**POLICE & FIRE PENSION INVESTMENT BOARD**
**FEBRUARY 24, 2006**

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| Members present: | Don Taute, Don Herz, Greg Sorensen, Mark Meyerson, Randall Case, Brad Thavenet, Mark Westphalen, Gerry Finnegan,. |
| Member absent: | Michael Donnelly. |
| Personnel Dept. Resource Staff: | Paul Lutomski, John Cripe |
| Consultants: | Max Callan, Todd Peterson |
| Others: | Jeff Hillabrand, LPU President |

Investment Board President Mark Meyerson calls the meeting to order and all present introduce themselves. Mr. Meyerson asks Paul Lutomski to read a summary of the October 27, 2005 minutes. Randall Case moves to approve the minutes, Greg Sorensen seconds the motion and the motion passes unanimously.

Mr. Meyerson asks Max Callan and Todd Peterson to present security performance for 2005 with recommendations to retain or replace securities.

**Max Callen** presents an economic review of 2005. Oil price was driving force and price of oil not expected to decrease. Full employment. Best domestic equity returns in Mid-cap value and growth. Best foreign was emerging markets. US markets have lagged foreign for last four years. DJIA +1.7% S&P500 +4.9%, NASDAQ 1.3%. Insurance, oil and gas industries up. Yield curve at beginning of year was traditional shape with 6 month t-bill at 2.5% and 30 year at 4.6%. At end of year curve was inverted with 6 month t-bill at 4.75% and 30 year at 4.5%.

Investment Policy Appendix “A” amended to include actual %, benchmark, benchmark return and portfolio return for each allocation category. Max Callen states recommendation to change the benchmark for Corporate Bonds from the Lehman Brothers Aggregate Bond Index to the Lehman Brothers Corporate Bond Index. Gerry Finnegan clarifies the index needs to be intermediate term. Mark Westphalen moves to approve the change, Don Herz seconds the motion and the motion passes unanimously. Max states Smith Hayes relationship with Board has changed from broker to advisor, advising on everything except real estate and hedge funds.

**Paul Lutomski** states Cash as an absolute amount of $3.3 million and 1.95% of total assets. Actual performance was 2.88%. Notation that this cash represents cash available to the pension held by the City Treasurer or held in money manager accounts. It is higher than the 1% target to pay benefits, because of December capital gains, and in anticipation of a $1 million hedge fund investment.

Paul Lutomski states Internally Managed Domestic Debt as an absolute amount of $7.9 million and 4.67% of total assets. Actual performance was 4.15%. Notation that pension administration is happy with this return given shift in shape of yield curve during 2005. Descriptions are:

$2 Million Corporate bond with cusip 4984QAG5 I-PreTSL II described Insurance Preferred Term Security II.  $2M purchased 3/9/04 from FTN.  Tranche is $52M of $523 M total deal size. Coupon of 5.2% non-callable quarterly until 5/9/08, then coupon is 3 mo LIBOR +200 bps w/no cap and becomes callable at par.  Matures 5/22/2033, but most likely to be called 3/9/12 – per FTN.   40 issuers with no single issuer comprising more than 5% of total pool.

$2M Corporate bond with cusip 44181EF60 described HSBC (Household Finance Co.) Float. $2M purchased 3/11/04 from KP.  Coupon of CPI+97bp no-cap paid monthly.  December yield 4.49%.  Matures 3/10/09.  Now, spread to 2009 TIPS +30bp.

$1M Corporate bond with cusip 74367CBS3.  $1M purchased 9/16/04. Protective Life Secured Debt.  Coupon started at 4.5% paid monthly then CPI +151 bps. Current yield 4.7%. Not callable. Matures 9/10/11.  Spread to 2011 TIPS +25 bps

$2M private placement coupon bond for construction of CNL Plaza II, a second CNL office tower with 275,000 sq ft on 12 stories in Orlando FL.   Purchased 5/21/04.  Approx. $50M total: $36M to one senior lender, $4M by CNL principals, $10M to secondary lenders (like PF Pen). Term is 5 yrs at 10% rate with quarterly coupon payments.  Note can be extended 2 yrs at 12% rate with quarterly coupon payments.  CNL can call $2M notes annually beginning in third year.

