Investment Policy, Objectives and Guidelines for the San Francisco City and County Employees' Retirement System

Mission Statement

San Francisco City and County Employees' Retirement System is dedicated to securing, protecting and prudently investing the pension Trust assets, administering mandated benefit programs, and providing promised benefits.

Approved: November 14, 2012

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INTRODUCTION

This document provides a framework for the management of the assets of the San Francisco City and County Employees' Retirement System ("SFERS" or the "System"). The purpose of the Investment Policy Statement ("IPS") is to assist the Retirement Board (the "Board") to effectively supervise and monitor the assets of SFERS (the "Plan"). Specifically, the IPS will address the following issues:

- The goals of the investment program;
- The policies and procedures for the management of the investments;
- Specific asset allocations, rebalancing procedures and investment guidelines;
- Performance objectives; and,
- Responsible parties.

The Board establishes this investment policy in accordance with applicable Local, State, and Federal laws. The Board members exercise authority and control over the management of the Plan, by setting policy that the Investment Staff executes either internally or through the use of external prudent experts with discretionary authority subject to policies established by SFERS. The Board oversees and guides the Plan and its policies subject to the following basic fiduciary principles:

- To act solely in the interest of, and for the exclusive purpose of providing benefits to, participants and their beneficiaries, minimizing contributions thereto, and defraying reasonable expenses of administering the Plan. The Board's duty to its participants and their beneficiaries shall take precedence over any other duty.
- To act with the care, skill, prudence and diligence under the circumstances then prevailing that a prudent expert acting in a like capacity and familiar with these matters would use in the conduct of an enterprise of a like character with like aims.
- To diversify the investments of the Plan so as to effectively trade off the risk of loss and appropriate rates of return. Diversification is applicable to the deployment of the assets as a whole, and does not preclude the use of concentrated investment styles.

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

INVESTMENT GOALS

SFERS' investment goals are:

- To provide SFERS participants with retirement benefits as required by City and County Charter and applicable laws. This will be accomplished through a carefully planned and executed long-term investment program.

- SFERS' assets will be managed on a total return basis. While SFERS recognizes the importance of the preservation of capital, it also adheres to the principle that varying degrees of investment risk are generally rewarded with compensating returns.

- On an annualized net-of-fee basis, over a full market cycle, the total portfolio will be expected to:
    1. Exceed the assumed actuarial rate of return (currently 7.58%[1]) over rolling five-year periods; and/or,
    2. Exceed a weighted index based on SFERS' asset allocation policy and respective asset class component benchmarks over rolling five year periods by an appropriate amount.

- To undertake all transactions for the sole benefit of SFERS members and beneficiaries, and for the exclusive purpose of providing benefits to them, minimizing contributions to the Plan and defraying reasonable administrative expenses associated with the Plan.

- To set asset allocation policy in a manner that encompasses a strategic, long-term perspective of capital markets as well as the nature and structure of SFERS' liabilities. SFERS recognizes that a strategic long-term asset allocation plan implemented in a consistent and disciplined manner will be the major determinant of the Plan's investment performance.

- To make decisions and follow investment policies which comply with "prudent expert" standards.

[1] The actuarial rate of return is being reduced to 7.50% (from 7.75%) over a three time period. The actuarial rate of return, as approved by the Retirement Board, will be 7.66% in Fiscal Year 2012, 7.58% in Fiscal Year 2013, and 7.50% in Fiscal Year 2014, and thereafter.

INVESTMENT POLICIES AND PROCEDURES

The policies and procedures of SFERS' investment program are designed to maximize the probability that the investment goals will be fulfilled.

Asset Allocation Policy

SFERS adopts and implements an asset allocation policy that is predicated on a number of factors, including:

- A projection of actuarial assets, liabilities and benefit payments and the cost of contributions;
- Historical and expected long-term capital market risk and return behavior;
- An assessment of future economic conditions, including inflation and interest rate levels; and,
- The current and projected funding status of the Plan.

This policy provides for diversification of assets in an effort to maximize the investment return of the Plan consistent with market conditions and risk tolerance. Asset allocation modeling identifies asset classes the Plan will utilize and the percentage that each asset class represents of the total fund.

Due to the fluctuation of market values, positioning within a specified range is acceptable and constitutes compliance with the policy. It is anticipated that an extended period of time may be required to fully implement the asset allocation policy, and that periodic revisions will occur. SFERS' Investment Staff ("Staff") and external consultants will monitor and assess the actual asset allocation versus policy and will evaluate any variation deemed significant.

Asset allocation policy shall be implemented through the use of investment managers (both internal and external) that will invest SFERS' assets subject to investment guidelines incorporated into the investment management agreements executed with authorized representatives of the System.

SFERS will also use passive management styles in market segments where there is a high degree of market efficiency, where low or no tracking error is desired, or to provide temporary exposure.

The long-term asset allocation targets and ranges for the investments of the Plan's assets are shown in Tab 1. These targets and ranges shall be in effect for both broad asset classes and public market sub-asset classes.

Investment Manager and Consultant Authority

The investment managers shall have full discretion to direct and manage the investment and reinvestment of assets allocated to them for management on SFERS' behalf in accordance with this document, applicable Local, State and Federal statutes and regulations, individual investment management agreements, approved investment guidelines, and executed contracts.

Consultants shall have no discretionary authority (unless such authority is delegated contractually by the Board and the Consultant) and shall be co-fiduciaries to the Plan. Consultants shall be responsible for making timely and appropriate recommendations on investment policy issues, for monitoring managers, and for reporting on manager and total fund performance (or asset class composite level performance for specialty consultants) on a quarterly basis. The Board and Staff will consider the comments and recommendations of Consultants in conjunction with other available information in making informed, prudent decisions.

Fiduciary Responsibilities

All investments must be underwritten and assets managed by a qualified investment manager acting in a fiduciary capacity to SFERS. Once retained, an investment manager must acknowledge in writing the manager's fiduciary responsibility to SFERS and acknowledge the objectives and policies contained in this Policy. It is expected that, at all times, the manager(s) will conduct themselves as fiduciaries in conformance with the California Constitution, Article XVI, Section 17 and Charter Section 12.100, unless a lesser standard of fiduciary duty is necessary because of generally prevailing industry standards for an investment of that type and nature. Any such generally prevailing industry standard shall be established upon the written advice of the investment consultant responsible for that asset class.

Commission Recapture

SFERS requires that active equity managers use good faith efforts to direct a specific percentage of brokerage transactions for Plan assets under their management through designated commission recapture brokers. SFERS also encourages its fixed-income managers, on a "best effort" basis, to utilize the services of designated commission recapture brokerage firms. It is understood that the commission recapture brokerage firms must provide the best price and execution consistent with market conditions, bearing in mind the best interests of the Plan's beneficiaries and considering all relevant factors.

SFERS will monitor on an ongoing basis the services provided by the commission recapture brokers so as to assure that the investment managers are securing the best execution of SFERS' brokerage transactions.

All rebates or credits from commissions paid to the commission recapture brokers will be realized in cash and rebated back to the Plan.

Emerging Business Enterprises

SFERS Staff, its investment managers, and its consultants shall make a good faith effort to retain and utilize the services and/or products of qualified Emerging Business Enterprises on a sub-contracting and/or joint venture basis when those services/products are provided consistent with the fiduciary responsibilities of the Board.

SFERS will also, to the extent possible, use and encourage the use by its managers of brokerage services offered by emerging brokerage firms, particularly certified San Francisco-based firms.

SFERS has also adopted a policy regarding emerging investment managers, which is included as Tab 8 of this document.

Proxy Voting

SFERS acknowledges that the ownership of equities requires proxies to be voted, and that such voting rights are a tangible asset of the System. The System commits to managing its proxy voting rights with the same care, skill, diligence and prudence as is exercised in managing its other assets, in the sole interest of the System's members and beneficiaries and in accordance with all applicable statutes.

The voting rights of individual stocks will be exercised by an assigned proxy provider under the supervision of the Investment Staff consistent with policy direction from the Retirement Board. The Board shall review the actions of the assigned proxy provider at least annually.

Securities Lending

The Board has authorized the execution of a "Security Lending Program," which will be performed by the Plan custodian or qualified third party securities lending agent(s). The program will be monitored and reviewed by the Investment Staff and will be established and governed by a written agreement. Unless otherwise designated, the income or losses generated by the lending program accrues to the Investment Cash account.

The SFERS Investment Policy and Program Overview for Securities Lending is included as Tab 12 of this document.

Custody of Assets

With the exception of assets invested in commingled funds or assets invested in an investment program approved to use one or more Prime Brokers, the assets of the Plan shall be held in a custody/record-keeping account in a master custody bank located in a national money center and in the international sub-custodian banks under contract with the custodian bank.

Staff shall be responsible for reviewing the cost-effectiveness and performance of the custodian on a regular basis (at least every five years), with input from SFERS' consultants as needed.

Derivatives

Derivatives may be employed by SFERS' investment managers (including internal managers) if permitted in the manager's written guidelines. The purpose of derivatives shall be to control portfolio risk, aid in liquidity management, augment return, and/or execute portfolio strategies in a timely and cost-effective manner. Derivatives are contracts or securities whose returns are derived from the returns of other securities, indices or instruments including, but not limited to futures, forwards, options, options on futures and private swaps. Examples of appropriate applications of derivative strategies include hedging interest rate and currency risk, executing a passive management style, maintaining exposure to a desired asset class while effecting asset allocation changes, and adjusting portfolio duration of fixed income portfolios.

Unless permitted to do so in their written guidelines, SFERS' investment managers are not allowed to utilize derivatives for speculative purposes, including creating leverage. SFERS' managers typically shall not borrow funds to purchase derivatives; any exceptions shall be specified in the investment manager's written guidelines. No derivatives positions can be established that create portfolio characteristics outside of portfolio guidelines.

Managers must ascertain and carefully monitor the creditworthiness of any third parties involved in derivative transactions.

Short Sales and Leverage

Short sales of securities and leverage may be allowed only if permitted in the investment manager's written guidelines, and shall typically be subject to expressed limits.

Rebalancing

A systematic rebalancing procedure, implemented on a regular basis when asset allocation ranges are breached, or when cash flows occur (e.g., for benefit payments or funding new investments), or for other reasons judged to be in the best interests of the Plan and its beneficiaries, will be used to maintain or to move asset allocations within their appropriate allowable ranges as delineated in Tab 1 of this Investment Policy Statement.

The Deputy Director for Investments ("DDI"), supported by the Deputy Division Directors for Public Markets and Private Markets, shall be responsible for undertaking rebalancing at the broad asset class level. The Senior Investment Officers or Senior Portfolio Managers ("SIO"s or "SPMs") shall be responsible for making rebalancing recommendations to the appropriate Deputy Division Director for their respective asset class(es) and for implementing those recommendations subject to approvals from the DDI. Rebalancing decisions will take into consideration a combination of various factors including but not limited to: cash needed for benefit payments and expenses, cash needed for investments, asset allocation shifts and weights relative to targets and permissible ranges, an assessment of capital markets conditions, and the performance, organizational and investment attributes of individual managers, including each manager's status under SFERS' Manager Monitoring and Retention Policy (Tab 7).

When broad asset class ranges are breached, the System will rebalance assets such that asset allocation is brought to within the ranges specified in Tab 1. For sub-asset classes, the SIO or SPMs will make recommendations regarding allocations to sub-asset classes within their area of responsibility, and shall rebalance according to the same rule when relevant ranges are breached. Sub-asset class targets and ranges are also delineated in Tab 1. Subject to approval by the appropriate Deputy Division Director and the DDI, Staff will also have discretion on how to redeploy assets within their asset class in accordance with applicable ranges. The Board recognizes that from time to time ranges may be breached for a period of time due to the absence of an appropriate manager and/or Staff judgment that an existing manager(s) should not be allocated additional assets, or when, in the judgment of Staff, market conditions are not favorable to rebalancing activities.

The DDI shall report to the Board monthly on the System's rebalancing activities, including any exceptions to policy.

Social Investment Procedures

Since it is necessary for adequate recognition to be given to the social consequences of corporate actions and security and portfolio investment decisions to achieve maximum long term investment returns from System assets, and since the individual decisions of Staff, Managers, Consultants, and other System fiduciaries have to be made within a framework that reflects the particular social situation and concerns of the participants and the System, the Retirement Board has adopted a set of Social Investment Procedures to guide the System. Social concerns to be addressed through investment policy shall follow the order of action as outlined in these

policies. In no event shall these policies take precedence over the fiduciary responsibility of producing investment returns for the exclusive benefit of the participants. Exceptions to the restrictions on securities holdings outlined here may be made as needed to permit investment in commingled holdings deemed to be in the best interests of SFERS and its beneficiaries.

The investment restrictions based on these procedures are as follows:

Tobacco-Related Holdings

SFERS does not permit its managers (including internal management) to hold securities of US-based companies involved in the production of tobacco products. This restriction applies to both US equity holdings and to US corporate bond holdings.

The Board will periodically review the impact of this restriction on its overall performance.

Sudan Related Holdings

Because the US Congress and the State Department have found the Sudanese Government to be complicit in genocide in the Darfur region, SFERS does not permit its managers (including internal management) to hold securities of companies doing business in Sudan based on criteria established by SFERS. The Retirement Board directed Investment Staff to inform companies meeting specified criteria of SFERS' intention to divest. Companies will have 90 days to respond. Managers will be informed of companies meeting specified criteria and be given an opportunity to explain why they cannot achieve their mandate if required to divest.

The Social Investment Procedures and lists of restricted securities based on the above may be found in Tab 10 of this document. The Board will periodically review the impact of this restriction on its overall performance.

Asset Class Definitions

SFERS will utilize the following portfolio components to fulfill the asset allocation targets and total fund performance goals established elsewhere in this document.

I. Capital Appreciation – The Capital Appreciation portfolio will serve as the long term "growth" engine of the portfolio. This portfolio will be the primary source of return as well as risk (volatility) for the portfolio. The Plan's Capital Appreciation portfolio may be comprised of different market segments and approaches, including:

- **Public Market Equities –** SFERS anticipates that total returns to equities will be higher than total returns to fixed income securities over the long run, and may be subject to greater volatility. SFERS' equity holdings will be well diversified with respect to region, capitalization ranges and investment styles. The public market equity components in the Plan's asset allocation mix are:
    - **US Equities –** This segment of the portfolio will provide broadly diversified exposure to the US equity market, in both large and small cap market segments, as well as diversified exposure to different style segments (e.g., growth and value). Passive, enhanced passive, and active management strategies may be used in US equity holdings, including internal management by SFERS' Staff.
    - **International Equities –** This portfolio provides access to equity markets outside the US and

consequently plays a significant role in diversifying SFERS' domestic equity portfolio. A core international segment will concentrate on larger companies in developed non-US equity markets while a small capitalization segment will ensure exposure to the smaller companies that are primarily located in developed markets. Both passive and active management may be used in the core international equity portfolio, although active strategies will be emphasized. An emerging markets segment further diversifies the developed market segments by investing in developing markets that have lower correlations with developed economies. As specified in their investment guidelines, active managers may be given discretion to hedge currency exposure in their portfolios. The System may retain external experts to provide currency overlay management.

- **Global Equities –** A global stock portfolio will invest in both US and non-US companies, including emerging markets. Managers will have the discretion to allocate between US and non-US companies depending on their view of opportunities, valuations, and growth prospects.

- **Opportunistic strategies** may also be included in the Public Market Equity segment for the purpose of enhancing return, managing risk, and/or taking advantage of management approaches or hybrid securities that embody equity as well as other characteristics.

- **Alternative Investment Program ("AIP" or the "Program") –** This portfolio is a significant source of investment return that has lower correlation with SFERS' other asset classes. The AIP will include investments in a variety of separate account or commingled/partnership vehicles including venture capital, buyout, turnaround, mezzanine, distressed securities, co-investments and direct investments, and special situations funds. The Program is recognized to be long-term in nature and highly illiquid. Because of their higher risk and illiquidity, alternative investments are expected to provide substantially higher returns over the long term than publicly traded equity securities. Alternative investments can also include more conservative but also relatively illiquid investments, which derive their returns from owning hard and natural resource related assets such as oil- and gas-related properties and timberland.

  The primary objective of the AIP is to provide a substantial return premium (500 basis points or more) over the S&P 500 Index over rolling 10-year periods. This hurdle will be used to evaluate all alternative investment opportunities. The Program will also evaluate opportunities based on whether they diversify the Plan by investment type and by manager to reduce manager and asset-specific risks. A third objective of the program is to reduce total portfolio volatility by investing in assets with a lower correlation to public equity markets.

  The Senior Investment Officers or Senior Portfolio Managers overseeing the Alternative Investment Program, Staff (including the Deputy Division Director for Private Markets), in conjunction with the Alternative Investment Consultant, will annually update the Statement of Objectives, Policies and Procedures for the asset class and submit to the Retirement Board for approval. Additionally, the Senior Investment Officers or Senior Portfolio Managers overseeing the Alternative Investment Program, in conjunction with the Alternative Investment Consultant, will normally submit an Annual Investment Plan no later than the December meeting of the Retirement Board for Board approval. The Annual Investment Plan will recap the status of the Program and achievement of plan goals, and will identify investment initiatives for the following calendar year. Upon adoption by the Retirement Board, the Statement of Objectives, Policies and Procedures and Annual Investment Plans (Tabs 4 and 5) shall become a part of this Investment Policy Statement.

II. Capital Preservation – The Capital Preservation portfolio is intended to provide "downside protection" to the portfolio in periods of financial market duress or disinflation by providing a stable return. Capital Preservation also aids in the diversification of the Plan's assets. The Capital Preservation portfolio may be comprised of different market segments and approaches, including:

- **Public Market Fixed Income** – The primary role of the Fixed Income portfolio is to provide a stable, predictable income while diversifying SFERS' investment portfolio. SFERS' Fixed Income portfolio will be well diversified, and may include, but not limited to, both investment grade and non-investment grade holdings, US and non-US issues, developed and emerging market debt, mortgage-backed securities and direct mortgage holdings, and dollar and non-dollar denominated holdings. Internally managed fixed income as well as specialty managers may be utilized. Both passive and active management may be used in the Fixed Income portfolio. Currency exposure may be actively managed by the System's Fixed Income manager(s) as specified in the manager's guidelines. Opportunistic strategies may also be included in the Fixed Income portfolio for the purpose of enhancing return, managing risk, or taking advantage of management approaches or hybrid securities that embody fixed income as well as other characteristics.

- **Cash** – Cash will be segmented into two categories:

  - **Cash needed for Payment of Benefits and Expenses** – This is cash that will be set aside for the specific purpose of paying benefits and expenses. This cash should generally not be used to meet capital calls or other investment funding requirements. The amount of cash "set aside" for this purpose should not be less than one or more than four months funding requirement, with a target of three months.

