND EQUAL OPPORTUNITY IN THE WORKPLACE

FOR SDCERS will generally support shareholder proposals seeking anti-discrimination and equal opportunity in the workplace.

25. SEPARATION OF CHAIRMAN AND CHIEF EXECUTIVE OFFICER POSITIONS (See related items #1, 5, 10, 18 & 27)

CASE-BY-CASE SDCERS will generally support shareholder proposals requiring the position of chairman to be filled by an independent Director. However, due to alternative governance structures, SDCERS will vote each proposal on a CASE-BY-CASE basis, taking into account the following:

- A designated lead Director, elected from the independent Directors, with clearly delineated duties.
- 2/3 independent Board,
- All independent key Committees,
- Established governance guidelines,
- The company should not have underperformed both its peers and index on both a one-year and three-year total shareholder returns basis, unless there has been a change in the Chairman/CEO position within that time, and
- The company does not have any problematic governance issues.

26. SHAREHOLDER PROPOSALS

CASE-BY-CASE SDCERS will evaluate shareholder proposals related to direct business issues and Board governance issues that may directly impact shareholder value on a CASE-BY-CASE basis.

EXPLANATION: With the rise of shareholder proposals in recent years, there are other issues that can be brought forward not explicitly called out in SDCERS' guidelines. SDCERS believes that all shareholder proposals are important and should receive appropriate attention. SDCERS will vote each proposal that directly relates to the company's profitability and stock performance on a CASE-BY-CASE basis. SDCERS will continue to ABSTAIN from all social and environmental proposals.

Continued ...

27. MAJORITY THRESHOLD VOTING
(See related items #1, 5, 10, 18 & 25)

FOR SDCERS will generally support precatory and binding shareholder proposals requesting that the Board change the company's bylaws to stipulate that Directors need to be elected with an affirmative majority of votes cast, provided it does not conflict with the state law where the company is incorporated. Binding resolutions should also allow for a plurality vote standard when there are more nominees than Board seats. In the case of a holdover Director, SDCERS supports companies that also adopt a post-election policy (Director resignation policy) so that the company will promptly address this situation.

28. PERFORMANCE-BASED EQUITY PROPOSALS
(See related items #11, 21 & 22)

FOR SDCERS will generally support shareholder proposals advocating the use of performance-based equity awards (i.e. performance-contingent options or restricted stock, indexed options or premium-priced options), unless the proposal is overly restrictive or the company has demonstrated that it is using a substantial portion of performance-based awards for its top executives. Additionally, SDCERS will also assess the company's performance-based equity program, if one exists, when evaluating such proposals.

EXPLANATION: SDCERS generally supports the principle of performance-based pay. SDCERS feels that there should be a strong linkage between the company's performance and compensation at the senior executive level.

Appendix A

San Diego City Employees' Retirement System
Guidelines For Analyzing Mergers

When proposals for mergers are referred from the proxy voting agent to SDCERS for voting, the matter will be researched and evaluated by staff. The Retirement Administrator, or designated staff, shall then vote the proxy on behalf of SDCERS based on their best judgment. The following items should be addressed when researching and evaluating all referred merger items:

1. General Background
2. What is the reason for the merger?
3. State the key provisions of the agreement.
4. Who will have management control?
5. How will the securities be converted?
6. Graphic depiction of before and after merger. Who owns what percentage of the company?
7. Who will benefit from the merger?
    a. Is management unfairly benefiting from this deal?
8. If additional stock is to be issued in conjunction with the merger, what will the company get in exchange for the stock issuance?
    a. Capital
    b. Shares of the acquired company
9. What are the opinions of financial advisors? Call the investment manager who is holding this security for their opinion.
10. Other considerations:
    a. Will the merger involve closing offices/plants and laying off employees?
    b. Environmental impacts.

Appendix B

San Diego City Employees' Retirement System
Glossary of Proxy Terms

<u>Affiliated Outside Directors</u> – Directors who are not employees of the corporation, or who do not beneficially own more than 50 percent of the company's voting power, but who, because of a family or business relationship with the company, cannot be assumed to be truly independent in judgment.

A Director is considered affiliated to the company if any of the following conditions are met:
- Former executive of the company or its affiliates
- Relative of a current employee of the company or its affiliates
- Relative of a former executive of the company or its affiliates
- Provided professional services to the company or its affiliates or to its officers either currently or within the past year
- Employed by a significant customer or supplier
- Has a transactional relationship with the company or its affiliates excluding investments in the company through a private placement
- Interlocking relationships as defined by the SEC involving members of the Board of Directors or its Compensation and Stock Option Committee
- Founder of the company buy not currently an employee
- Trustee, Director or employee for a charitable or non-profit organization that received grants or endowments from the company or its affiliates
- Board attestation that an outside Director is not independent

<u>Blank Check Preferred Stock</u> – A popular term for preferred stock in which the Board of Directors is given broad discretion to establish voting, conversion, dividend and other rights of preferred stock at the time the Board issues the stock. Some Boards that have authority to issue blank check preferred stock have used it to create takeover defenses.

<u>Classified Board</u> – A company that has a classified, or staggered, Board is one in which Directors are typically divided into three classes, with each class serving three-year terms; each class reelection occurs in different years. Whereas, a declassified Board has Directors that serve one-year terms, and the entire Board is elected annually.

<u>Confidential Voting</u> – Also known as closed voting or voting by secret ballot, under confidential voting procedures, all proxies, ballots and voting tabulations that identify shareholders are kept confidential. Independent vote tabulators and inspectors of election are responsible for examining individual ballots, while management and shareholders are only told vote totals.