$1, 075,000 Private placement coupon bond with cusip 547856AP9.  Total deal of $16.46M. Purchased at par value on 08/01/05.  Pays semi-annual coupon at 6.1% annual rate in May and November.  Debt service provide by interest from first lien on $34M trust fund with untouchable principle.  Issued by KP on behalf of the Lower Brule Sioux Tribe.  Matures 5/01/09. Comparable U.S. Treasury yield 4.10%.

**Todd Peterson** states Corporate bonds represented by Calvert Income fund as an absolute amount of $17.1 million and 10.06% of total assets. Actual performance was 4.22% and published performance was 4.21%.  Difference due to redemption in 2005.  Notation that this fund is excellent in top 2% of Morningstar category for last year.

Corporate bonds represented by PIMCO Real Return fund as an absolute amount of $7.1 million and 4.17% of total assets. Actual performance was 2.85% and published performance was 2.64%.  Difference due to redemption in 2005.  Notation that Morningstar has no good TIPS benchmark but this fund is excellent TIPS fund even being in top 40% of Morningstar category for last year.

Large growth equity represented by American Funds Growth Fund as an absolute amount of $5.8 million and 3.41% of total assets. Actual performance was 14.23% and published performance was 14.23%.  Notation that this fund is largest in US and will be watched to see if managers can handle its size and it has 17% assets in foreign.   In top 7% of Morningstar category for last year.

Large value equity represented by Dodge and Cox Fund  as an absolute amount of $5.3 million and 3.09% of total assets. Actual performance was 8.57% and published performance was 9.37%.  Difference due to redemption in 2005.  Notation that it also had 17% assets in foreign. In top 17% of Morningstar category for last year, 7% for 3 yr and 2% for 5 yr.

Mid growth equity represented by Alger Growth Fund as an absolute amount of $5.3 million and 3.13% of total assets. Actual performance was 6.10% and published performance was 10.32%.

Difference due to purchase in 2005. Notation that it replaced CAP20 in October 2005. In top 47% of Morningstar category for last year. Top 6% for 10 years.

Mid value equity represented by Hotchkis and Wiley Mid Cap Value I as an absolute amount of $17.4 million and 10.28% of total assets. Actual performance was 8.90% and published performance was 10.75%. Difference due to purchase in 2005. Notation that it is a large holding and contributed to high overall return. In top 30% of Morningstar category for last year. Top 1% for 3 and 5 years.

Small growth equity represented by Baron Growth as an absolute amount of $5.7 million and 3.33% of total assets. Actual performance was 5.71% and published performance was 5.71%. Notation that small segment did worse than mid or large last year. In top 50% of Morningstar category for last year. Top 39% for 3, 8% for 5 year and 5% for 10 years.

Small value equity represented by four funds:

Boston Partners as an absolute amount of $4.8 million and 2.85% of total assets. Actual performance was 7.78% and published performance was 7.78%. Notation that one year they are up, the next they are down. In top 38% of Morningstar category for last year. Top 24% for 3, 7% for 5 years.

Heartland Value as an absolute amount of $6 million and 3.52% of total assets. Actual performance was 1.99% and published performance was 1.99%. Notation that they visited last year and warned they had a good run and it could not continue. They have about 50% in micro-cap. One manager under SEC investigation. No concern at this time. In top 87% of Morningstar category for last year. Top 29% for 3, 18% for 5 years.

**Gerry Finnegan** asked how Heartland is defining micro-cap. **Todd Peterson** answered $500 million or less.

Royce Special Equity as an absolute amount of $5.5 million and 3.24% of total assets. Actual performance was -2.11% and published performance was -0.99%. Notation that they also have large micro-cap percentage. Closed fund. Defensive, counter cyclical compared to other small-cap values. May want to look at deleting it in July if we want to decrease small-cap exposure. In top 93% of Morningstar category for last year. Top 100% for 3, 17% for 5 years.

**Gerry Finnegan** asked how long we would have to hold it to complete a full cycle of returns. **Max Callen** answered 3-5 years.