  - **Cash Available for Investment** – This is cash which is available for investment following SFERS' Investment Guidelines contained herein. As a matter of principle, SFERS will strive to maintain a "zero cash" policy, i.e., all funds available for investment should be kept invested in accordance with this Investment Policy. Cash Available for Investment should not exceed 1% of Plan assets, with a target of 0%.

III. Inflation Hedges/Real Assets –Inflation Hedges/Real Assets are assets that provide investors with a better hedge against loss of purchasing power than traditional asset classes including equities and bonds. Moreover, these strategies maintain lower correlation to traditional asset classes, providing diversification benefits. The Plan's Inflation Hedges/Real Assets portfolio may be comprised of different market segments and approaches, including:

- **Real Estate –** SFERS' real estate program (the "Program") invests in real estate commingled funds, co-investments and separate accounts. The Program is diversified by property type and geography, exposed to properties both in the US and internationally, and includes global publicly listed real estate securities. The Program is designed to provide return from both income and capital appreciation. Real estate performance generally has low correlation with traditional public market asset classes, and therefore provides diversification benefits to the Plan. SFERS recognizes the illiquid, long-term nature of its private real estate portfolio and the role the Program plays in providing diversification to the overall portfolio. The Program is also a hedge against the possibility of severe and persistent inflation. SFERS has determined that active management will lead to returns that are superior for real estate than 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 Senior Investment Officer or Senior Portfolio Manager overseeing the Real Estate portfolio, Staff (including the Deputy Division Director for Private Markets), and the Real Estate Consultant annually update the Investment Objectives, Policies and Procedures and the Annual Investment Strategy for the asset class and submit these documents to the Retirement Board for approval. The Annual Investment Plan recaps the status of the Program and the achievement of plan goals, and identifies investment strategies, projects and programs for the following fiscal year. Upon adoption by the Retirement Board, the Investment Objectives, Policies and Procedures and the Annual Investment Strategy (Tabs 2 and 3, respectively) shall become a part of this Investment Policy Statement.

GENERAL INVESTMENT OBJECTIVES AND GUIDELINES FOR PUBLIC MARKET SECURITIES

Public Market Equity Portfolios

The public equity portfolios, both internal and external, will be managed on a total return basis following specific investment styles and will be evaluated against specific market benchmarks that represent their investment style. These benchmarks will be specified in the written investment guidelines governing each portfolio. In the case of active managers where such comparisons are applicable, investment results will also be compared to returns of a peer group of managers with similar styles. These benchmarks may also be modified, as appropriate to the manager's investment style, to exclude US tobacco stocks. General equity guidelines for active managers include the following.

- SFERS' holdings by all managers in aggregate in a single stock shall not constitute more than 5% of the outstanding voting stock of any company.
- Unless authorized in guidelines, equity managers' cash holdings shall not exceed 5% of portfolio market value.
- American Depositary Receipts or other depository receipts listed on a major stock exchange or on the NASDAQ are permitted if specified in the managers' guidelines.
- Convertible securities may be held in equity portfolios if authorized in guidelines, and shall be considered equity holdings.
- Securities must be traded on a regulated stock exchange, or listed on the NASDAQ or a comparable foreign market operation.
- Forward or futures contracts for foreign currencies may be entered into for hedging purposes or pending the selection and purchase of suitable investments in or the settlement of any such securities transactions only in portfolios designated specifically to hold these types of securities (i.e., currency overlay).

Any exemption from these general guidelines requires review by Investment Staff and approval from the Board.

Fixed Income Portfolios

The internal and external fixed income portfolios will be managed on a total return basis, following specific investment styles and will be evaluated against specific market indices that represent a specific investment style or market segment. Where applicable, fixed income portfolio investment results will also be compared to returns of a peer group of managers investing with a similar style.

General fixed income guidelines for active managers include the following:

- Permissible securities shall include, but are not limited to, cash equivalents, forward foreign exchange contracts, currency futures, financial futures, government and government agency bonds, Eurobonds, mortgage backed securities (including collateralized mortgage obligations, commercial mortgages, commercial mortgage backed securities, asset-backed bonds, corporate bonds (including convertible bonds), or other securities specifically authorized by the Retirement Board and incorporated in the Manager's Investment Guidelines. If authorized in written guidelines, derivatives, including forward or futures contracts for foreign currencies, may be used to control risk and augment return, or to effect portfolio management decisions in a timely, cost-effective manner.

Any exemption from these general guidelines requires review by Investment Staff and approval from the Retirement Board.

INVESTMENT MANAGER POLICY

The selection of investment managers will be accomplished in accordance with all applicable Local, State and Federal laws and regulations. Each investment manager must function under a formal contract that delineates responsibilities, establishes guidelines, and articulates performance expectations.

Specific policies with respect to managers in non-public market segments are addressed in the Real Estate Investment Objectives, Policies and Procedures (Tab 2) and the Alternative Investments Statement of Objectives, Policies and Procedures (Tab 4).

SFERS will utilize both internally and externally managed portfolios based on specific styles and methodologies. The external managers will be expected to acknowledge in writing that they are Plan fiduciaries and will have discretion and authority to determine investment strategy, security selection and timing within their assigned mandate, and subject to IPS guidelines and any other guidelines specific to their portfolio. Performance of each portfolio will be monitored and evaluated on a regular basis relative to a suitable benchmark and, where appropriate, relative to a peer group of managers with similar investment styles.

A policy framework for Opportunistic Strategies in Global Equity and Public Market Fixed Income is included at Tab 9 of this Investment Policy Statement.

Investment managers, as prudent experts, will be expected to know SFERS' policies (as outlined in this and other appropriate documents) and any specific guidelines for their portfolios, and to comply with those policies and guidelines. It is each manager's responsibility to identify policies and guidelines that may have an adverse impact on performance, and to initiate discussion with Staff toward possible improvement of said policies or guidelines through Board action.

The Board and Staff will also review each investment manager's adherence to investment guidelines, and any material changes in the manager's organization (e.g., personnel changes, new business developments, etc.). The investment managers retained by SFERS will be responsible for informing the Board and Staff of all such material changes on a timely basis.

SFERS shall follow the Guidelines for Manager Monitoring and Retention that appears at Tab 7 in evaluating its fixed income and equity managers.

Investment managers under contract to SFERS shall have discretion to establish and execute transactions with any securities broker/dealer as the manager determines to be in the best interest of SFERS. The investment managers must obtain the best available prices and most favorable executions with respect to all portfolio transactions, keeping in mind SFERS' desire to transact with commission recapture and emerging brokers, as market conditions permit. Unless otherwise approved in writing, managers are prohibited from engaging in transactions with an affiliated broker/dealer.

Selection Criteria for Investment Managers

Criteria will be established for each manager search undertaken by SFERS, and will be tailored to SFERS' needs in each search.

In general, eligible managers will possess attributes including, but not limited to, the following:

- The firm must be SEC-registered or exempt from registration. Firms claiming exemption from registration requirements must provide appropriate documentation and disclosures indicating reasons for exemption.
- The firm or its senior investment professionals must be experienced in managing money for institutional clients in the asset class/product category/investment style specified by SFERS.
- The firm must display a record of stability in attracting and retaining qualified investment professionals, as well as a record of managing asset growth effectively, both in gaining and retaining clients.
- The firm must have an asset base sufficient to accommodate SFERS' portfolio. In general, firms should have at least $250 million of discretionary institutional assets under management, and SFERS' portfolio should make up no more than 20% of the firm's total asset base after funding. Exceptions may be made on a case-by-case basis.
- The firm must demonstrate adherence to the investment style sought by SFERS, and adherence to the firm's stated investment discipline.
- The firm's fees should be competitive with industry standards for the product category.
- The firm must comply with the "Duties of the Investment Managers" outlined herein and conform to CFA Institute/Global Investment Performance Standards for performance reporting.

When making a recommendation to retain a manager, any exceptions to these attributes for a recommended manager shall be noted to the Board in writing by Staff or the General Investment Consultant.

Criteria for Investment Manager Termination

SFERS reserves the right to terminate an investment manager at any time for any reason. Guidelines for manager monitoring and retention are included at Tab 7.

Grounds for investment manager termination may include, but are not limited to, the following:

- Failure to comply with the guidelines agreed upon for management of SFERS' portfolio, including holding any restricted issues.
- Failure to achieve performance objectives specified in the manager's guidelines.
- Significant deviation from the manager's stated investment philosophy and/or process.
- Loss of key personnel or changes in ownership structure.
- Evidence of illegal or unethical behavior by the investment management firm or its principals.
- Lack of willingness to cooperate with reasonable requests by SFERS for information, meetings or other material related to its portfolios.
- Loss of confidence by the Board or Staff in the investment manager.
- A change in the Plan's asset allocation program, which necessitates a shift of assets to another sub-asset class or sector.

The presence of any one of these factors will be carefully reviewed by SFERS' Staff and the Board, but will not necessarily result in an automatic termination.

DUTIES OF RESPONSIBLE PARTIES

Duties of the SFERS Board

The Board will adhere to the following procedures in the management of SFERS' assets:

- The Board's primary responsibility is to set the policy framework in which the implementation of SFERS' investment program will take place. Staff will be responsible for the timely implementation and administration of the Board's policy decisions.
- The Board shall formally review SFERS' investment structure, asset allocation and financial performance at least every three years, or more frequently should capital markets or the financial condition of the Plan undergo a material, long-term change necessitating such a review. The review will include recommended adjustments to the long-term, strategic asset allocation to reflect any changes in applicable regulations, long-term capital market assumptions, actuarial assumptions or SFERS' financial condition.
- The Board shall review target allocations and allowable ranges to asset class sub-sectors in the public markets portion of the Plan on at least an annual basis.
- The Retirement Board shall review SFERS' investment results at least quarterly,[2] or more often as needed, to ensure that policy guidelines continue to be met. The Board shall monitor investment returns on both an absolute basis and relative to appropriate benchmarks and peer group comparisons. The sources of information for these reviews shall include Staff, outside consultants, the custodian, the performance measurement provider, and SFERS' investment managers.
- The Board may retain investment consultants to provide such services as conducting performance and manager reviews, asset allocation, and investment research. The comments and recommendations of the consultants will be considered in conjunction with other available information to aid the Board in making informed, prudent decisions. In selecting external consultants, the Board shall consider the recommendations of Staff.
- The Board shall be responsible for taking appropriate action if investment objectives are not being met or if policies and guidelines are not being followed.
- The Board shall direct Staff to administer SFERS' investments in a cost-effective manner subject to Board approval. Investment-related costs include, but are not limited to, management, consulting and custodial fees, transaction costs and other administrative costs chargeable to SFERS.
- The Board shall be responsible for selecting a qualified custodian with advice from Staff, and from the Consultant(s) if directed by the Staff or the Board.
- The Board shall provide oversight of the effectiveness of Staff's implementation of its policy directives.

Duties of the Investment Staff

SFERS' Investment Staff plays a significant role in the management and oversight of the Plan, and is responsible for the timely implementation and administration of the Board's policy decisions. The Board shall monitor the performance of the Investment Staff in carrying out the duties, which include:

- Managing investment funds according to written investment guidelines as directed by the Board.
- Carrying out rebalancing activity in accordance with the policy stated in this document.

[2] Performance of Alternative assets and equity real estate is reviewed semi-annually.

- Monitoring external managers for adherence to SFERS' written policies and guidelines, and in accordance with SFERS' Manager Monitoring and Retention Policy for Equity and Fixed Income. Reviews for portfolios managed by external managers will focus on:
  1. Compliance with the investment guidelines.
  2. Compliance with the terms of the contracts, and the manager's ability to provide the System with timely, accurate and useful information.
  3. Manager's ability to continue to achieve its objectives given its investment process and resources.
  4. Material changes in a manager's organization. This may include, but is not limited to changes in investment philosophy, personnel or ownership, acquisitions or losses of major accounts, etc. The manager will be responsible for advising SFERS' Staff of any material changes in personnel, investment strategy, or other pertinent information potentially affecting performance.
  5. Investment performance relative to each manager's stated performance benchmark(s) as set forth in the manager's investment guidelines as well as the manager's rankings in an appropriate peer group comparison.
  6. Manager's status under the Plan's policies related to Manager Monitoring and Retention.
- Providing due diligence, oversight, and investment recommendations regarding all investment portfolios, including real estate and alternative investments, with assistance from the respective Consultant(s).
- Identifying, measuring and evaluating risk in SFERS' public market holdings.
- Evaluating and managing relationships with the Consultant(s) to the Plan to ensure that the Consultant(s) are providing all the necessary assistance to Staff and the Board as set forth in their service contracts and meeting the needs of the System.
- Making recommendations to the Board regarding retention of Consultant(s).
- Conducting manager searches with assistance from Consultant(s).
- Managing portfolio restructurings resulting from manager terminations with the assistance of Consultants, managers, or other parties, as needed.
- Conducting, directing Consultants and/or managers to conduct, or participating in any special research required to manage the Plan more effectively and in response to any questions or issues raised by the Retirement Board.
- Reviewing the cost-effectiveness and performance of the custodian on a regular basis (at least every five years), with input from SFERS' Consultants as needed or as directed by the Board.
- Monitoring and reviewing the System's securities lending program (if any) on an ongoing basis.
- Monitoring on an ongoing basis the services provided by the commission recapture brokers so as to ensure that the investment managers are securing the best execution of SFERS' brokerage transactions.
- Supporting the Board in the development and approval of the Real Estate Annual Investment Strategy and Annual Investment Plan for Alternative Investments, implementing and monitoring the Plan, and reporting at least quarterly on investment activity and matters of significance.

Duties of the Investment Managers

The duties of the Investment Managers shall include:

- Provide the Plan with a written agreement to invest within the guidelines established.
- Provide the Plan with proof of liability and fiduciary insurance coverage on an annual basis.
- Be an SEC-Registered Investment Advisor under the 1940 Act or exempt from registration, 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, and purchasing and selling securities.
- Execute all transactions for the benefit of the Plan with brokers and dealers qualified to execute institutional orders on an ongoing basis at the best net cost to the Plan, and, where appropriate, facilitate the recapture of commissions on behalf of the Plan.
- Reconcile monthly accounting, transaction and asset summary data with custodian valuations, and communicate and resolve any significant discrepancies with the custodian.
- Maintain frequent and open communication with the System on all significant matters pertaining to the Investment Plan, including, but not limited to, the following:

    1. Major changes in the Investment Manager's investment outlook, investment strategy and portfolio structure;
    2. Significant changes in ownership, organizational structure, financial condition or senior personnel;
    3. Any changes in the Portfolio Manager(s) or other personnel assigned to the Plan;
    4. Each client which terminates its relationship with the Investment Manager, and whose assets represent 5% of the firm's AUM or $100 million, whichever is less, within 30 days of such termination;
    5. All pertinent issues which the Investment Manager deems to be of significant interest or material importance to its investment process; and
    6. Meet with the Staff or the Board on an as-needed basis.

Duties of the Master Custodian

The Master Custodian shall be responsible for the following actions:

- Provide complete global custody and depository services for the designated accounts.
- Manage, if directed by the Board, a Short Term Investment Fund for investment of any cash not invested by managers, and ensure that all available cash is invested in this or other fixed income vehicles approved by the Board for this purpose. If the cash reserves are managed externally, full cooperation must be provided to the external cash manager.
- Provide in a timely and effective manner a monthly report of the investment activities implemented by the investment managers and the performance of each portfolio.
- Collect all income and principal realizable and properly report it on the periodic accounting 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 SFERS' Staff situations where accurate security pricing, valuation and accrued income is either not possible or subject to considerable uncertainty.
- Reconcile monthly with SFERS investment managers on price variance and portfolio valuation.
- Provide assistance to the Plan to complete such activities as the annual audit, transaction verification or other unique issues as required by the Board.
- Manage a securities lending program to enhance income if directed to do so by the Board. The custodian may also be called upon to manage the cash collateral associated with the securities lending program. If the securities lending program is managed externally, full cooperation must be provided to the external securities lending agent.

Duties of the Investment Consultants

The selection of Consultants will be accomplished in accordance with all applicable Local, State and Federal laws and regulations. Each Consultant shall be a co-fiduciary to the Plan, and must function under a formal contract that delineates responsibilities and appropriate performance expectations.

Consultants shall have no discretionary authority (unless such authority is delegated contractually by the Board and the Consultant). They shall be responsible for making timely and appropriate recommendations on investment policy issues, for monitoring managers, and for reporting on performance results on a quarterly basis. The Board and Staff will consider the comments and recommendations of Consultants in conjunction with other available information in making informed, prudent decisions.

Each Consultant shall abide by The Code of Ethics and The Standards of Professional Conduct established by the CFA Institute (formerly the Association for Investment Management and Research) in carrying out its responsibilities with respect to SFERS. The CFA Institute Code appears at Tab 6.

The General Investment Consultant shall be responsible for the following actions:

- Make recommendations to the Board and Staff regarding investment policy and strategic asset allocation, including sub-asset class structure.
- Assist SFERS Staff in the selection of qualified investment managers, and make recommendations to the Board and Staff on manager selection and manager guidelines.
- Assist Staff in the oversight of existing managers, including monitoring changes in personnel, organization, ownership, the investment process, compliance with guidelines, and other issues likely to affect performance.
- Assist Staff in the selection of a qualified custodian (including a securities lending agent and/or a cash manager) if directed by the Board and Staff.
- Prepare quarterly performance summaries regarding SFERS' manager, composite, and total plan results and make recommendations addressing any performance issues.
- Provide topical research and education on investment subjects that are relevant to SFERS.
- Other tasks as requested by the Board or Staff consistent with the function served by the General Investment Consultant.

The Real Estate Consultant shall be responsible for the following actions:

- Make recommendations to the Board and SFERS Staff regarding investment policy and strategic asset allocation as they pertain to real estate, and regarding public market securities that are affected by real estate-related issues.
- Assist SFERS Staff in the selection of qualified real estate investment managers and make recommendations to the full Board on manager selections. This will also include selection of managers of public market securities requiring real estate expertise.
- Assist SFERS Staff in the oversight of existing managers including monitoring changes in personnel, ownership and the investment process.
- Prepare a semi-annual performance report including performance of SFERS' real estate investment managers and total real estate assets, including a check on guideline compliance and adherence to investment style and discipline.
- Provide topical research and education on real estate investment subjects that are relevant to SFERS.
- Other tasks as requested by the Board or Staff consistent with the function served by the Real Estate

Consultant.