<u>Cumulative Voting</u> – Normally, shareholders cast one vote for each Director for each share of stock owned. Cumulative voting permits shareholders to apportion the total number of votes they have in any way they wish among candidates for the Board. Where cumulative voting is in effect, a minority of shares may be able to elect one or more Directors by giving all of their votes to one or several candidates.

Expensing of Stock Options – Stock options represent a bona fide cost to companies and shareholders, which should be reflected in the income statement. Expensing options would provide greater transparency of the company's earnings and profitability, as well as curb excessive option grants. Currently, fixed-price options enjoy a favorable accounting and tax treatment over other forms of compensation, including indexed options which are more closely tied to firm performance.

Fair Price Requirements – Fair price requirements compel anyone acquiring control of a corporation to pay all shareholders the highest price that the acquirer pays to any shareholder during a specified period of time. Fair price requirements may be included in a corporation's charter, or in state business incorporation statutes. Fair price requirements are intended to deter two-tier tender offers in which shareholders who tender their shares first receive a higher price for their shares than other shareholders.

Golden Parachutes – A popular phrase for severance agreement that provide generous benefits to top executives who are fired or who resign following a change in management control. Some golden parachutes can be deployed even without a change in control if a potential acquirer crosses a specified ownership threshold.

Greenmail – Greenmail refers to the practice of repurchasing shares from a bidder at an above-market price in exchange for the bidder's agreement not to acquire the target company. Greenmail is widely considered to be a form of blackmail. Some companies have attempted to deter greenmail by adding anti-greenmail provisions to their charters.

Holdover Director – This situation occurs when an incumbent Director is not elected to the Board using the Majority Voting Standard. The incumbent Director will continue to serve as a "Holdover" Director until the Director's successor is duly elected and qualified.

Increase Authorized Common Stock – Companies increase their supply of common stock for a variety of ordinary business purposes: raising new capital, funding stock compensation programs, business acquisitions and implementation of stock splits or payment of stock dividends. When proposing an increase, companies will request a number of authorized shares that provides a cushion for unexpected financing needs or unanticipated opportunities. Shareholders should scrutinize requests for additional authorized shares by companies that have used stock to fund lavish incentive compensation programs or to finance mergers that have not enhanced shareholder value.

Independent Directors – Independent Director is defined as a Director that has no connection to the company other than Board seat. Even if a Director has served on the Board for over ten years, a Director is still considered to be independent.

Inside Directors – A Director who also serves as an employee of the company or a non-employee officer of the company who is one of the five most highly paid individuals. As an employee of the company, an inside Director may not be able fulfill one of their primary obligations: to oversee and evaluate management on behalf of shareholders. Directors who have beneficial ownership of more than 50 percent of the company's voting power are also defined as inside Directors.

Majority Threshold Voting – A voting system in which the winning candidate must receive more than 50% of the votes cast.

Poison Pill – The popular term for a takeover defense that permits all shareholders other than an acquirer to purchase shares in a company at a discount if the company becomes a takeover target. A company with a pill (also known as a shareholder rights plan) usually distributes warrants or purchase rights that become exercisable when a triggering event occurs. The triggering event occurs when an acquirer buys more than a specified amount of a target company's stock without permission of the target company's Board. Once the pill is triggered, shareholders (except for the acquirer) usually have the right to purchase shares directly from the target company at a 50 percent discount, diluting both ownership interest and voting rights. Most pills have provisions that permit the Board to cancel the pill by redeeming the outstanding warrants or rights at nominal cost. Pills can force acquirers to bargain directly with a target company's Board, but they can also be used to deter or to block acquisition bids altogether. Corporations are not required by law to submit their poison pills for shareholder approval, and very few companies have chosen to seek shareholder approval.

Plurality Voting – A voting system in which the winning candidate receives the highest number of affirmative votes cast. The Director is elected irrespective of how small the number of affirmative votes is in comparison to the total number of shares voted. For example, a Director could be elected with one affirmative vote and several million withheld votes under the plurality voting system.

Reincorporation – Reincorporation refers to changing the state of incorporation. A company that reincorporates must obtain shareholder approval for the move and for the new charter it adopts when it shifts its state of incorporation. Many reincorporations involve moves to Delaware to take advantage of Delaware's flexible corporate laws.

Stock Options – Give holders the right to purchase stock at a fixed price for a specified period of time. The difference between the exercise price and the market price is called the "spread" and constitutes the reward to the option holder. The value of an option grant is heavily dependent on the volatility of a particular company's stock. The more volatile the company's stock, the more valuable the option grant. Thus, options are usually most valuable at high-growth, low-dividend companies.

Supermajority – Most state corporation laws require that mergers, acquisitions and amendments to the corporate charter by approved by a majority of the outstanding shares. A company may, however, set a higher requirement by obtaining shareholder approval for a higher threshold. Some supermajority requirements apply to mergers and acquisitions. Others apply to amendments to the charter itself – that is, the charter, or certain parts of it, may be amended in the future only if the amendments receive the specified supermajority level of support.

Written Consent – The ability to act by written consent allows shareholders to take action collectively without a shareholders' meeting. The written consent procedure was developed originally to permit closely held corporations to act quickly by obtaining consents from their shareholders. The procedure is, however, available in many states to publicly traded companies as well, unless prohibited or restricted in a company's charter. Many companies have sought shareholder approval to restrict or abolish the written consent procedure; their principal reason for doing so is to prevent takeovers opposed by the incumbent Board and management.