**Todd Peterson**: Aegis Value as an absolute amount of $5.9 million and 3.48% of total assets. Actual performance was 4.45% and published performance was 3.85%. Notation that it had a $6 million redemption in 2005. They had 50% in cash at one time, now 35%, desired 15%. Closed fund. Should see better relative performance as cash decreases. In top 75% of Morningstar category for last year. Top 97% for 3, 13% for 5 years.

International Equity represented by American Funds Europacific Growth Fund as an absolute amount of $31.6 million and 18.60% of total assets. Actual performance was 25.87% and published performance was 21.12%. Notation that difference due to $19 million investment in 2005. In top 6% of Morningstar category for last year. Top 11% for 3yrs, 6% for 5 yrs and top 3% for 10yrs.

Global Strategy represented by American Funds Capital World Growth and Income as an absolute amount of $9.2 million and 5.40% of total assets. Actual performance was 6.99% and published performance was 14.72%. Notation that difference due to $8.7 million investment in 2005. In top 28% of Morningstar category for last year. Top 21% for 3yrs, 4% for 5 yrs and top 5% for 10yrs.

**Paul Lutomski**: Real Estate is represented by four funds. As an absolute amount of $22.5 million and 13.27% of total assets. Actual performance was 21.73%. The NCREIF index returned 20.06% for 2005 and the NAREIT index returned 8.26%

Rreef America REIT II as an absolute amount of $4.3 million. Actual performance was 14.00%. Notation that $3 million invested in 2005. Compared favorably to NCRIEF index. Composed of core real estate with 30% leverage in allocations that do not follow NCREIF. Income return was 6.6% and the rest was appreciation.

JP Morgan Strategic Property Fund as an absolute amount of $13 million. Actual performance was 30.69%. Compared favorably to NCRIEF index. Composed of core real estate with 30% leverage in allocations that do follow NCREIF. Income return was 6.8% and the rest was appreciation.

CNL Hospitality Properties as an absolute amount of $2.2 million. Actual performance was 10.18%. Compared favorably to NAREIT index. Composed of hotels. Income return was 5.5% and the rest was capital gains on the sale of shares. We requested the sale of $1.5 million when CNL lowered its dividend from 7.7% to 5.5%. We received about $500,000 in January so have another $200,000 to complete the request.

CNL Retirement Properties as an absolute amount of $3 million. Actual performance was 10.01%. Compared favorably to NAREIT index. Composed of retirement properties.

Detail materials for all real estate holdings are in the binder.

**Todd Peterson:** Alternatives category has two sections. In the Convertibles section Calamos Growth and Income fund has an absolute amount of $4 million and 2.35% of total assets. Actual performance was 7.65% and published performance was 8.06%. Notation that difference due purchase and redemption in 2005. There is no better convertible bond fund to invest in. In top 3% of Morningstar category for last year. Top 13% for 3yrs, 13% for 5 yrs and top 1% for 10yrs.

**Paul Lutomski:** Hedge fund of funds is represented by the JP Morgan Multi-strategy Fund with an amount of $4.8 million and 2.8% of total assets. Performance was 6.54%. Notation that the binder contains detailed information and I am not presenting as a hedge fund expert. There is detailed data in the January 31, 2005 document we mailed out comparing the Multi-strategy fund and the Arden Fund. We have read that so I will go over the high points.

On July 25, 2005 the Police and Fire Pension Investment Board approved the new asset allocation targets listed in Appendix “A”. Following the Board’s October 27, 2005 approval of new investments, pension assets were adjusted to the new allocation targets with one exception. The exception is that $1 million remains to be added to a Fund of Hedge Funds. We would have purchase more of the Multi-strategy fund, but it was closed to new investment.

The pension owns $4.7 million of J.P. Morgan Multi-Strategy Fund Series B (MSFB), a fund of hedge funds. The fund is closed to new investment. A new fund, the J.P. Morgan Multi-Strategy Fund II Access Fund Ltd. (Access Fund) is open to new investment, but Bill Killam of J.P. Morgan has recommended Arden Alternative Advisors SPC Fund (Arden Fund).

The City of Lincoln Pension Administration sense checked Mr. Killam's recommendation rational and agree with him. The Board needs to decide if they want to purchase either, none or both of these two investments, or search for a different fund of hedge funds, or a different alternative investment .