The Alternative Asset Investment Consultant shall be responsible for the following:

- Make recommendations to the Board and SFERS Staff regarding investment policy and strategic asset allocation as they pertain to alternative investments.
- Assist SFERS Staff in the selection of qualified alternative asset investment managers and make recommendations to the full Board for selections requiring Board ratification.
- Assist in the oversight of existing managers (including any public market securities managers related to the Alternative Investment portfolio), including monitoring changes in personnel, ownership and the investment process.
- Prepare a semi-annual performance report including performance of SFERS' alternative asset managers and total alternative asset holdings, program policy guidelines, and adherence to investment style and discipline.
- Provide topical research and education on investment subjects that are relevant to SFERS, especially those that relate to alternative investments.
- Other tasks as requested by the Board or Staff consistent with the function served by the Alternative Asset Consultant.

Duties of the Proxy Consultant

- Make recommendations to the Retirement Board regarding voting of proxies.
- Assist Staff in implementation of the Retirement Board's policy on voting proxies.
- Prepare an annual report documenting proxy voting activities performed on behalf of SFERS.

Duties of the Performance Measurement Provider

- The performance measurement provider shall provide regular performance reports including performance attribution of SFERS' asset class composites and total assets, and a check on guideline compliance and adherence to investment style and discipline. Performance calculations shall conform to the CFA Institute's Global Investment Performance Standards.

Tab 1
Strategic Asset Allocation

	Target Percent	Allowable Range	Composite Benchmark
Growth/Capital Appreciation	**63%**	**53-73%**	
Global Equity	*47.0%*	*40-54%*	*MSCI ACWI Investable Market Index ($, ND)*
Alternative Assets (Private Equity)	*16%*	*10-20%*	*S&P 500 + 500 bps annualized (long-term)*
Real Assets/Inflation Hedge	**12%**	**9-15%**	
Real Estate (including REITs)	*12%*	*9-15%*	*8%*
Capital Preservation/Risk Reduction	**25%**	**20-30%**	
Fixed Income	*25%*	*20-30%*	*100% Barclays Capital US Universal Index*
Cash	*0%*	*0-1%*	*90-day Treasury Bills*
Total Fund Composite	**100%**		**Benchmarks Weighted by Strategic Allocation Targets**

Note: Asset Allocation Targets Approved: October 10, 2012.

Tab 1 (continued)
Sub-Asset Class Targets

Global Public Market Equity

	Target Percent of Asset Class	*Sub-Asset Class Minimum*	*Sub-Asset Class Maximum*
Passive S&P 500	16%	*10%*	*22%*
Enhanced S&P 500	5%	*0%*	*7%*
US Large Cap Value	9%	*6%*	*12%*
US Large Cap Growth	9%	*6%*	*12%*
US Small Cap	6%	*4%*	*8%*
US Convertibles	3%	*0%*	*5%*
Core International	14%	*9%*	*19%*
Growth International	5%	*3%*	*7%*
Value International	11%	*7%*	*15%*
Small Cap International	6%	*4%*	*8%*
Emerging Markets	11%	*7%*	*15%*
Global Equity	5%	*0%*	*7%*
Opportunistic Strategies	0%	*0%*	*10%*
Currency Overlay *(% of the International Equity composite to be overlaid)*	50% *of Intl Equity Holdings*	*25% of Intl Equity Holdings*	*55% of Intl Equity Holdings*

Equity sub-asset class targets reviewed and approved October 10, 2012.

Fixed Income

	Target Percent of Asset Class	Sub-Asset Class Minimum	Sub-Asset Class Maximum
Internal Fixed Income	6%	0%	20%
BC Aggregate Index Fund	6%	0%	20%
Core/CorePlus US Bonds	59%	45%	70%
Commercial Mortgages	7%	5%	13%
High Yield Corporates/Bank Loans	8%	6%	10%
High Yield CMBS	5%	3%	10%
Emerging Market Debt	9%	4%	14%
Opportunistic Strategies	0%	*0%*	*10%*

Fixed Income sub-asset class targets reviewed and approved October 10, 2012.

Tab 2

City and County of San Francisco Employees Retirement System
Approved Real Estate Investment Objectives, Policies and Procedures

The City and County of San Francisco Employees Retirement System ("the System" or "SFERS") includes real estate investments in the total Plan portfolio as a means to seek, over the long term, enhanced risk/return characteristics for the System's investment portfolio.

This document establishes the specific objectives, policies and procedures involved in the implementation and oversight of the System's real estate program.

- The Investment **Objectives** define the role of and allocation to real estate in the broader portfolio and the resulting return expectations for the program.

- The Investment **Policies** state the limitations within which SFERS will adhere when investing the real estate allocation.

- The Investment **Procedures** provide guidelines for the implementation of the asset class and the control and monitoring of the program.

I. INVESTMENT OBJECTIVES

As with all asset classes, Real Estate is intended to provide specific benefit to the Plan's trust fund, e.g., risk adjusted returns, diversification and potential for a hedge against inflation. A clear statement of these primary objectives is a key to the measurement of the real estate program success.

A. The Role of Real Estate

The role of the asset class is to:

- Generate a long term, net return consistent with the results of the most recently approved Asset-Liability Study
- Provide low correlations to traditional asset classes
- Provide a hedge against inflation when market dynamics allow

B. Asset Allocation

The long-term allocation is determined through the Asset- Liability Study conducted by the General Consultant.

SFERS has approved a long-term asset allocation target of twelve percent (12%) with a range of nine percent (9%) to fifteen percent (15%). It is the intention of the Board to allow for under and overweighting of the real estate portfolio within the approved range based on market conditions.

C. Performance Objectives

The performance objective of The System's real estate portfolio is to produce a total return net of fees that meets or exceeds the expected returns over a 10 to 15 year horizon modeled in the most recently approved Asset-Liability Study. SFERS has approved a net return expectation of 8% for the real estate asset class. The 8% net Objective represents a significant premium over the 6.5% net long term expectation for passive, core real estate. Incremental returns are expected to result from any one or more of the following active management strategies.

1. Actively managing those assets providing stabilized returns from cash flow in order to maintain cash flow levels over the duration of the hold period.
2. Assume life cycle or market risk to actively create/restore value for realization or stabilized hold.
3. Tactically allocate to strategies favored by market dynamics during isolated periods of time.
4. Selection of high conviction managers and strategies with above median performance expectations.

The following investment dynamics will impact certain allocations, funding and early stage returns of the real estate portfolio:

1. The need to allow for reasonable vintage year diversification requires annual pacing of allocations
2. The allocations made each year may require a two to four year investment period

3. The returns generated during investment of capital and the initial years of implementation are most often negative reflecting fees on committed capital and early stages of value creation.

The current SFERS funded real estate portfolio is projected to require allocations through 2021 in order to reach the most efficient portfolio capable of achieving the 8% target return. The Board and Staff acknowledge that the current portfolio composition and the asset class dynamics will restrict the ability to achieve an 8% net of fee return during that period, but every effort will be made to prudently reposition the portfolio toward the 8% return objective as soon as practicable.

II. INVESTMENT POLICIES

The System has established policies to ensure the preservation of capital and the generation of returns commensurate with the overall risks assumed within the portfolio. The following are policies with which SFERS will comply when managing the real estate portfolio.

A. Portfolio Composition

The System divides the real estate into two sub-portfolios: (1) Core and (2) Non-Core. Non-core investments will be further classified as (1) Value Added and (2) Opportunistic. Each sub-portfolio is defined by its respective market risk/return characteristics and all are defined in Exhibit A to this document.

B. Performance Indices

Analysis of performance in excess, or short of, the 8% net return objective will be completed through the use of similarly risked pools of investment capital available through standard industry sources. All comparisons will be made on a rolling five year basis as well as other appropriate time periods and will utilize net of fee returns and indices.

Private Portfolios -

The Core Portfolio will be compared to the National Council of Real Estate Investment Fiduciaries (“NCREIF”) Fund Index (“NFI”) - Open-End Diversified Core Equity (“ODCE”).

The ODCE represents a broadly diversified market basket of institutionally owned and operated properties held in open-ended commingled funds. All funds are implementing a core strategy with a focus on income, debt limitations of 30% and the assumption of limited operating risk. Consistent with the characteristics of an appropriate index, the ODCE provides quarterly private market valuations, periodic liquidity (into and out of vehicle), and visibility into the composition of the portfolios reporting to the index. Returns are available on both a gross and net of fee basis.

The Value-Added Portfolio will be compared to the NFI-Open-End Value-Added funds group ("ODVE"). The ODVE represents a diversified market basket of institutionally owned and operated properties held in open-ended commingled funds. All funds are implementing various Value Added strategies with the use of leverage as an integral part of the strategy. Consistent with the characteristics of an appropriate index, the ODVE provides quarterly private market valuations, periodic liquidity (into and out of vehicle), and visibility into the composition of the portfolios reporting to the index. Returns are available on both a gross and net of fee basis.

The Opportunistic Portfolio will be compared to NCREIF Vintage Year Peer Performance using NFI Vintage Periods in order to evaluate the success of allocations by style and manager/fund within given year(s). To-date and projected IRR's and equity multiples will also be used to evaluate the performance of the program.

Public Portfolio –

The Public Portfolio will be compared to the FTSE EPRA/NAREIT Developed Real Estate Index in USD. The Index is published and available to investors and managers for performance evaluation.

C. Risk Management

Risk Management begins with an understanding of the risks associated with each individual investment and the aggregate risk of the portfolio. In real estate, investments can be grouped and broadly defined with respect to long term risk/return expectations while short term expectations from each group will vary from market cycle to market cycle.

The SFERS real estate portfolio composition will vary from year to year based on the going forward expectations for the market opportunities and the minimal risk necessary to achieve the net return objective. In order to achieve the return objective, while minimizing total portfolio risk, the following portfolio composition constraints will be as follows:

Component	Minimum/Maximum [1]	
Core - Private	Minimum	20%
Core - Public Securities	Target[2]	10%
Non-Core - Private	Maximum	80%
Value Added	Minimum	40%
Opportunistic	Minimum	30%

Beyond portfolio composition, additional risks exist during the implementation and investment stages. The System will mitigate risk in a prudent manner in order to protect capital and generate returns commensurate with risks. The following identifies how the most significant risks with respect to real estate investing are controlled or mitigated.

1. *Procedural Risk*

   Attached as Exhibit B are the Defined Roles of Participants established to facilitate implementation of the program.

2. *Investment Holding Vehicle Risk*

   The System recognizes that, regardless of investment structure, real estate is an illiquid asset class. Vehicles that maximize investor control of the investment mandate are preferred however the degree of control will be balanced with need to achieve appropriate risk/return performance results. As such, The System will access investments through a number of vehicle structures.

   a) Individually Managed Accounts (IMA)

      IMA's provide access to wholly owned/controlled assets providing optimal investment mandate controls and oversight for SFERS. The use of the IMA structure will be limited to those areas (predominantly Core strategies) where prudent diversification against systemic risk can be exercised and long term hold positions are expected at the asset level. IMA Manager(s) will assume an appropriate level of discretion, balanced by control and monitoring procedures established by the Board, Staff and Consultant and detailed in the **"Procedures"** section of this document.

[1] The Staff has authorization to make the investments once the allocations have been approved by the Retirement Board

[2] Because of the public nature of real estate securities, Staff will manage the sub-portfolio between the ranges of 8% to 12% with a target of 10% in order to allow for market fluctuations without forcing rebalancing.

b) Commingled Funds/Club Investments

Commingled Funds/Club Investments are structured to give a high level of discretion to the Manager. These vehicles are therefore most often used in the Non-core (Value-Added and Opportunistic) risk sectors. Both Commingled Funds and Club Investments pool multiple investor capital sources; Clubs limit the number of investors to generally less than five. The greater limitation on investor control inherent in these vehicles is acceptable given the flexibility required to achieve expected returns. Nonetheless, preference will be given to vehicles with reasonable investor control and market competitive fees. Any legally permissible vehicle will be allowed including, but not limited to, joint ventures, limited partnerships, real estate investment trusts and limited liability corporations. Club Investments will generally exhibit similar structures and controls but may also allow for more limited discretion to the manager and/or better investor alignment of interests.

The System will invest in Commingled Funds and Club Investments in accordance with the **"Procedures"** section of this document.

c) Co-Investment

Co-investments will be presented in a variety of structures depending on the source of the co-investment asset. Preference will be given to those co-investments extending the greatest level of control to the co-investment position/partnership. Most Co-investments will be side-by-side with Commingled Funds and therefore control may be relinquished to the manager in order to achieve targeted returns.

The System will invest in Co-investments in accordance with the **"Procedures"** section of this document.

3. Diversification Risk

SFERS will seek to diversify its real estate program so as to mitigate the major risks associated with the allocation of capital into the real estate asset class.

a) Manager

Manager diversification will be managed through the use of multiple managers within risk/return sub-portfolios of Core, Value Added and Opportunistic strategies.

b) Strategy

The System may diversify the risk associated with a single strategy through the selection of multiple investment pools. At the time of investment, no single vehicle will be more than thirty percent (30%) of the target real estate portfolio to ensure that any possible underperformance of one vehicle will not unduly impact the total portfolio. The System will also optimize control by ensuring that no single investor in a commingled investment has a 'controlling vote' by virtue of its' pro rata investment.

c) Property Type and Location

The System will also diversify its exposure by property type and location. It is expected that at various points in time, the portfolio will be over/underweighted to a single property type or location by virtue of the prospects for relative returns. Exposure to any single property type or geographic location (defined as a single NPI region and/or a single country except the United States) in excess of thirty-five percent (35%) of the total targeted real estate portfolio will be presented to the Board as an exception during the Semi-Annual Performance review by Staff and Consultant.

With the maturation of the real estate asset class, investments have become global in nature. The System will seek optimal risk adjusted returns within the context of opportunities located both domestically and internationally. International investments will be limited to no more than thirty percent (30%) of the total targeted real estate portfolio and may include core private and public investments as well as non-core investments.

d) Investment Size

There is no maximum investment size for equity real estate investments, however, at no time shall the net investment value of a single property within an IMA account or a single Commingled Fund/Club/Co-investment, exceed ten percent (10%) of the net investment value of the total targeted real estate portfolio.

4. *Leverage Risk*

The use of leverage in the real estate portfolio can provide benefits in the form of increased diversification and enhanced returns. Leverage will also increase the gross asset exposure of the real estate allocation and amplify the impact of valuation changes on total return. The System will use leverage limits in order to manage the downside of leverage (volatility) without excluding the benefits (diversification, alpha). The availability

and cost of leverage will be factors considered in determining its use. Limits are established for each investment style based on the risk/return profile of the underlying investments.

a) Core- 40% Portfolio Leverage Limit

Core 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 Core real estate investments, the System has established a forty percent (40%) leverage limit.

For any single Core asset managed through an individually managed account, or Co-investment, third-party debt will be limited to fifty percent (50%) of the market value of the asset, must provide positive debt-service coverage and must be non-recourse, unless approved by the Board. All asset specific debt must demonstrate that leveraged IRR projections provide a return premium over the unleveraged IRR equal to three basis points (3 bps) of return for each one percent (1%) of leverage. Property specific debt will be monitored as detailed in the **"Procedures"** section of this document.

b) Value Added - 65% Portfolio and Asset Limit

Investments classified as Value Added generally provide a higher proportion of appreciation, as compared to income, than do Core assets. Value Added strategies are most often accessed through commingled/club vehicles which generally limit leverage to no more than sixty-five percent (65%) of the market value of the total portfolio. The System will limit its leverage in the Value Added component of the portfolio to sixty-five percent (65%). No single commingled/club portfolio may exceed this limit.

When accessed through an individually managed account, assets with third-party debt will be limited to sixty-five (65%) of the market value of any single asset, must provide positive debt-service coverage over the life of the investment, and must be non-recourse, unless approved by the Board. All Value Add IMA asset specific debt must demonstrate that leveraged IRR projections provide a return premium over the unleveraged IRR equal to three basis points (3 bps) of return for each one percent (1%) of leverage. Property specific debt will be monitored as detailed in the **"Procedures"** section of this document.

c) Opportunistic

Investments classified as Opportunistic utilize third-party debt as an integral part of their total return strategy. Such investments will be made through Commingled Funds/Clue/Co-investment 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 and presented to the Retirement Board.

d) Sumitomo Note Repurchase Program

In 1993, SFERS entered a recourse debt program with Sumitomo Bank in order to establish attractive financing for SFERS' wholly owned assets managed by RREEF. RREEF continues to utilize the program subject to authorization from SFERS.

Attached, as Exhibit C, is a description of the Sumitomo Note Repurchase Program.

5. In Kind Distributions

In order to mitigate the risk of assuming direct management for a distribution from any commingled fund, co-investment or separate account program, SFERS will limit the acceptability of In Kind Distributions to real property located in the United States and public securities traded on any public market. Such holdings would be transferred to appropriately selected IMA managers within the portfolio for takeover and management through liquidation.

III. INVESTMENT PROCEDURES

The System will always act to protect capital and generate returns commensurate with risk. The following identifies how the most significant risks with respect to real estate implementation will be mitigated and monitored.

A. Annual Investment Strategy

Each year the Staff and Consultant will provide the Board with a proposed Annual Investment Strategy ('AIS") for Board approval and subsequent implementation. The AIS will address all issues requested by the Board to include the following:

1. Portfolio Review

Provide a review of the current portfolio relative to approved Objectives, Policies and Procedures and the recommendations approved in the prior year's AIS.

2. *Strategic Perspective*

   Provide a review of the SFERS program in the context of the then current market including recommended changes to Objectives, Policy and Procedures for improving performance both near and long term.

3. *Market Opportunities*

   Provide a review of the optimal market opportunities available to SFERS based on program needs and objectives.

4. *Capital Pacing*

   Provide an analysis of the portfolio growth and projected activity to determine an appropriate recommendation for annual capital allocations in the ensuing year.

B. Individually Managed Accounts ("IMA")

IMA Managers will have discretionary authority over the selection of specific investments. However, certain controls will be maintained to ensure compliance with approved 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. Attached as Exhibit D are the approved Emerging Manager Guidelines which apply in each manager selection.

1. *IMA 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 Investment Policy, Objectives and Procedures for San Francisco City and County Employees' Retirement System ("Investment Policy Statement").
   b) Staff, assisted by Consultant, shall establish evaluation criteria, desired levels of competency and respective weightings for evaluation factors.
   c) Consultant shall screen its database to identify Manager Candidates exhibiting qualities consistent with Staff and Consultant qualification criteria. Staff may identify additional candidates.
   d) Staff and Consultant shall interview, through formal presentations and/or site-visits (when deemed appropriate), the highest-ranking Managers.

e) Staff and Consultant, shall present a report to the Board, which explains the ranking procedure and reviews the findings and recommendation for manager(s) selection.
f) Staff, with the assistance of Consultant, shall coordinate final presentations as necessary.
g) Board shall select a Manager based on review and evaluation of information presented in the steps noted above.
h) After the City Attorney's review, Staff and Consultant will negotiate and close manager investment agreements, including final fee structures.