As in 2002 when we bought Multi-strategy, we recommend the pension's hedge fund strategy be a multi-strategy multi-manager fund-of-hedge-funds from a large established company with at least 10 years experience. The fund-of-hedge-funds should include at least 10 managers and different styles. The incentive structure should include a hurdle rate and a loss carry forward provision. Consideration should be given to the expense structure which will likely include management and origination fees. A higher level of liquidity is preferable. Returns, volatility and non-correlation to other markets should be such as to accomplish the objective stated in the investment policy. We looked at those same criteria this time.

Regarding Item 1: General Organization. Access Fund and Arden Fund are both multi-strategy, multi-manager fund-of-hedge-funds managed by a large established company with at least 10 years experience. Both funds meet the criteria.

Regarding Item 2: Diversification. A multi-manager approach can mitigate fund-specific manager risk by reducing dispersion of results and a multi-strategy approach can improve risk-adjusted returns. Each fund has low correlation with traditional assets. Access Fund uses 43 managers/funds, 6 strategies, global coverage, $636 million assets. Arden Fund uses 20-35 managers/funds, 3 strategies 14 sub-strategies, global coverage, $1.9 billion assets. Both funds are basically the same regarding diversification.

Regarding Item 3: Incentives and Expenses. Incentives and Expenses consist of a hurdle rate incentive linked to a loss carry-forward provision, a management fee and an origination fee.

Access Fund Class "A" shares have a 1.6% of average assets management fee payable annually regardless of performance. Access Fund Class "B" shares have a 1.25% of average assets management fee payable regardless of performance.

Access Fund's hurdle rate and loss carry forward provision is equal to the 3-month T-Bill (currently at about 4%.) The manager is paid an incentive fee of 10% of profits above the hurdle rate. A 1.5% origination fee is payable when investing.

Arden Fund has a 1.00% of average assets management fee payable regardless of performance. The hurdle rate and loss carry forward provision is equal to the 3-month T-Bill (currently at about 4%.) The manager is paid an incentive fee of 10% of profits above the hurdle rate. A 1.5% origination fee is payable when investing. Both funds are basically the same regarding incentive and expenses.
Regarding Item 4: Liquidity: Access Fund Class A shares provide quarterly liquidity and Class B shares provide annual liquidity. Arden Fund provides quarterly liquidity. A tie again.

Regarding Item 5: Correlation. Both funds have low correlation to traditional assets

The difference boils down to Item 6: Return and Risk. Arden is better than Access in risk and return. Returns are relatively equal, but Arden's frequency distribution is preferable due to less variation. The Arden Fund has lower risk as measured by STD (4.02% vs. 2.68%), higher positive months (92% vs. 83%), and a smaller drawdown (2.68% vs 8.36%).

Gerry Finnegan asks that the Board be included in the investment selection process at an earlier time in the future for assets on which Smith Hayes does not advise and to have a better process. He points out that hedge funds to not have to follow GAAP or ERISA, recommends inclusion of a "claw-back" provision (in case of lost principle) in the future and investigation of other foundation's usage of hedge funds. He mentions the existence of investible hedge fund indexes, the recent proliferation of hedge funds and that the average hedge fund half-life is only 3 or 4 years. Suggests looking at CALPERS investment policy regarding hedge funds.

Mark Meyerson reads an email from Michael Donnelly stating that the email be used as his proxy vote for the Arden Fund assuming someone else moves and seconds a motion for its purchase.

Mark Westphalen makes a motion to purchase $1 million of the Arden Fund and Don Taute seconds the motion. Motion passes unanimously. Any new business?

May 25, 2006 scheduled for next educational meeting with topics to include fiduciary responsibilities and JP Morgan presenting on Fund of hedge funds and real estate.

July 27, 2006 scheduled as next asset allocation meeting.

Gerry Finnegan asks what the fiduciary discussion will include. John Cripe states he was at a conference lat month where a fiduciary presentation was made and he would like to bring that presenter, or another suitable expert, to the Board because no one is expressing interest in attending conferences (except Mr. Meyerson). Mr. Meyerson agrees the conferences he has attended are educational and helpful.

Mark Westphalen suggests we add a comparison of return since inception vs. benchmark return to each security's summary page.

Meeting adjourns at 12:12 p.m.