2. IMA Investment Procedures

a) Manager Investment Plan

Each IMA Manager shall prepare an annual Manager Investment Plan, which sets forth the investment criteria for said Manager's allocation including the reinvestment of proceeds from sales or refinancing. The investment criteria shall be consistent with the mandate assigned to the manager and comply with all parameters of this document. Investment Plans will also set forth the IMA Manager's evaluation of current market opportunities and include a summary of the Annual Hold/Sell Review of each asset in the context of the market evaluation.

b) Preliminary Investment Package

Prior to making an investment, the Manager shall provide a Preliminary Investment Memorandum to Staff and Consultant. The preliminary package shall include an analysis of the investment relative to the currently approved Manager Investment Plan and SFERS documentation. The Package will include a projected hold/sell analysis for the proposed asset as well as 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 SFERS' 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 each acquisition, including document execution, funding and closing dates, updating the list as necessary.

3. *IMA Control and Monitoring*

a) Budget and Management Plan

Each IMA Manager shall submit a Budget and Management Plan (in form, timing and substance consistent with Staff and Consultant requests) for the upcoming year for each direct investment and the aggregate IMA. The Budget and Management Plan will include:

- A narrative of the asset/portfolio strategy
- An asset/portfolio level estimate of income and cash flow for the ensuing year. The statements 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 distribution projections.
- A hold/sell analysis of each asset under management. The hold/sell 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 objectives, the approved SFERS SIP, and Manager Investment.

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 ensuing year, the Manager shall notify the Retirement System in writing within a reasonable time of the occurrence of any significant event (i.e. a variance greater than 15% on budgeted NOI projections) relating to an investment that was not projected in the submitted Budget and Management Plan.

b) IMA Valuations

All investments will be valued in accordance with Global Investment Performance Standards ("GIPS") as created and administered by the CFA Institute.

C. Commingled Funds/Club Investments

The following procedures will be utilized in the selection, closing and monitoring of specific Commingled Fund/Club investments. Attached as Exhibit D are the approved Emerging Manager Guidelines applicable to each selection process.

1. Commingled Fund/Club Selection Process

a) Staff and Consultant will regularly evaluate the universe of investment opportunities targeting new investment selection within the Annual Investment Strategy ("AIS"). In all cases, the minimum criteria will comply with those approved in the Investment Policy Statement.
b) Staff and Consultant will conduct due diligence on each targeted Fund/Club to determine whether the offering meets approved AIS objectives. Due diligence may include on-site review of the manager and/or properties managed by same. At a minimum, analysis of track record, key individuals, organizational capabilities, real estate skills, strategy experience and compliance with prior mandates will be addressed in the due diligence process. The process will also include broad comparisons of any targeted Fund/Club to other offerings with similar strategies.
c) Staff and/or Consultant, shall recommend offering(s) for approval by the Board.
d) Upon approval, the Staff and Consultant will negotiate with selected Fund(s)/Club(s) on behalf of the System in order to improve, where possible, the final terms of the investment for the System.
e) Final due diligence by Staff, Consultant and the System's legal counsel, under the City Attorney's direction, will include review of the commingled fund's formation and associated legal documents. Any significant issues uncovered in this phase will be brought to the attention of the Board prior to closing.

2. Commingled Fund/Club Investment Control and Monitoring

Commingled Fund and Club Investments will be monitored quarterly by Staff and Consultant to evaluate investment performance and to ensure compliance with vehicle documents.

D. Co-Investments

Co-Investments may allow the System to over/under weight specific property types,

strategies and/or managers. The following procedures will be utilized in the selection, review and monitoring of Co-investment opportunities.

1. Co-Investment Selection Process

Co-investment opportunities may be sourced through existing Commingled Fund positions or through managers/funds offering co-investment positions to external capital sources. Co-investment opportunities are most often presented with limited windows for analysis. As such, the process for investment is intended to improve the ability of SFERS to participate in such investments prudently.

a) For properties sourced through existing Commingled Funds:

i. Consultant shall ensure that the co-investment is appropriate for additional investment, providing an opinion of prudence addressing the following:
ii. Legal Counsel, as directed by the City Attorney's Office, will be used to ensure that the investment documents provide appropriate conflict mitigation and secure optimal rights and controls for the System.

- Selected properties are consistent with Board approved AIS.
- Recommended cost/valuation is supported by appropriate market and property analysis.
- Potential conflicts are mitigated through partnership documentation as designed by Legal Counsel.
- Additional investment will comply with the approved Objectives, Policies and Procedures with respect to targeted return objectives and manager, property type or strategy exposure.
- Legal Counsel, as directed by the City Attorney's Office, will be used to ensure that the investment documents provide appropriate conflict mitigation and secure optimal rights and controls for the System.

iii. Staff will retain discretion to allocate up to $25 million toward any co-investment with affirmative results of sections D.1.a.i. and ii.
iv. Co-investments greater than $25 million are subject to the above process and Board approval.

b) For properties sourced through managers/vehicles in which SFERS is not an investor

i. Staff and Consultant shall complete both organizational and strategy due diligence in compliance with the approved Commingled Fund/Club Investment procedures.
ii. Consultant shall ensure that the co-investment is appropriate for investment and provide an opinion of prudence addressing the following:
    - Selected properties are consistent with Board approved AIS.
    - Recommended cost/valuation is supported by appropriate market and property analysis.
    - Potential conflicts are mitigated through partnership documentation as designed by Legal Counsel.
    - Additional investment will comply with the approved Objectives, Policies and Procedures with respect to targeted return objectives and manager, property type or strategy exposure.
iii. Legal Counsel, as directed by City Attorney's Office, will be used to ensure that the investment documents provide appropriate conflict mitigation and secure optimal rights and controls for the System.
IV. Staff and/or Consultant shall recommend approval of the holding vehicle consistent with commingled fund/co-investment procedures. Approval for the co-investment allocation will also require Board approval based on the appropriate portfolio impact.

2. *Co-Investment Control and Monitoring*

Co-Investments are similar in structure to an IMA account but are generally held within commingled funds. As such, Co-investments will utilize the same control and monitoring systems as detailed in the commingled fund procedures approved in this document.

E. Secondary Market Purchases

The purchase of existing limited partnership interests in the secondary market is a limited and relatively new tool in the real estate asset class. As in the Alternative Investment Program, secondary units can be purchased from existing fund or club investors looking to gain liquidity prior to the full term of the partnership. Secondary purchases provide numerous benefits such as:

- Access to an existing pool of assets rather than a blind pool allocation
- Shorter investment horizon for capital allocation from near term liquidations
- Ability to strategically and tactically manage portfolio diversification

- Potential for discounts to current carrying value and/or market value

Transactions are limited within the real estate asset class. Investors with in-place policies and procedures are capable of taking advantage of the intermittent opportunities in a quick and efficient manner.

1. *Secondary Unit Purchase Process*

   a) Secondary units must be offered by an existing Fund/Club within the SFERS portfolio. Should a more robust secondary market develop in the asset class, units in funds/clubs not held by SFERS would be considered as an addition to the secondary policies and procedures.
   b) Secondary offerings will be subject to Staff and Consultant concurrence that the unit purchase is appropriate for investment and provide an opinion of prudence addressing the following:
      - Additional allocation is consistent with Board approved AIS.
      - Recommended cost/valuation is supported by appropriate market and property analysis.
      - Potential conflicts are mitigated through partnership documentation as designed by Legal Counsel.
      - Additional investment will comply with the approved Objectives, Policies and Procedures with respect to targeted return objectives and manager, property type or strategy exposure when evaluated in combination with the existing Fund/Club position
   c) If above concurrence is reached, Staff would have authority to acquire secondary interests at or below the current carrying value of the units.

2. *Secondary Unit Control and Monitoring*

   Units purchased on the secondary market will be monitored within the existing fund/club investment and utilize the same control and monitoring systems as detailed in the commingled fund procedures approved in this document.

IV. Performance Measurement And Analysis

On a quarterly basis, the Consultant will prepare a comprehensive report addressing each investment, IMA, and Manager. The evaluation system shall provide such information as may be required by the System to understand and administer its investments and Managers. The content of the report shall include attributes for both the investment managers and the total portfolio including: income, appreciation, gross and net returns for

the portfolio and each manager, cash-flow, internal rate of return where appropriate, diversification, comparisons to relevant industry performance indices, and compliance with approved Objectives, Policies and Procedures as well as the governing AIS as appropriate.

The Consultant shall prepare and forward to the System a Performance Measurement Report within ninety (90) days following the last day of each quarter or within five working days of complete and accurate submission of all manager data.

Exhibit A
Portfolio Component Definitions

Core Investments

Core investments include existing, substantially leased income-producing properties located principally in metropolitan areas that exhibit reasonable economic diversification. Core properties typically exhibit the following characteristics:

- Predictable income flows with a high proportion of anticipated total return arising from current income and cash flow;
- At least 80% leased upon purchase of the asset;
- Located in an economically diversified metropolitan area;
- Credit quality tenants and a staggered lease maturity schedule;
- Quality construction and design features;
- Reasonable assurance of a broad pool of potential purchasers upon disposition;
- Properties requiring quality asset and portfolio management but not requiring specialized operating expertise which is not readily available in the market; and,
- Investment structures using all cash or conforming within debt policy limits.

Public real estate securities (e.g. Real Estate Investment Trusts or REITs) will be considered part of the Core component of the SFERS' portfolio. Public real estate securities are publicly traded companies that manage a portfolio of real estate based investments in order to produce income and capital appreciation for investors.

Non-Core Investments

Non-Core investments represent those properties and/or investment strategies that require specialized acquisition and management expertise or skill to mitigate the business and leasing risk associated with an individual investment. Non-Core investments may have greater volatility compared to Core investments. Non-Core investments may exhibit one or more of the following characteristics:

- Properties located in secondary and tertiary markets, which are not economically diversified and may have accompanying susceptibility to imbalances of demand and supply;
- Property types which require specialized management skills focusing primarily on operating business expertise rather than pure real estate portfolio management expertise;
- Properties which are considered to be in "work out" mode;
- Properties involving significant repositioning through lease-up, development and/or re-development risks;

- Financing or investment structures that impact cash flows and/or are not breaking even at acquisition; and
- Investment structures using leverage as an integral part of the total return strategy.
- Non-Core properties can further be broken down into two styles: Value Added and Opportunistic.

Value-Added Investments

Value Added real estate is characterized as properties that take on moderate additional risk from one or more of the following sources – leasing, redevelopment, repositioning, the use of moderate leverage and specialized property.

Opportunistic Investments

Opportunistic real estate takes on risk greater than that assumed in a Value Added strategy in order to achieve a higher level of return. High Return investments include a variety of strategies such as development or major redevelopment of office, retail, industrial, multifamily or specialized property types. Additionally, High Return investments could include land investing, operating company investing, distressed debt/properties, highly leveraged properties and other specialized investments.

Exhibit B

Defined Roles of Participants

The real estate program shall be planned, implemented, and monitored through the coordinated efforts of the Board, 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 SFERS 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 from time to time be necessary.
- Approves the Objectives, Policies and Procedures and the Strategic Investment Plan for the real estate program.
- Approves Staff and Consultant recommendations for selection, retention and removal of Managers.
- Reviews the real estate portfolio on a semi-annual basis to evaluate the investment performance and to ensure compliance with controlling documents

Duties of the SFERS Staff

- Establishes program guidelines for and executes the real estate investment program.
- Reports to the Board on matters of policy.
- Oversees Consultant's preparation of the Strategic Investment Plan. In conjunction with Consultant, presents and recommends the Strategic Investment Plan to the Board for approval.
- Completes the Annual Budget and Management Plan review and approval process.
- Brings any non-conforming items or significant issues to the attention of the Board.
- Documents and monitors funding procedures.
- Completes other activity as directed by the Board.
- Ensures manager reviews a copy of the Placement Agent Policy, as approved by the Retirement Board and that the manager has timely completed all required forms.

Individually Managed Account ("IMA") Duties of Staff:

- Conducts searches for professional services and investment managers and, with the assistance of the Consultant, recommends the selection to the Board for approval.
- Obtain City Attorney concurrence that manager complies with the Fiduciary Responsibilities as required in the Policy.
- Obtain City Attorney concurrence that manager complies with the Placement Agent Policy, as approved by the Retirement Board and City Attorney.
- Reviews Annual Manager Investment Plans.
- Reviews the Budget and Management Plans prepared by IMA Managers.
- Reviews Preliminary Investment Packages submitted by IMA Managers.
- Reviews fees (as reviewed and approved by Consultant) for compliance and insures that Incentive Fees are processed appropriately.
- Reviews annual audit, managers' valuations, and third-party appraisal reports.
- Performs other duties required to execute the IMA Investment Procedures, as more fully described in this document.
- Coordinates efforts of Consultant, Legal Counsel and CPA/Appraisal firms during the review process for Co-Investment opportunities.
- Monitors the closing process.

Commingled Fund/Co-investment Duties of Staff:

- Conducts screening, review, and selection for recommendation of Commingled Fund offerings in accordance with the Commingled Fund selection and closing process more fully described in Section IV.B. of this document.
- Oversees the commitment process, and with legal counsel, reviews and executes any required documentation.

<u>Duties of the Consultant</u>

- Reports directly to the Board and Staff on matters of policy.
- Brings any non-conforming items or significant issues to the attention of the Board and Staff on no less than a semi-annual basis.
- Monitors the performance of the real estate portfolio and compliance with Board approved policy.
- Prepares the Annual Investment Strategy and recommends the Allocation Plan to the Board for approval.

- Prepares the Quarterly Performance Report to evaluate investment performance and to ensure compliance with policy guidelines and approved Investment Plan. Presents Performance Report to the Board semi-annually.
- Reviews all proposed fees to determine appropriateness relative to industry standards and manager mandate.
- Provides Board and Staff with research and education on real estate related subjects as requested.

Individually Managed Account Duties of Consultant:

- Assists Staff in conducting searches for investment managers and makes recommendations to the Board along with Staff.
- Oversees preparation of Annual Manager Investment Plans.
- Reviews the Budget and Management Plans prepared by IMA Managers.
- Reviews the methodology and accuracy of all Individually Managed Account incentive fees and recommends payment based on compliance with terms of appropriate Manager mandate.
- Performs other duties required to execute the IMA Investment Procedures as more fully described in this document.

Commingled Fund/Co-investment Duties of Consultant:

- Conducts analysis of Commingled Fund offerings in accordance with the Commingled Fund selection process in this document.
- Provides written analysis of Commingled Funds and Co-investment.
- Reviews proposed co-investment asset(s) to ensure compliance with Board approved Strategic Investment Plans.
- Evaluates disposition and unwind recommendations in light of market conditions and Board approved Strategic and Annual Investment plans.

<u>Duties of City Attorney's Office</u>

- Reviews all terms and conditions of agreements
- Evaluates potential conflicts of interest in co-investment structure(s) and assets.
- Recommends strategies to mitigate/minimize said conflicts.
- Determines and recommends outside legal counsel for document review as appropriate.
- Confirms manager has received the Placement Agent Policy and timely completed all required forms.

Duties of the Manager

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

Individually Managed Account Managers:

- Acquires, manages and disposes of assets on behalf of the Retirement System.
- Adheres to the current reporting standards designated within the Manager contract.
- 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.
- Provides quarterly financial statements and annual audited reports.
- Meets with the Staff and Consultant for the Annual Real Estate Portfolio Review.
- Prepares an Annual Hold/Sell Review.

Commingled Fund /Co-Investment Managers:

- Adheres to the current reporting standards designated within the Manager contract.
- 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 annual meetings to discuss important developments regarding investment and management issues.
- Provides market valuations not less than annually.

Exhibit C

Sumitomo Note Repurchase Program

The following procedure regarding RREEF's use of the Sumitomo Note Repurchase Program to refinance existing assets in SFERS' real estate portfolio will be followed:

- RREEF may use the Program to refinance maturing loans only subject to the following:
  - Compliance with SFERS' Strategic and Annual Investment Plans for the Real Estate Asset Class
  - RREEF Investment Committee approval

- RREEF will provide Staff and Consultant financial justification for each proposed recourse loan

- Staff and Consultant will provide written notification of proposed recourse loans to the Deputy Director for Investments for his information

- Staff and Consultant will inform the Board of the exposure to the recourse debt in the Semi-Annual Performance Measurement Reports provided to the Board,

- Each year, Staff and Consultant will assess and discuss the need to allow RREEF's usage of the recourse Sumitomo Note Repurchase Program in its Annual Strategic and Investment Plans.

Exhibit D

Emerging Manager Guidelines

Barriers to entry for new firms launching established or new product strategies often provide opportunity to capitalize on niche management firms and/or strategies. Such 'Emerging Manager' firms shall be included in each selection process and, if meeting appropriate criteria, included in the semi-final review of candidates. Evaluation of these candidates will adhere to the following minimum criteria:

- No person or entity, other than the principals or employees of the named firm may own more than forty-nine percent (49%) of the management firm being considered for allocation

- The firm will not be required to currently adhere to industry wide performance reporting standards, but must demonstrate the ability to adhere to such performance reporting standards within 12 months. Review of the firm's adoption of current standards will occur on the one year anniversary of any allocation.

- The firm must currently manage no less than $100 million in the selected strategy. A preference for firms with other public fund clients and experience will be given.

- Total assets under management may not exceed $2 billion in aggregate capital including non-institutional capital.

- The capital to be allocated by SFERS may not exceed 35% of the firm's total assets under management after the allocation, which is an exception to SFERS' Investment Policy Statement with a 20% limit.

- No client can represent more than 50% of the management firm's total assets under management.

- Any firm with less than a five year track record may utilize track records established at prior firms when performance can be clearly attributed to the emerging firm's key individual(s) and is consistent with reporting standards.

Tab 3

City and County of San Francisco Employees' Retirement System

2012-2013 Investment Strategy

CONTENTS:

DATE: MAY 9, 2012

PREPARED BY: MICOLYN MAGEE, PRINCIPAL

THE TOWNSEND GROUP

601 Montgomery Street
Suite 525
San Francisco, CA 94111 USA

MEMORANDUM

TO: BOARD OF RETIREMENT
CITY AND COUNTY OF SAN FRANCISCO EMPLOYEES' RETIREMENT SYSTEM

FROM: THE TOWNSEND GROUP

SUBJECT: 2012-2013 REAL ESTATE INVESTMENT STRATEGY – EXECUTIVE SUMMARY

DATE: MAY 9, 2012

CC: LINDSEY ADAMS, SENIOR PORTFOLIO MANAGER, REAL ESTATE

EXECUTIVE SUMMARY

The purpose of this report is to review the City and County of San Francisco Employees' Retirement System's ("SFERS" or the "System") Real Estate Program and recommend appropriate changes to the Real Estate Objectives, Policies and Procedures ("OPP"). The review also includes projections for portfolio growth resulting in investment allocations required to maintain program objectives.

The Real Estate Investment Strategy ('RE Strategy") is provided in Tab B and reviews the portfolio performance and compliance with the approved OPP documents. The RE Strategy includes recommendations for changes to:

1. The approved OPP; and
2. The investment strategy to be implemented for fiscal year 2012/2013 (July 1, 2012 through June 30, 2013).

A redline version of the OPP is provided under Tab C. Tab D provides a History of SFERS' Real Estate Portfolio updated through December 31, 2011.

OPP RECOMMENDATIONS

1. Adopt language to restrict "In Kind Distributions" to public market assets and/or private market assets within the United States.

2. Housekeeping changes to Section I.C. to remove time specific references from long term document structure.

2012-2013 INVESTMENT ALLOCATION RECOMMENDATIONS

1. Continue active management to strategically reduce Core holdings toward 20% optimal exposure
2. Allow Staff to retain discretion on up to $50 million for public core allocation based on market activity and portfolio growth in order to maintain a 10%exposure.
3. Allocate up to $400 million to appropriate Non-core investment strategies consistent with the View of the World, market opportunities and portfolio return needs.

CITY AND COUNTY OF SAN FRANCISCO
EMPLOYEES' RETIREMENT SYSTEM

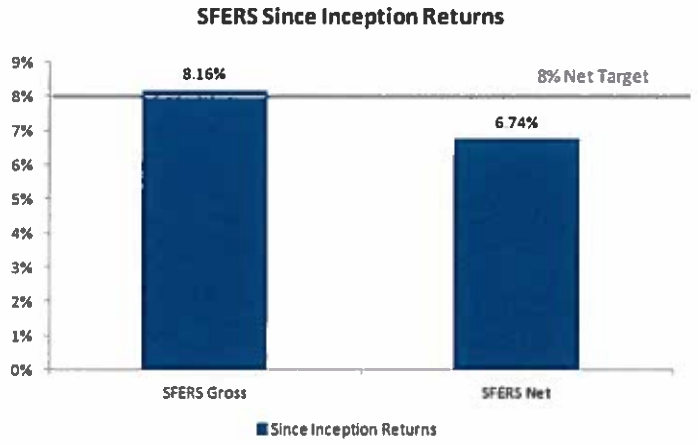
2012-2013 REAL ESTATE INVESTMENT STRATEGY
May 9, 2012

The following evaluates the current City and County of San Francisco Employees' Retirement System's (the "System", or "SFERS") real estate portfolio, discusses the Objectives, Policies and Procedures ("OPP") utilized to implement the allocation and provides recommendations to meet the investment needs of the portfolio in light of today's market opportunities.

SFERS' real estate program (the" Program" or the "Portfolio") began in 1978 and has been through a number of market cycles and programmatic shifts in risk/strategy. In order to provide context and understanding for existing Retirement Board members, an overview of the history of the Program was created in 2011 and is provided again this year with updates through December 31, 2011. The Program's is attached as Section A

PORTFOLIO ANALYSIS – DECEMBER 31, 2011

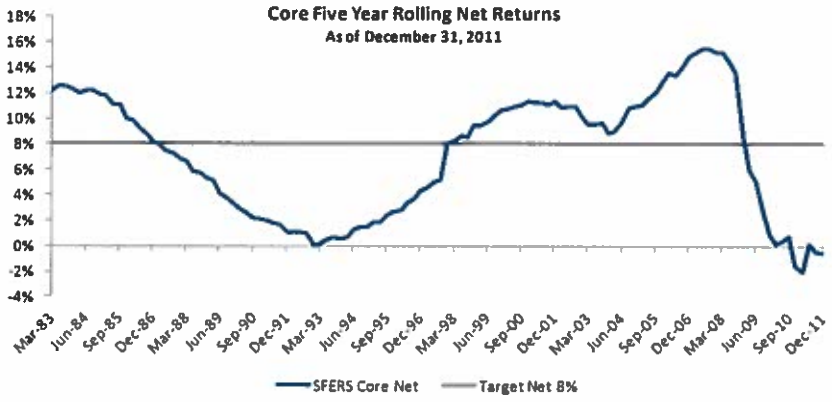
The chart below illustrates the total return since inception for the Portfolio relative to the current eight percent (8%) net target.



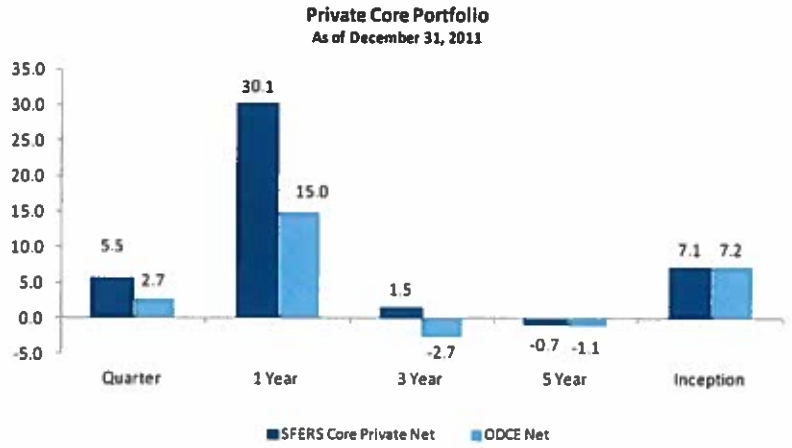
The following section discusses the drivers of performance and provides context and understanding of the Program's successes as well as necessary adjustments for improvement.

Performance Drivers

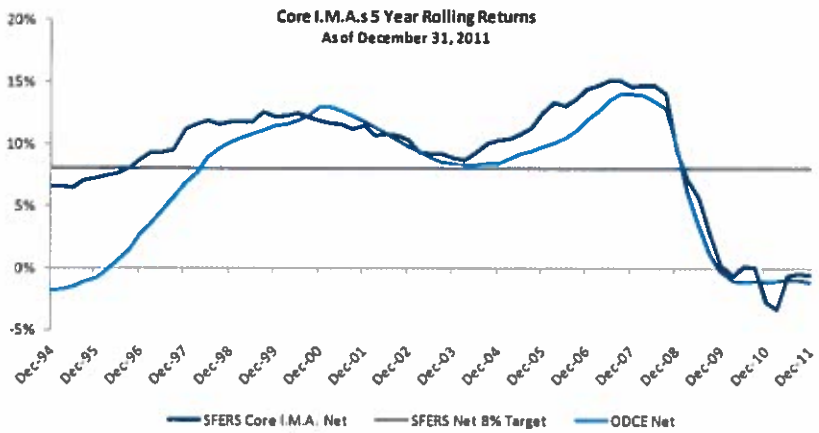
Core Portfolio – The Core Portfolio drives the performance of the Program in most periods. SFERS first Non-core allocation was made in 1989. As late as June 1993, however, the Program was still 92% in core strategies. Allocations to Value IMA's began shifting the Program such that Core assets had their lowest exposure of 27% in 2001. Despite continued allocations to Non-core strategies, the Portfolio reached a new peak of 75% Core holdings in 2007 predominately due to the transfer of the AMB Value portfolio to Core. The chart below shows the rolling five year returns for the total Core portfolio.



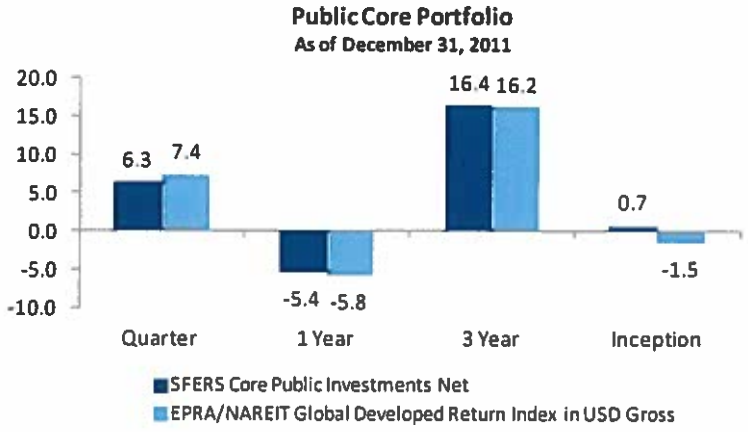
Private Core – Relative to its 20% minimum, the Private Core is funded at 47.5% of the total real estate portfolio decreasing to 42.7% assuming investment of all unfunded commitments. The long term, net of fee return expectation for Core strategies is 6.5%. Over-exposure to Core could challenge the total portfolio's ability to achieve the 8% net target. However, in the recent market cycle the recovery of Core assets has provided a strong contribution to returns. In addition to being accretive to the 8% net target, the Private Core portfolio has exceeded the peer comparison Open-end Diversified Core Equity ("ODCE") over most periods.



The Program's since inception returns are impacted by underperformance from closed end commingled funds acquired in the 1980's and a significant market correction in 1990. Beginning in the 1992 market recovery, the Core individually managed accounts ("IMAs"; inception 1990) drove the core portfolio to meet or exceed the 8% target for most periods until the 2008 financial crisis. These portfolios continue to drive performance and are the focus of the Core Private program.



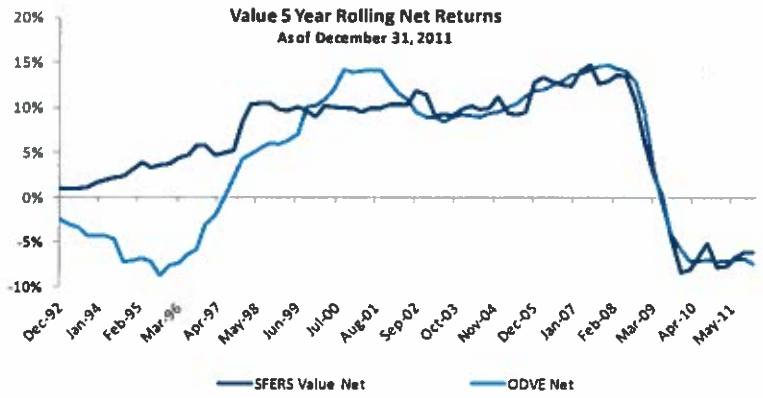
Public Core Portfolio - The Public Core holdings represent less than 10% of the total real estate program and have a limited track record with a 2008 (peak of market) inception. Performance to date has been dilutive to the total real estate return. However, long term public market return expectations allow for accretive returns above the 8% target. More time and multiple cycles are needed to fully assess the success of this sector and the selected managers.



Non-core Portfolio

Value Portfolio – In 1989, a small commingled fund allocation began the Program's Non-core investment experience. Beginning in 1994, Value assets were primarily acquired through individually managed accounts and co-investment programs. As capital was invested, Value grew to represent 59% of the total real estate portfolio in 2005. Minimal new Value allocations occurred from 2005 forward due to concerns about a possible market correction and underperformance from some existing Value IMA's. Instead, allocations focused on limited Core opportunities with existing IMA's and unique Opportunistic strategies believed to be less correlated to a potential US market correction. As a result, the Value portfolio has hovered at approximately 30% of the total portfolio since 2008.

The Value portfolio can be compared to the Open-End Diversified Value Equity ("ODVE") peer group. The following chart shows performance of the total Value portfolio over rolling five year periods.



Since inception, neither the SFERS Value nor the ODVE performed at the long term expected return of 8% after fees. Value creation strategies are sensitive to various cycles and allocations should take the current and projected cycles (market, property and economic) into account including managing the entrance and exit for the strategy. SFERS has begun this process by closing the Value IMA programs and focusing on closed end commingled and/or co-investment investments intended to capture market cycle opportunity for implementation of value strategies.

Opportunistic Portfolio – The first Opportunistic investment was made in 1996. As with private equity investments, Opportunistic strategies have a slow draw down period during which fees on committed capital create an extended J-Curve return pattern. The higher returning end of the J-Curve does not appear until liquidations/realizations occur. Expected returns for funds considered Opportunistic are to achieve an IRR in excess of 12% net.

The SFERS Opportunistic portfolio is in various stages of investment and liquidation. For Opportunistic strategies, investment success can best be measured by looking at a number of elements to reach a final conclusion. The Opportunistic portfolio is analyzed on a quarterly lag basis due to delayed publication of the Vintage Year Peer Groups. The following table details the results of existing Opportunistic investment allocations as of September 30, 2011. Data in the table below is consistent with the analysis provided in the December 31, 2011 Semi-Annual Review Summary, which is provided under separate cover.

September 30, 2011	Vintage Year	Commitment/ Unfunded $ (millions)	Market Value (millions)	Net IRR	Vintage Year Median Net IRR	Equity Multiple	Net Time Weighted Return
Fully Liquidated Funds							
DLJ RE Cap	1997 - 2007	$18 / $0	$0.0	11.0%	N/A	1.3	N/A
Active Funds							
OCM RE Opp Fund A	1996	$20 / $0	$0.3	8.1%	N/A	1.6	-1.6%
DLJ RE Cap II	1999	$30 / $1.6	$3.0	17.5%	14.4%	1.5	7.8%
Apollo RE Fund IV	1999	$35 / $0	$6.5	5.3%	14.4%	1.3	1.3%
Blackstone Fund III	2000	$35 / $0	$0.3	21.4%	19.4%	2.0	18.6%
Prologis Japan Fund	2005	$46/ $0	$71.1	11.6%	-2.6%	1.6	14.4%
Blackstone RE Int'l Fund II	2006	$25 / $1.3	$14.6	-5.0%	-0.3%	0.8	-2.1%
CIM RE Fund III	2007	$50 / $17	$35.2	-3.0%	-3.7%	1.0	Gapped
Urban America II	2007	$25 / $1.8	$14.3	-13.0%	-3.7%	0.6	-35.8%
Almanac V	2008	$40 / $14.2	$24.0	4.0%	N/A	1.0	4.9%
AEW Partners VI	2010	$25 / $13.0	$11.9	-0.7%	N/A	1.0	3.9%
Harrison Street RE III	2010	$25 / $18.7	$5.6	-15.4%	N/A	0.9	-3.7%
Almanac VI	N/A	$50 / $50.0	$0.0	N/A	N/A	N/A	N/A
Bristol Value II	N/A	$25 / $25.0	$0.0	N/A	N/A	N/A	N/A
Fortress Japan Opportunity Fund II	N/A	$25 / $25.0	$0.0	N/A	N/A	N/A	N/A

Opportunistic funds selected early in the program were generally successful.

- DLJ Real Estate Capital I – Is fully liquidated with a realized net IRR of 11% and an equity multiple of 1.3x. Both return parameters are below the 12% net and 1.5x multiple expectation for opportunistic investments.
- OCM Fund A did not meet the net IRR objective due to a prolonged liquidation however the 1.6x multiple is accretive to SFERS' cash flow.
- DLJ Real Estate Capital II is nearly fully liquidated and has achieved above target as well as above median net IRR's and a strong 1.5x equity multiple
- Apollo significantly underperformed its net IRR and multiple expectations on both an absolute and relative basis.

- Blackstone Fund III has been the strongest performer to date with returns above target, median and multiple expectations.

The greatest challenges remain with funds in vintage years 2005-2008, which share one or all of the three following dynamics: 1) Remain in the earlier stages of strategy implementation; 2) Have a to-date return drag caused by commitment fees, and/or 3) Will likely be members of the three to four worst performing vintage years for real estate broadly and high return specifically. At this point, it is hard to reliably predict the final outcome for these funds. It appears that the Prologis Japan is doing well on an absolute basis and that the CIM Fund is doing well relative to its Vintage peer group. Both funds have considerable time remaining for strategy implementation.

New fund selections have continued in order to capitalize on the market recovery and place capital in higher returning strategies needed to achieve the real estate target return of 8%. It is expected that 2009-2013 will be the best performing vintage years as funds access opportunities created by the Global Financial Crisis and the subsequent recovery.

Summary

The analysis of performance for the real state portfolio through December 31, 2011 supports the findings from the 2011-2012 Real Estate Strategy completed in July 2011:

1. The Core portfolio has been the most consistent in achieving return targets, exceeding most passive alternatives available in the market. However, size has dampened total portfolio performance.

2. The Value portfolio has benefited from focused approaches to investment and those vehicles/strategies with life terms consistent with the value creation strategy.

3. The Opportunistic Portfolio has been challenged in reaching funding targets with mixed results for performance; primarily due to vintage year exposures. Vintage year diversification and strong manager selection are keys to achieving alpha for the real estate portfolio.

Objectives, Policies and Procedures ("OPP") – Discussion and Recommendations

For fiscal year 2012/2013, no significant changes are recommended. However, one issue has come to light as the implementation of the program has unfolded. Specifically, the existing OPP is silent with respect to the acceptability of "In Kind Distributions" from liquidating commingled fund investments. To date, this issue has been addressed through side letters negotiated by SFERS' legal counsel. It is recommended that SFERS adopt a policy of restricting In Kind Distributions to public market assets (equity or debt) which are readily tradable and to private market assets within the United States. Given the existing relationship with IMA managers holding US properties, SFERS has a ready pool of managers to assume responsibility for any property received In Kind. No such relationship exists internationally and assumption of such an asset would be an undue drain on resources and therefore reasonably prohibited.

Housekeeping changes have also been made to the discussion of the performance objectives (Section I.C) in order to make the discussion less time specific as this is more consistent with the purpose and tenor of the full document.

A redlined OPP providing the wording for all recommended changes can be found under Tab 3.

2012-2013 INVESTMENT ANALYSIS

SFERS seeks to invest 9% - 15% of total plan assets into real estate, with a target of 12%. As of December 31, 2011, the Real Estate Portfolio is funded at 10.1% with additional unfunded commitments bringing the portfolio to 11.2% The spread between the invested and target levels provides SFERS with an opportunity to take advantage of the market recovery.

Pacing Model –

To anticipate investment needs for the immediate year and project future growth and needs of the portfolio, a pacing model was utilized to determine appropriate allocations over the near term and review the impact of annual allocations on achieving program objectives. In making projections, we assumed the following:

Total Plan/Real Estate	Core	Non-Core
$14.6 billion 4Q11	2 Year Allocation Drawdown	3 Year Allocation Drawdown
12% Real Estate Target	10 Year Hold	4 Year Hold
1.5% Total Plan Growth	5% Cash	3% Cash
	6.5% Net IRR	10% Net IRR

Key Pacing Results:

12% Target Reached in 2018-2019
All Allocations to Non-Core Strategies
1.4X Non-Core Over-Commitment Needed
Core/Non-Core Optimal Composition Reached in 2021

The goal of reaching the 12% funding target will be balanced by vintage year diversification and market opportunity. As in 2011, Townsend recommends that SFERS front load their Non-Core allocations over the next three years in order to participate in the recovery. Projections allow for allocations of up to $400 million in 2012-2013, $400 million in 2013-2014 and $300 million in 2014-2015 without a likelihood of over funding the allocation. An annual allocation of $200-$300 would be needed in each subsequent year in order to replace liquidations and accommodate Total Plan growth.

These needs will be reviewed annually to adjust for actual results and market behavior but they speak to the availability of significant capital for investment into the next 3-4 vintage year periods.

2012-2013 INVESTMENT ALLOCATION RECOMMENDATIONS

Private Core Portfolio – The Core Portfolio will remain over its optimal 20% for some time. However, active management should allow for strategic dispositions when opportunities present themselves. SFERS should continue to allow for the Bridge Pool to be available to Core IMA's to encourage active disposition and repositioning of Core portfolios.

Public Core Portfolio – The Public Portfolio should remain at its 10% limit until or unless the existing managers indicate a reduced/increased position is advisable. In order to accommodate portfolio growth or shifts in market value, Townsend recommends that up to $50 million should continue to be available for allocation in 2012-2013 in order to maintain the 10% exposure.

Non-Core Portfolio – Townsend recommends that up to $400 million be allocated to Non-Core investments in 2012-2013. Selected investments will be consistent with the Townsend View of the World and SFERS return requirements. Strategies are expected to fill capital voids as investors return to seeking yield while avoiding risk. Higher return strategies with strong income components will continue to be favored as will managers with niche strategies and focused approaches to investment. Each investment allocation will be subject to Board approval.

City and County of San Francisco Employees Retirement System
~~Approved~~ Recommended Real Estate Investment Objectives, Policies and Procedures

The City and County of San Francisco Employees Retirement System ("the System" or "SFERS") includes real estate investments in the total Plan portfolio as a means to seek, over the long term, enhanced risk/return characteristics for the System's investment portfolio.

This document establishes the specific objectives, policies and procedures involved in the implementation and oversight of the System's real estate program.

- The Investment **Objectives** define the role of and allocation to real estate in the broader portfolio and the resulting return expectations for the program.
- The Investment **Policies** state the limitations within which SFERS will adhere when investing the real estate allocation.
- The Investment **Procedures** provide guidelines for the implementation of the asset class and the control and monitoring of the program.

I. INVESTMENT OBJECTIVES

As with all asset classes, Real Estate is intended to provide specific benefit to the Plan's trust fund, e.g., risk adjusted returns, diversification and potential for a hedge against inflation. A clear statement of these primary objectives is a key to the measurement of the real estate program success.

A. The Role of Real Estate

The role of the asset class is to:

- Generate a long term, net return consistent with the results of the most recently approved Asset-Liability Study
- Provide low correlations to traditional asset classes
- Provide a hedge against inflation when market dynamics allow

B. Asset Allocation

The long-term allocation is determined through the Asset- Liability Study conducted by the General Consultant.

SFERS has approved a long-term asset allocation target of twelve percent (12%) with a range of nine percent (9%) to fifteen percent (15%). It is the intention of the Board to allow for under and overweighting of the real estate portfolio within the approved range based on market conditions.

C. Performance Objectives

The performance objective of The System's real estate portfolio is to produce a total return net of fees that meets or exceeds the expected returns over a 10 to 15 year horizon modeled in the most recently approved Asset-Liability Study. SFERS has approved a net return expectation of 8% for the real estate asset class. The 8% net Objective represents a significant premium over the 6.5% net long term expectation for passive, core real estate. Incremental returns are expected to result from any one or more of the following active management strategies.

1. Actively managing those assets providing stabilized returns from cash flow in order to maintain cash flow levels over the duration of the hold period.
2. Assume life cycle or market risk to actively create/restore value for realization or stabilized hold.
3. Tactically allocate to strategies favored by market dynamics during isolated periods of time.
4. Selection of high conviction managers and strategies with above median performance expectations.

The following investment dynamics will impact certain allocations, funding and early stage returns of the real estate portfolio:

1. The need to allow for reasonable vintage year diversification requires annual pacing of allocations
2. The allocations made each year may require a two to four year investment period

3. The returns generated during investment of capital and the initial years of implementation are most often negative reflecting fees on committed capital and early stages of value creation.

~~The March 31, 2011~~ The current SFERS funded real estate portfolio ~~was 56% Core and 44% Non-Core (as defined in later sections) and~~ is projected to require allocations through 2021 in order to reach the most efficient portfolio capable of achieving the 8% target return. The Board and Staff acknowledge that the ~~March 31, 2011~~ current portfolio composition and ~~these~~ the asset class dynamics will restrict the ability to achieve an 8% net of fee return during that period, but every effort will be made to ~~will~~ prudently ~~seek to~~ reposition the portfolio toward the 8% return objective as soon as practicable.

II. INVESTMENT POLICIES

The System has established policies to ensure the preservation of capital and the generation of returns commensurate with the overall risks assumed within the portfolio. The following are policies with which SFERS will comply when managing the real estate portfolio.

A. Portfolio Composition

The System divides the real estate into two sub-portfolios: (1) Core and (2) Non-Core. Non-core investments will be further classified as (1) Value Added and (2) Opportunistic. Each sub-portfolio is defined by its respective market risk/return characteristics and all are defined in Exhibit A to this document.

B. Performance Indices

Analysis of performance in excess, or short of, the 8% net return objective will be completed through the use of similarly risked pools of investment capital available through standard industry sources. All comparisons will be made on a rolling five year basis as well as other appropriate time periods and will utilize net of fee returns and indices.

Private Portfolios -

The Core Portfolio will be compared to the National Council of Real Estate Investment Fiduciaries ("NCREIF") Fund Index ("NFI") - Open-End Diversified Core Equity ("ODCE"). The ODCE represents a broadly diversified market basket of institutionally owned and operated properties held in open-ended commingled funds. All funds are implementing a core strategy with a focus on income, debt limitations of 30% and the assumption of limited operating risk. Consistent with the characteristics of an appropriate index, the ODCE provides quarterly private market valuations, periodic liquidity (into and out of vehicle), and visibility into the composition of the portfolios reporting to the index. Returns are available on both a gross and net of fee basis.

The Value-Added Portfolio will be compared to the NFI-Open-End Value-Added funds group ("ODVE"). The ODVE represents a diversified market basket of institutionally owned and operated properties held in open-ended commingled funds. All funds are implementing various Value Added strategies with the use of leverage as an integral part of the strategy. Consistent with the characteristics of an appropriate index, the ODVE provides quarterly private market valuations, periodic liquidity (into and out of vehicle), and visibility into the composition of the portfolios reporting to the index. Returns are available on both a gross and net of fee basis.

The Opportunistic Portfolio will be compared to NCREIF Vintage Year Peer Performance using NFI Vintage Periods in order to evaluate the success of allocations by style and manager/fund within given year(s). To-date and projected IRR's and equity multiples will also be used to evaluate the performance of the program.

Public Portfolio –

The Public Portfolio will be compared to the FTSE EPRA/NAREIT Developed Real Estate Index in USD. The Index is published and available to investors and managers for performance evaluation.

C. Risk Management

Risk Management begins with an understanding of the risks associated with each individual investment and the aggregate risk of the portfolio. In real estate, investments can be grouped and broadly defined with respect to long term risk/return expectations while short term expectations from each group will vary from market cycle to market cycle.

The SFERS real estate portfolio composition will vary from year to year based on the going forward expectations for the market opportunities and the minimal risk necessary to achieve the net return objective. In order to achieve the return objective, while minimizing total portfolio risk, the following portfolio composition constraints will be as follows:

Component	Minimum/Maximum [1]	
Core - Private	Minimum	20%
Core - Public Securities	Target[2]	10%
Non-Core - Private	Maximum	80%
Value Added	Minimum	40%
Opportunistic	Minimum	30%

Beyond portfolio composition, additional risks exist during the implementation and investment stages. The System will mitigate risk in a prudent manner in order to protect capital and generate returns commensurate with risks. The following identifies how the most significant risks with respect to real estate investing are controlled or mitigated.

[1] The Staff has authorization to make the investments once the allocations have been approved by the Retirement Board

[2] Because of the public nature of real estate securities, Staff will manage the sub-portfolio between the ranges of 8% to 12% with a target of 10% in order to allow for market fluctuations without forcing rebalancing.

1. *Pracedural Risk*

   Attached as Exhibit B are the Defined Roles of Participants established to facilitate implementation of the program.

2. *Investment Holding Vehicle Risk*

   The System recognizes that, regardless of investment structure, real estate is an illiquid asset class. Vehicles that maximize investor control of the investment mandate are preferred however the degree of control will be balanced with need to achieve appropriate risk/return performance results. As such, The System will access investments through a number of vehicle structures.

   a) Individually Managed Accounts (IMA)

      IMA's provide access to wholly owned/controlled assets providing optimal investment mandate controls and oversight for SFERS. The use of the IMA structure will be limited to those areas (predominantly Core strategies) where prudent diversification against systemic risk can be exercised and long term hold positions are expected at the asset level. IMA Manager(s) will assume an appropriate level of discretion, balanced by control and monitoring procedures established by the Board, Staff and Consultant and detailed in the **"Procedures"** section of this document.

   b) Commingled Funds/Club Investments

      Commingled Funds/Club Investments are structured to give a high level of discretion to the Manager. These vehicles are therefore most often used in the Non-core (Value-Added and Opportunistic) risk sectors. Both Commingled Funds and Club Investments pool multiple investor capital sources; Clubs limit the number of investors to generally less than five. The greater limitation on investor control inherent in these vehicles is acceptable given the flexibility required to achieve expected returns. Nonetheless, preference will be given to vehicles with reasonable investor control and market competitive fees. Any legally permissible vehicle will be allowed including, but not limited to, joint ventures, limited partnerships, real estate investment trusts and limited liability corporations. Club Investments will generally exhibit similar structures and controls but may also allow for more limited discretion to the manager and/or better investor alignment of interests.

      The System will invest in Commingled Funds and Club Investments in accordance with the **"Procedures"** section of this document.

c) Co-Investment

Co-investments will be presented in a variety of structures depending on the source of the co-investment asset. Preference will be given to those co-investments extending the greatest level of control to the co-investment position/partnership. Most Co-investments will be side-by-side with Commingled Funds and therefore control may be relinquished to the manager in order to achieve targeted returns.

The System will invest in Co-investments in accordance with the **"Procedures"** section of this document.

3. *Diversification Risk*

SFERS will seek to diversify its real estate program so as to mitigate the major risks associated with the allocation of capital into the real estate asset class.

a) Manager

Manager diversification will be managed through the use of multiple managers within risk/return sub-portfolios of Core, Value Added and Opportunistic strategies.

b) Strategy

The System may diversify the risk associated with a single strategy through the selection of multiple investment pools. At the time of investment, no single vehicle will be more than thirty percent (30%) of the target real estate portfolio to ensure that any possible underperformance of one vehicle will not unduly impact the total portfolio. The System will also optimize control by ensuring that no single investor in a commingled investment has a 'controlling vote' by virtue of its' pro rata investment.

c) Property Type and Location

The System will also diversify its exposure by property type and location. It is expected that at various points in time, the portfolio will be over/underweighted to a single property type or location by virtue of the prospects for relative returns. Exposure to any single property type or geographic location (defined as a single NPI region and/or a single country except the United States) in excess of thirty-five percent (35%) of the total targeted real estate portfolio will be presented to the Board as an exception during the Semi-Annual Performance review by Staff and Consultant.

With the maturation of the real estate asset class, investments have become global in nature. The System will seek optimal risk adjusted returns within the context of opportunities located both domestically and internationally. International investments will be limited to no more than thirty percent (30%) of the total targeted real estate portfolio and may include core private and public investments as well as non-core investments.

d) Investment Size

There is no maximum investment size for equity real estate investments, however, at no time shall the net investment value of a single property within an IMA account or a single Commingled Fund/Club/Co-investment, exceed ten percent (10%) of the net investment value of the total targeted real estate portfolio.

4. *Leverage Risk*

The use of leverage in the real estate portfolio can provide benefits in the form of increased diversification and enhanced returns. Leverage will also increase the gross asset exposure of the real estate allocation and amplify the impact of valuation changes on total return. The System will use leverage limits in order to manage the downside of leverage (volatility) without excluding the benefits (diversification, alpha). The availability and cost of leverage will be factors considered in determining its use. Limits are established for each investment style based on the risk/return profile of the underlying investments.

a) Core- 40% Portfolio Leverage Limit

Core 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 Core real estate investments, the System has established a forty percent (40%) leverage limit.

For any single Core asset managed through an individually managed account, or Co-investment, third-party debt will be limited to fifty percent (50%) of the market value of the asset, must provide positive debt-service coverage and must be non-recourse, unless approved by the Board. All asset specific debt must demonstrate that leveraged IRR projections provide a return premium over the unleveraged IRR equal to three basis points (3 bps) of return for each one percent (1%) of leverage. Property specific debt will be monitored as detailed in the **"Procedures"** section of this document.

b) Value Added - 65% Portfolio and Asset Limit

Investments classified as Value Added generally provide a higher proportion of appreciation, as compared to income, than do Core assets. Value Added strategies are most often accessed through commingled/club vehicles which generally limit leverage to no more than sixty-five percent (65%) of the market value of the total portfolio. The System will limit its leverage in the Value Added component of the portfolio to sixty-five percent (65%). No single commingled/club portfolio may exceed this limit.

When accessed through an individually managed account, assets with third-party debt will be limited to sixty-five (65%) of the market value of any single asset, must provide positive debt-service coverage over the life of the investment, and must be non-recourse, unless approved by the Board. All Value Add IMA asset specific debt must demonstrate that leveraged IRR projections provide a return premium over the unleveraged IRR equal to three basis points (3 bps) of return for each one percent (1%) of leverage. Property specific debt will be monitored as detailed in the **"Procedures"** section of this document.

c) Opportunistic

Investments classified as Opportunistic utilize third-party debt as an integral part of their total return strategy. Such investments will be made through Commingled Funds/Clue/Co-investment 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 and presented to the Retirement Board.

d) Sumitomo Note Repurchase Program

In 1993, SFERS entered a recourse debt program with Sumitomo Bank in order to establish attractive financing for SFERS' wholly owned assets managed by RREEF. RREEF continues to utilize the program subject to authorization from SFERS.

Attached, as Exhibit C, is a description of the Sumitomo Note Repurchase Program.

5. In Kind Distributions

~~5.~~ In order to mitigate the risk of assuming direct management for a distribution from any commingled fund, co-investment or separate account program, SFERS will limit the acceptability of In Kind Distributions to real property located in the United States and public securities traded on any public market. Such holdings would be transferred to

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appropriately selected IMA managers within the portfolio for takeover and management through liquidation.

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III. INVESTMENT PROCEDURES

The System will always act to protect capital and generate returns commensurate with risk. The following identifies how the most significant risks with respect to real estate implementation will be mitigated and monitored.

A. Annual Investment Strategy

Each year the Staff and Consultant will provide the Board with a proposed Annual Investment Strategy ('AIS") for Board approval and subsequent implementation. The AIS will address all issues requested by the Board to include the following:

1. *Portfolio Review*

   Provide a review of the current portfolio relative to approved Objectives, Policies and Procedures and the recommendations approved in the prior year's AIS.

2. *Strategic Perspective*

   Provide a review of the SFERS program in the context of the then current market including recommended changes to Objectives, Policy and Procedures for improving performance both near and long term.

3. *Market Opportunities*

   Provide a review of the optimal market opportunities available to SFERS based on program needs and objectives.

4. *Capital Pacing*

   Provide an analysis of the portfolio growth and projected activity to determine an appropriate recommendation for annual capital allocations in the ensuing year.

B. Individually Managed Accounts ("IMA")

IMA Managers will have discretionary authority over the selection of specific investments. However, certain controls will be maintained to ensure compliance with approved 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. Attached as Exhibit D are the approved Emerging Manager Guidelines which apply in each manager selection.

1. *IMA 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 Investment Policy, Objectives and Procedures for San Francisco City and County Employees' Retirement System ("Investment Policy Statement").
b) Staff, assisted by Consultant, shall establish evaluation criteria, desired levels of competency and respective weightings for evaluation factors.
c) Consultant shall screen its database to identify Manager Candidates exhibiting qualities consistent with Staff and Consultant qualification criteria. Staff may identify additional candidates.
d) Staff and Consultant shall interview, through formal presentations and/or site-visits (when deemed appropriate), the highest-ranking Managers.
e) Staff and Consultant, shall present a report to the Board, which explains the ranking procedure and reviews the findings and recommendation for manager(s) selection.
f) Staff, with the assistance of Consultant, shall coordinate final presentations as necessary.
g) Board shall select a Manager based on review and evaluation of information presented in the steps noted above.
h) After the City Attorney's review, Staff and Consultant will negotiate and close manager investment agreements, including final fee structures.

2. *IMA Investment Procedures*

a) Manager Investment Plan

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

be consistent with the mandate assigned to the manager and comply with all parameters of this document. Investment Plans will also set forth the IMA Manager's evaluation of current market opportunities and include a summary of the Annual Hold/Sell Review of each asset in the context of the market evaluation.

b) Preliminary Investment Package

Prior to making an investment, the Manager shall provide a Preliminary Investment Memorandum to Staff and Consultant. The preliminary package shall include an analysis of the investment relative to the currently approved Manager Investment Plan and SFERS documentation. The Package will include a projected hold/sell analysis for the proposed asset as well as 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 SFERS' 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 each acquisition, including document execution, funding and closing dates, updating the list as necessary.

3. *IMA Control and Monitoring*

a) Budget and Management Plan

Each IMA Manager shall submit a Budget and Management Plan (in form, timing and substance consistent with Staff and Consultant requests) for the upcoming year for each direct investment and the aggregate IMA. The Budget and Management Plan will include:

- A narrative of the asset/portfolio strategy
- An asset/portfolio level estimate of income and cash flow for the ensuing year. The statements 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 distribution projections.

- A hold/sell analysis of each asset under management. The hold/sell 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 objectives, the approved SFERS SIP, and Manager Investment.

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 ensuing year, the Manager shall notify the Retirement System in writing within a reasonable time of the occurrence of any significant event (i.e. a variance greater than 15% on budgeted NOI projections) relating to an investment that was not projected in the submitted Budget and Management Plan.

b) IMA Valuations

All investments will be valued in accordance with Global Investment Performance Standards ("GIPS") as created and administered by the CFA Institute.

C. Commingled Funds/Club Investments

The following procedures will be utilized in the selection, closing and monitoring of specific Commingled Fund/Club investments. Attached as Exhibit D are the approved Emerging Manager Guidelines applicable to each selection process.

1. Commingled Fund/Club Selection Process

a) Staff and Consultant will regularly evaluate the universe of investment opportunities targeting new investment selection within the Annual Investment Strategy ("AIS"). In all cases, the minimum criteria will comply with those approved in the Investment Policy Statement.
b) Staff and Consultant will conduct due diligence on each targeted Fund/Club to determine whether the offering meets approved AIS objectives. Due diligence may include on-site review of the manager and/or properties managed by same. At a minimum, analysis of track record, key individuals,

organizational capabilities, real estate skills, strategy experience and compliance with prior mandates will be addressed in the due diligence process. The process will also include broad comparisons of any targeted Fund/Club to other offerings with similar strategies.

c) Staff and/or Consultant, shall recommend offering(s) for approval by the Board.
d) Upon approval, the Staff and Consultant will negotiate with selected Fund(s)/Club(s) on behalf of the System in order to improve, where possible, the final terms of the investment for the System.
e) Final due diligence by Staff, Consultant and the System's legal counsel, under the City Attorney's direction, will include review of the commingled fund's formation and associated legal documents. Any significant issues uncovered in this phase will be brought to the attention of the Board prior to closing.

2. *Commingled Fund/Club Investment Control and Monitoring*

Commingled Fund and Club Investments will be monitored quarterly by Staff and Consultant to evaluate investment performance and to ensure compliance with vehicle documents.

D. Co-Investments

Co-Investments may allow the System to over/under weight specific property types, strategies and/or managers. The following procedures will be utilized in the selection, review and monitoring of Co-investment opportunities.

1. *Co-Investment Selection Process*

Co-investment opportunities may be sourced through existing Commingled Fund positions or through managers/funds offering co-investment positions to external capital sources. Co-investment opportunities are most often presented with limited windows for analysis. As such, the process for investment is intended to improve the ability of SFERS to participate in such investments prudently.

a) For properties sourced through existing Commingled Funds:

i. Consultant shall ensure that the co-investment is appropriate for additional investment, providing an opinion of prudence addressing the following:

ii. Legal Counsel, as directed by the City Attorney's Office, will be used to ensure that the investment documents provide appropriate conflict mitigation and secure optimal rights and controls for the System.

- Selected properties are consistent with Board approved AIS.
- Recommended cost/valuation is supported by appropriate market and property analysis.
- Potential conflicts are mitigated through partnership documentation as designed by Legal Counsel.
- Additional investment will comply with the approved Objectives, Policies and Procedures with respect to targeted return objectives and manager, property type or strategy exposure.
- Legal Counsel, as directed by the City Attorney's Office, will be used to ensure that the investment documents provide appropriate conflict mitigation and secure optimal rights and controls for the System.

iii. Staff will retain discretion to allocate up to $25 million toward any co-investment with affirmative results of sections D.1.a.i. and ii.

iv. Co-investments greater than $25 million are subject to the above process and Board approval.

b) For properties sourced through managers/vehicles in which SFERS is not an investor

i. Staff and Consultant shall complete both organizational and strategy due diligence in compliance with the approved Commingled Fund/Club Investment procedures.

ii. Consultant shall ensure that the co-investment is appropriate for investment and provide an opinion of prudence addressing the following:
   - Selected properties are consistent with Board approved AIS.
   - Recommended cost/valuation is supported by appropriate market and property analysis.
   - Potential conflicts are mitigated through partnership documentation as designed by Legal Counsel.
   - Additional investment will comply with the approved Objectives, Policies and Procedures with respect to targeted return objectives and manager, property type or strategy exposure.

iii. Legal Counsel, as directed by City Attorney's Office, will be used to ensure that the investment documents provide appropriate conflict mitigation and secure optimal rights and controls for the System.

IV. Staff and/or Consultant shall recommend approval of the holding vehicle consistent with commingled fund/co-investment procedures. Approval for the co-investment allocation will also require Board approval based on the appropriate portfolio impact.

2. *Co-Investment Control and Monitoring*

Co-Investments are similar in structure to an IMA account but are generally held within commingled funds. As such, Co-investments will utilize the same control and monitoring systems as detailed in the commingled fund procedures approved in this document.

E. Secondary Market Purchases

The purchase of existing limited partnership interests in the secondary market is a limited and relatively new tool in the real estate asset class. As in the Alternative Investment Program, secondary units can be purchased from existing fund or club investors looking to gain liquidity prior to the full term of the partnership. Secondary purchases provide numerous benefits such as:

- Access to an existing pool of assets rather than a blind pool allocation
- Shorter investment horizon for capital allocation from near term liquidations
- Ability to strategically and tactically manage portfolio diversification
- Potential for discounts to current carrying value and/or market value

Transactions are limited within the real estate asset class. Investors with in-place policies and procedures are capable of taking advantage of the intermittent opportunities in a quick and efficient manner.

1. *Secondary Unit Purchase Process*

a) Secondary units must be offered by an existing Fund/Club within the SFERS portfolio. Should a more robust secondary market develop in the asset class, units in funds/clubs not held by SFERS would be considered as an addition to the secondary policies and procedures.
b) Secondary offerings will be subject to Staff and Consultant concurrence that the unit purchase is appropriate for investment and provide an opinion of prudence addressing the following:
   - Additional allocation is consistent with Board approved AIS.

- Recommended cost/valuation is supported by appropriate market and property analysis.
- Potential conflicts are mitigated through partnership documentation as designed by Legal Counsel.
- Additional investment will comply with the approved Objectives, Policies and Procedures with respect to targeted return objectives and manager, property type or strategy exposure when evaluated in combination with the existing Fund/Club position

c) If above concurrence is reached, Staff would have authority to acquire secondary interests at or below the current carrying value of the units.

2. *Secondary Unit Control and Monitoring*

Units purchased on the secondary market will be monitored within the existing fund/club investment and utilize the same control and monitoring systems as detailed in the commingled fund procedures approved in this document.

IV. Performance Measurement And Analysis

On a quarterly basis, the Consultant will prepare a comprehensive report addressing each investment, IMA, and Manager. The evaluation system shall provide such information as may be required by the System to understand and administer its investments and Managers. The content of the report shall include attributes for both the investment managers and the total portfolio including: income, appreciation, gross and net returns for the portfolio and each manager, cash-flow, internal rate of return where appropriate, diversification, comparisons to relevant industry performance indices, and compliance with approved Objectives, Policies and Procedures as well as the governing AIS as appropriate.

The Consultant shall prepare and forward to the System a Performance Measurement Report within ninety (90) days following the last day of each quarter or within five working days of complete and accurate submission of all manager data.

Exhibit A
Portfolio Component Definitions

Core Investments

Core investments include existing, substantially leased income-producing properties located principally in metropolitan areas that exhibit reasonable economic diversification. Core properties typically exhibit the following characteristics:

- Predictable income flows with a high proportion of anticipated total return arising from current income and cash flow;
- At least 80% leased upon purchase of the asset;
- Located in an economically diversified metropolitan area;
- Credit quality tenants and a staggered lease maturity schedule;
- Quality construction and design features;
- Reasonable assurance of a broad pool of potential purchasers upon disposition;
- Properties requiring quality asset and portfolio management but not requiring specialized operating expertise which is not readily available in the market; and,
- Investment structures using all cash or conforming within debt policy limits.

Public real estate securities (e.g. Real Estate Investment Trusts or REITs) will be considered part of the Core component of the SFERS' portfolio. Public real estate securities are publicly traded companies that manage a portfolio of real estate based investments in order to produce income and capital appreciation for investors.

Non-Core Investments

Non-Core investments represent those properties and/or investment strategies that require specialized acquisition and management expertise or skill to mitigate the business and leasing risk associated with an individual investment. Non-Core investments may have greater volatility compared to Core investments. Non-Core investments may exhibit one or more of the following characteristics:

- Properties located in secondary and tertiary markets, which are not economically diversified and may have accompanying susceptibility to imbalances of demand and supply;
- Property types which require specialized management skills focusing primarily on operating business expertise rather than pure real estate portfolio management expertise;
- Properties which are considered to be in "work out" mode;
- Properties involving significant repositioning through lease-up, development and/or re-development risks;

- Financing or investment structures that impact cash flows and/or are not breaking even at acquisition; and
- Investment structures using leverage as an integral part of the total return strategy.
- Non-Core properties can further be broken down into two styles: Value Added and Opportunistic.

Value-Added Investments

Value Added real estate is characterized as properties that take on moderate additional risk from one or more of the following sources – leasing, redevelopment, repositioning, the use of moderate leverage and specialized property.

Opportunistic Investments

Opportunistic real estate takes on risk greater than that assumed in a Value Added strategy in order to achieve a higher level of return. High Return investments include a variety of strategies such as development or major redevelopment of office, retail, industrial, multifamily or specialized property types. Additionally, High Return investments could include land investing, operating company investing, distressed debt/properties, highly leveraged properties and other specialized investments.

Exhibit B

Defined Roles of Participants

The real estate program shall be planned, implemented, and monitored through the coordinated efforts of the Board, 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 SFERS 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 from time to time be necessary.
- Approves the Objectives, Policies and Procedures and the Strategic Investment Plan for the real estate program.
- Approves Staff and Consultant recommendations for selection, retention and removal of Managers.
- Reviews the real estate portfolio on a semi-annual basis to evaluate the investment performance and to ensure compliance with controlling documents

Duties of the SFERS Staff

- Establishes program guidelines for and executes the real estate investment program.
- Reports to the Board on matters of policy.
- Oversees Consultant's preparation of the Strategic Investment Plan. In conjunction with Consultant, presents and recommends the Strategic Investment Plan to the Board for approval.
- Completes the Annual Budget and Management Plan review and approval process.
- Brings any non-conforming items or significant issues to the attention of the Board.
- Documents and monitors funding procedures.
- Completes other activity as directed by the Board.
- Ensures manager reviews a copy of the Placement Agent Policy, as approved by the Retirement Board and that the manager has timely completed all required forms.

Individually Managed Account ("IMA") Duties of Staff:

- Conducts searches for professional services and investment managers and, with the assistance of the Consultant, recommends the selection to the Board for approval.
- Obtain City Attorney concurrence that manager complies with the Fiduciary Responsibilities as required in the Policy.
- Obtain City Attorney concurrence that manager complies with the Placement Agent Policy, as approved by the Retirement Board and City Attorney.
- Reviews Annual Manager Investment Plans.
- Reviews the Budget and Management Plans prepared by IMA Managers.
- Reviews Preliminary Investment Packages submitted by IMA Managers.
- Reviews fees (as reviewed and approved by Consultant) for compliance and insures that Incentive Fees are processed appropriately.
- Reviews annual audit, managers' valuations, and third-party appraisal reports.
- Performs other duties required to execute the IMA Investment Procedures, as more fully described in this document.
- Coordinates efforts of Consultant, Legal Counsel and CPA/Appraisal firms during the review process for Co-Investment opportunities.
- Monitors the closing process.

Commingled Fund/Co-investment Duties of Staff:

- Conducts screening, review, and selection for recommendation of Commingled Fund offerings in accordance with the Commingled Fund selection and closing process more fully described in Section IV.B. of this document.
- Oversees the commitment process, and with legal counsel, reviews and executes any required documentation.

<u>Duties of the Consultant</u>

- Reports directly to the Board and Staff on matters of policy.
- Brings any non-conforming items or significant issues to the attention of the Board and Staff on no less than a semi-annual basis.
- Monitors the performance of the real estate portfolio and compliance with Board approved policy.
- Prepares the Annual Investment Strategy and recommends the Allocation Plan to the Board for approval.

- Prepares the Quarterly Performance Report to evaluate investment performance and to ensure compliance with policy guidelines and approved Investment Plan. Presents Performance Report to the Board semi-annually.
- Reviews all proposed fees to determine appropriateness relative to industry standards and manager mandate.
- Provides Board and Staff with research and education on real estate related subjects as requested.

Individually Managed Account Duties of Consultant:

- Assists Staff in conducting searches for investment managers and makes recommendations to the Board along with Staff.
- Oversees preparation of Annual Manager Investment Plans.
- Reviews the Budget and Management Plans prepared by IMA Managers.
- Reviews the methodology and accuracy of all Individually Managed Account incentive fees and recommends payment based on compliance with terms of appropriate Manager mandate.
- Performs other duties required to execute the IMA Investment Procedures as more fully described in this document.

Commingled Fund/Co-investment Duties of Consultant:

- Conducts analysis of Commingled Fund offerings in accordance with the Commingled Fund selection process in this document.
- Provides written analysis of Commingled Funds and Co-investment.
- Reviews proposed co-investment asset(s) to ensure compliance with Board approved Strategic Investment Plans.
- Evaluates disposition and unwind recommendations in light of market conditions and Board approved Strategic and Annual Investment plans.

Duties of City Attorney's Office

- Reviews all terms and conditions of agreements
- Evaluates potential conflicts of interest in co-investment structure(s) and assets.
- Recommends strategies to mitigate/minimize said conflicts.
- Determines and recommends outside legal counsel for document review as appropriate.
- Confirms manager has received the Placement Agent Policy and timely completed all required forms.

Duties of the Manager

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

Individually Managed Account Managers:

- Acquires, manages and disposes of assets on behalf of the Retirement System.
- Adheres to the current reporting standards designated within the Manager contract.
- 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.
- Provides quarterly financial statements and annual audited reports.
- Meets with the Staff and Consultant for the Annual Real Estate Portfolio Review.
- Prepares an Annual Hold/Sell Review.

Commingled Fund /Co-Investment Managers:

- Adheres to the current reporting standards designated within the Manager contract.
- 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 annual meetings to discuss important developments regarding investment and management issues.
- Provides market valuations not less than annually.

Exhibit C

Sumitomo Note Repurchase Program

The following procedure regarding RREEF's use of the Sumitomo Note Repurchase Program to refinance existing assets in SFERS' real estate portfolio will be followed:

- RREEF may use the Program to refinance maturing loans only subject to the following:
  - Compliance with SFERS' Strategic and Annual Investment Plans for the Real Estate Asset Class
  - RREEF Investment Committee approval
- RREEF will provide Staff and Consultant financial justification for each proposed recourse loan
- Staff and Consultant will provide written notification of proposed recourse loans to the Deputy Director for Investments for his information
- Staff and Consultant will inform the Board of the exposure to the recourse debt in the Semi-Annual Performance Measurement Reports provided to the Board,
- Each year, Staff and Consultant will assess and discuss the need to allow RREEF's usage of the recourse Sumitomo Note Repurchase Program in its Annual Strategic and Investment Plans.

Exhibit D

Emerging Manager Guidelines

Barriers to entry for new firms launching established or new product strategies often provide opportunity to capitalize on niche management firms and/or strategies. Such 'Emerging Manager' firms shall be included in each selection process and, if meeting appropriate criteria, included in the semi-final review of candidates. Evaluation of these candidates will adhere to the following minimum criteria:

- No person or entity, other than the principals or employees of the named firm may own more than forty-nine percent (49%) of the management firm being considered for allocation
- The firm will not be required to currently adhere to industry wide performance reporting standards, but must demonstrate the ability to adhere to such performance reporting standards within 12 months. Review of the firm's adoption of current standards will occur on the one year anniversary of any allocation.
- The firm must currently manage no less than $100 million in the selected strategy. A preference for firms with other public fund clients and experience will be given.
- Total assets under management may not exceed $2 billion in aggregate capital including non-institutional capital.
- The capital to be allocated by SFERS may not exceed 35% of the firm's total assets under management after the allocation, which is an exception to SFERS' Investment Policy Statement with a 20% limit.
- No client can represent more than 50% of the management firm's total assets under management.
- Any firm with less than a five year track record may utilize track records established at prior firms when performance can be clearly attributed to the emerging firm's key individual(s) and is consistent with reporting standards.

HISTORY OF SFERS' REAL ESTATE PORTFOLIO

As an asset class, real estate has historically been expected to provide institutional investors with a market competitive return between equities and fixed income; stable income returns and a hedge against inflation.

Consistent with its peers and limited by the industry maturation process, The City and County of San Francisco Employees' Retirement System ("The Retirement System" "SFERS") began its real estate investment program in 1978 by investing in core commingled funds with expectations of achieving a real rate of return about 5% (8% nominal). It was not until after the real estate market collapse of 1990 that a broader role for the asset class and increasing alternatives were made readily available to institutional investors.

In 1992, SFERS allowed for up to 25% of its real estate portfolio to be invested in Non-Core strategies. The return target for these investments was a real rate of return of 7% (10% nominal). In addition, SFERS moved from limited control core commingled funds to wholly owned Individually Managed Accounts ("IMA") for no less than 75% of the real estate portfolio. Seven years of strong market returns built Plan Sponsor programs to well funded positions and investor, as well as market, sophistication generated greater tolerance for risk in all asset classes. For the five years ending June 30, 1999 the SFERS real estate portfolio achieved an 11.2% return comparing favorably to the SFERS targeted 10% return and the NCREIF Property Index ("NPI") return of 11.3%.

In 1999, SFERS began to look for additional alpha from real estate. The targeted return was increased to a total nominal return of 12% gross. Higher returns were expected to be generated through an increased Non-Core exposure of up to 60%; allowing Core holdings to decline as low as 40% of the total real estate portfolio. In 2002, the asset allocation process resulted in an increased target for real estate; going from 8% of the total Plan to 12%.

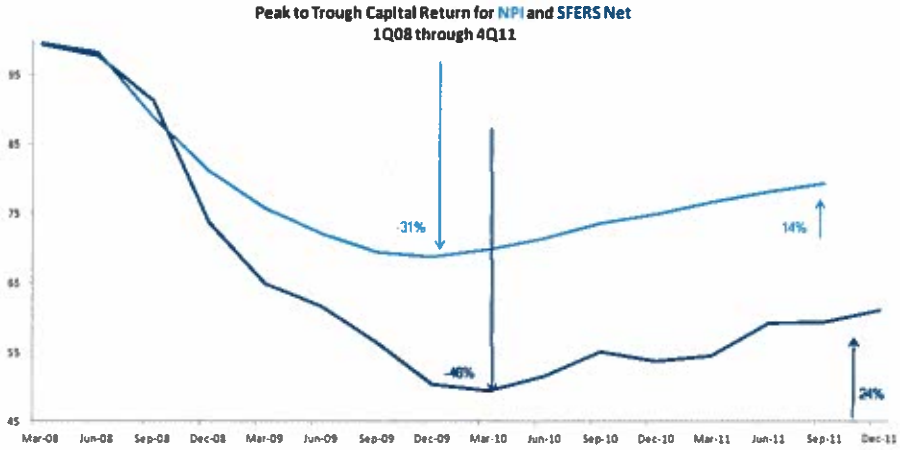
From 1999 through 2004, capital allocations focused on Non-Core IMA's and a limited number of Non-Core commingled funds. The real estate portfolio grew from a June 30, 1999 market value of $513 million (4.8% of total Plan) to a June 30, 2004 market value of $999 million (8.5% of total Plan). For the five year period ending June 30, 2004, the SFERS portfolio posted a 10.8% return underperforming the 12% return target while exceeding the NPI of 9.4%. Performance was significantly impacted by the expected 'J Curve' effect on the portfolio which was dilutive to the historically stable returns generated by the core portfolio but also reflected the lower returns being achieved in the core sector of the market reflected in NPI's 9.4%

In 2004 SFERS adopted a new return target of NPI +150 bps and in 2005 reduced its target allocation to 10%. Despite significant investment allocations, SFERS had not been able to maintain the 12% allocation target. Concerns about the increasing likelihood of a market correction and the absence of compelling needs within the portfolio resulted in limited allocations from 2005 to 2008. The 10% allocation to real estate was managed within a target range of 8% -13% to allow for tactical/timely investing.

For the five year period ending June 30, 2008 (pre-Lehman crash), the SFERS portfolio posted a 14.9% return compared to the NPI +150 bps target of 16.5% and the NPI return of 15.0%. The June 30, 2008 reporting period reflects the peak of the rising market. By September 30, 2008 the market had collapsed and index returns were negative for the first time in almost ten years. Performance was most impacted by the significant exposure to core assets, under performance of the Value-Added portfolio and limited exposure to Opportunistic.

June 30, 2008	% of Funded	5 Year Return
Core	75%	15.0%
Value-Added	18%	13.6%
Opportunistic	7%	24.9%
Total SFERS	100%	**14.9%**
NPI		14.3%
Target NPI+150		**16.5%**

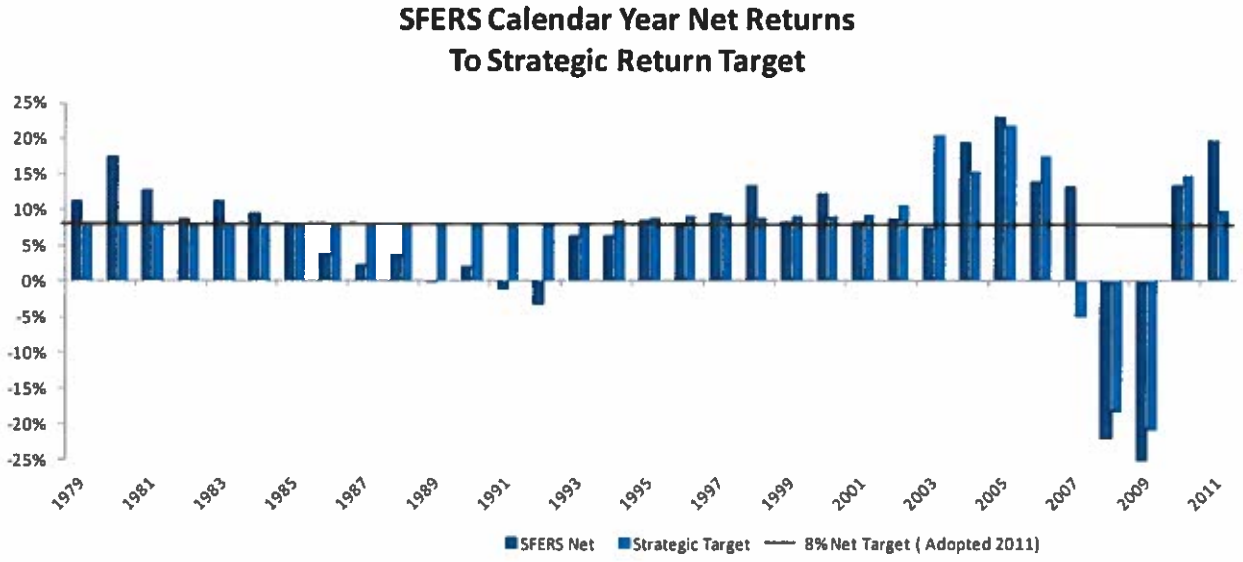
From the June 2008 peak of the real estate market to the trough of March 2010, the unlevered NPI experienced a decline of 33% while SFERS experienced a leveraged decline of 46%. From the trough of March 31, 2010 to the most recent quarterly data of December 31, 2011, the NPI recovered 14% while SFERS recovered 24%.



The following table provides a summary of the historical changes to SFERS' portfolio objectives and risk profile.

Strategic Plan Year(s)	Target Allocation	Minimum Core	Target Return
1978-1991	8%	100%	5% Real Return
1992-1999		75%	5% Real Return (Core) 7% Real Return (Value)
1999-2002		40%	
2002-2004	12%		12% Nominal
2004			NPI +150 bps
2005	10%		
2009	12%	20%	
2011			8% Net Nominal Return

The chart below shows the historical returns compared to the approved targets adopted over time. Each target is used from the date of approval until a new target was approved.



The chart highlights several significant shifts in the implementation of the SFERS program:

- Core Individually Managed Accounts started in 1990 allowing SFERS to participate in a market recovery begun in 1992.
- Allocations to Value-Added IMA's in 1994 contributed to performance in excess of the target beginning June 1998.
- Significant allocations from 1996-2001 to high return (commingled) and Value-Added (IMA) strategies, along with increased capital to existing IMA's shifted the risk profile of the program.
- From 2002 through 2004 all allocations went to existing IMA's, including core, seeking to dampen J-Curve from Non-Core allocations made in 1999-2001.
- In 2003, the portfolio was a near 50/50 split between core and Value-Added (funded and committed) but with the predominance of high return capital in the J-Curve Non-Core investments dragged the portfolio below its targeted returns.
- In 2004 the Board approved a market based benchmark
- In 2005, concerns over the level of core exposure (given target), the cost of core and the risk to operating fundamentals in an anticipated market correction led SFERS to focus allocations in Non-Core return strategies expected to provide low correlations to a US real estate correction.
- In 2008 to the present, SFERS has selectively allocated capital with a focus on increasing Non-core exposure prudently.

Tab 4

City and County of San Francisco Employees' Retirement System
Alternative Investment Program Objectives, Policies and Procedures

The City and County of San Francisco Employees' Retirement System (the "System" or "SFERS") includes alternative investments in the total plan portfolio as a means to seek, over the long term, enhanced risk/return characteristics for SFERS' investment portfolio.

This document establishes the specific objectives, policies and procedures involved in the implementation and oversight of the System's Alternative Investment Program ("AIP" or the "Program").

- The Investment **Objectives** define the role of and allocation to the AIP in the broader portfolio and the resulting return expectations for the Program.
- The Investment **Policies** state the limitations within which SFERS will adhere when investing the alternative investment allocation.
- The Investment **Procedures** provide guidelines for the implementation of the asset class and the **Control and Monitoring** of the Program.

I. INVESTMENT OBJECTIVES

As with all asset classes, a clear statement of the objectives for the AIP is key to the measurement of the Program's success. In December 1989, SFERS established the long-term investment objectives for the Alternative Investment Program. These objectives are reviewed and updated annually.

A. The Role of the Alternative Investment Program

Primary Objective: Provide a total return (net of fees and carried interest) that exceeds the annual return of the S&P 500 by 500 basis points over rolling ten-year periods and maintain a well diversified exposure to alternative investments of 16%[1] within a range of 12% to 20%. Individual investments should have an expected return of no less than 15% net internal rate of return ("IRR"). Unless an investment is expected to meet or exceed this minimum return goal, it should not be considered.

Secondary Objective: To diversify by investment type, manager and vintage year to reduce manager, market and asset specific risk. Investments, that meet this secondary objective, will not be considered if they are not also expected to meet or exceed the primary objective.

Tertiary Objective: To reduce total portfolio volatility by investing in asset types that have a low statistical correlation with other asset classes. Investments, that meet this tertiary objective, will not be considered if they are not also expected to meet or exceed the primary and secondary objectives

[1] An increase in SFERS' alternative investments target allocation from 14% (+/-3%) to 16% (+/-4%) was approved by the Retirement Board in September 2011.

B. Asset Allocation

SFERS' allocation to the AIP shall remain within the limits authorized by SFERS' Retirement Board (the "Board"). The target allocation is 16% with a range of +/- 4% of SFERS' assets (based on the net asset value of the invested portfolio). Allocated capital is defined as invested capital (based on reported values). SFERS recognizes that it is necessary to make capital commitments in excess of the target allocation in order to achieve and maintain its 16% target.

An important implementation goal for SFERS is to spread out the timing of new commitments to avoid an undue concentration of commitments in any one calendar year. Over the long-term, it is expected that the amount of new commitments added to the portfolio each calendar year may increase slightly to garner the benefits of time diversification and match the expected growth of SFERS' total plan assets.

II. INVESTMENT POLICIES

SFERS has established policies to ensure the preservation of capital and the generation of returns commensurate with the overall risks assumed within the portfolio. The following characteristics will be included in the analysis of investments and the management of the AIP:

A. Investment Criteria

SFERS' staff and consultant will utilize a rigorous due diligence process to screen and select fund managers based upon certain qualifications that are particularly important. These qualifications will apply to both brand name funds as well as emerging managers.

1) **Manager Experience**. There must be demonstrated long-term experience of the core investment team particularly as it relates to their defined investment focus. SFERS recognizes that with first time funds, this experience may originate from several different sources.

2) **Track Record**. The track record of the manager must be clearly superior through more than one economic cycle. This record must be consistent and include a review of all individual investment records. This record will be compared with those of other managers, as well as industry benchmarks. With respect to first time funds, different partners may have investment track records from different sources. It is particularly important with first time funds to ascertain that individual partner track records are accurate and that partners are not taking credit for deals where they were not the principal lead at their prior firms.

3) **Organization**. The organization must be able to provide complete documentation of all aspects of sourcing, investing, monitoring, and investor reporting. There must be oversight and backup capabilities.

4) **Continuity**. The partners in the firm should have invested together, with little turnover, for a significant period of time. Personal chemistry and career objectives of the general partners should be aligned to provide confidence in the stability and effectiveness of the investment team throughout the life of the partnership. A first time fund will not be able to meet the first criteria, but they must demonstrate a cohesiveness and alignment of interests across the investment team.

5) **Common objectives**. The investment objectives of the manager and SFERS must be parallel as measured by duration, focus and return objectives.

6) **Reputation**. The investment professionals must be people of good character and integrity, and have an acknowledged stature in the investment and business communities.

B. Program Composition

Overall, the AIP is a large, mature and well-diversified portfolio. The Portfolio's current investments and unfunded commitments will provide exposure to the various private equity sectors over the next three to five years. Staff's and consultant's strategy is to work within the parameters established in order to reduce the volatility in the portfolio and enhance returns.

SFERS' AIP will have three Primary Sector allocations: Venture Capital, Buyout and Special Situations. International is not defined as a separate sector, but rather a geographic allocation that is viewed as a separate consideration within each of these Sectors.

Primary Private Equity Sectors:

1) Venture Capital

Venture Capital investing involves the financing of start-up, growth or expansion stage companies focused primarily on the information technology, healthcare and clean technology sectors. The holding period for most venture capital investments is generally longer than that of buyout investments because companies are in the early stages of the product life cycle, requiring multiple rounds of financing before achieving sufficient critical mass and a positive exit. Both strategic sales and the public equity markets are used as the exit mechanisms for venture capital investments. Long-term returns in a diversified venture capital strategy are expected to meet or exceed SFERS' AIP objectives. The specific categories within venture capital are addressed below.

- **Early-stage funds**. Focused on creating new, entrepreneurial companies (usually within high growth sectors such as information technology and healthcare) rather than concentrating on established, profitable companies. Companies may be at the product idea stage or may be in the early stages of product development. Early-stage funds are generally considered to be the riskiest of the private equity investment strategies because the business, financing and technology risk surrounding this type of venture capital investing is extremely high. However, the corresponding rewards for success are typically higher.

- **Later-stage funds**. Focused on companies that are experiencing rapid growth through the sale of more proven products. Capital is usually targeted at the last rounds of financing before a company's initial public offering or strategic sale. With this understanding, later-stage investing is considered the least risky of the venture capital stages because the technology risk has been eliminated, company products are more proven, and revenues are growing. Consequently, companies are better positioned to go

public or to be sold to an industry buyer. Risk is associated more with valuation and timing considerations in later stage deals.

- **Multi-stage or balanced funds.** Able to invest across all of the venture capital stages. Firms take this barbell approach to minimize the effects of the "J-curve"[2] and provide earlier liquidity to investors than would be the case with only early stage investments. The mix (of early or late stage investments) will be a function of the market environment and where the general partners are seeing compelling opportunities.

Many times, a fund will be marketed based on its primary strategy as opposed to the ultimate makeup of the fund. For example, if the majority of a fund's capital has been invested in early stage investments, the fund will be labeled early stage by SFERS, even though it may have a few later stage investments in the portfolio as well.

2) Buyout/Corporate Finance;

Buyout funds acquire companies through the purchase of controlling interests of preferred and/or common equity with transactions generally utilizing some degree of leverage. Target companies are generally established businesses in more mature industries with less overall business risk relative to venture capital. However, depending on the amount of leverage in the capital structure of the investment and general economic conditions, leveraged buyouts can have meaningful total risk. The typical holding period for buyout investments is between four to seven years and exit strategies are less dependent (than venture capital) on the public market and usually involve strategic sales. This reduced reliance on the public market allows for liquidity events to occur continually throughout the life of a fund.

3) Special Situations;

Special Situations funds typically (i) execute distressed debt trading strategies or invest in distressed principal transactions; (ii) invest in mezzanine securities; (iii) purchase diversified secondary interests; (iv) focus on specific industry niches such as commodity based oil and gas exploration; or (v) co-invest along standard funds. The following is a brief description of several special situations strategies.

- Restructuring or Distressed Debt funds target investments in under-performing companies. A typical company may have filed for bankruptcy protection or be in the process of a reorganization. The targeted debt instruments are senior in the capital structure. Some managers seek to gain control of the bankruptcy or reorganization process so they have more influence on the ultimate outcome. Other funds may seek to arbitrage the value of the debt security with newly issued equity or to liquidate the value of the company through a negotiated workout. Distressed Debt trading strategies tend to be more cyclical than control strategies and therefore are not as attractive under all market conditions.

[2] Alternative investments typically follow a "J-curve" pattern of exhibiting negative returns during the early years of a fund's lifecycle as management fees are not yet offset by increases in portfolio valuations. Returns will typically turn positive in year three or four as each fund investment matures and successful portfolio companies emerge.

- Subordinated Debt or Mezzanine funds typically involve lower risk, higher capitalization and cash flow-oriented assets. An investment is characterized by debt instruments with current pay cash coupons and warrants which allow the portfolio to share in the appreciation of the equity of the company. The securities are typically unsecured junior obligations.

Secondary Private Equity

Secondary fund investments allow investors to gain the positive attributes of private equity investing while mitigating many of the risks. Listed below are common reasons why institutions invest in secondary funds:

- Limited J-Curve. From a portfolio management perspective, secondary fund investments reduce the length and severity of a portfolio's "J-curve."
- Reduced "Blind Pool." Investing well into a partnership's life and analyzing its assets eliminates much of the uncertainty and risk associated with a "blind pool."
- Discount. The market's illiquidity combined with the liquidity needs for the sellers often allows for a price discount from net asset value.
- Shorter Holding Period. Buying into partnerships at a later stage results in a significant time discount, shortening the holding period and resulting in earlier distributions.
- Diversification. Buying into a series of mature funds provides immediate diversification across vintage years, industries and geography.

Direct secondary investments, where SFERS would acquire a limited partnership interest in an existing fund, would be categorized into the appropriate Sector based on the strategy of the partnership.

C. Risk Management

Risk Management begins with an understanding of the risks associated with each individual investment and the aggregate risk of the portfolio. Private equity investments can be grouped and broadly defined with respect to long term risk/return expectations while short term expectations from each group will vary from market cycle to market cycle.

Private equity is generally considered an attractive asset class for institutional portfolios because it has historically generated high rates of return with a relatively low correlation to more traditional assets. Although private equity has the widest spread between the top and bottom quartile partnerships, as much as 1,000 basis points difference, consistent long-term attractive returns can be achieved through careful investment selection and the inherent risks can be minimized through reasonable stage, manager, vintage year (time), geographic and industry diversification.

SFERS' AIP is dedicated to providing long-term returns primarily through capital appreciation. The objective of the program is to create a portfolio of private equity investments that will provide consistent, long-term, risk-adjusted returns that exceed the public equity market returns by 500 basis points and with individual investment having a minimum net IRR target of 15%. While venture capital and buyouts are expected to generate the highest returns within the AIP (> 18%), the lower risk strategies associated with special situations investments such as distressed debt, mezzanine and secondary fund-of-funds offer

expected returns of at least 15% and add diversification, quicker return of capital and more predictable cash flows. It is important to note that the returns for each of the individual fund investments will typically follow the "J-curve" pattern.

A portfolio of diversified investments reduces the variability of returns that, in turn, reduces risk. Diversification in the alternative investment asset class is achieved by investing in a number of different partnerships and managers with varying investment styles, each operating in a variety of industries and geographies. Further, by spreading out the commitments to alternative investment partnerships over a period of time, an investor is able to reduce the exposure to risk in the asset class. By most measures, SFERS' alternative investment portfolio is highly diversified.

The AIP's diversification will be driven by the following four events:

1) Commitment pace,

2) Pace of capital invested by the fund managers,

3) Valuation changes in underlying investments, and

4) Timing of exits from underlying investments.

The interaction of these four factors will cause the diversification at any reporting date to differ from the AIP's target diversification.

D. Eligible Investments

The alternative investment universe includes the following broad investment strategies:

- **Venture Capital:** Financing start-up or expansion stage companies (primarily technology-based investment targets)
- **Buyouts:** Seek to acquire controlling interests in public or private companies
- **Special Situations:** Strategies characterized by higher levels of current income or a broad mandate and may include:
  - **Mezzanine:** Investments in unsecured or junior obligations with equity enhancements;
  - **Distressed Debt:** Focus on under-performing companies in need of operating or financial restructuring in or out of bankruptcy; and
  - **Secondary Acquisitions:** Purchase of existing partnership interests from the original owners

The alternative investment universe of eligible investments also includes fund-of-funds, however, these will be classified under one of the sectors outlined above. The table on the following page provides allocation ranges for each of the sectors.

Sector	SFERS' Allocation Ranges
Venture	**20-40%**
Seed/Early	5-15%
Late/Expansion	5-15%
Multi Stage	5-15%
Buyout/Corp Finance	**40-60%**
Small/Mid	20-30%
Large	20-30%
Special Situations	**10-30%**

Note: Investment strategies that will not be considered for SFERS' AIP at this time include real estate, hedge funds, public markets, commodities, infrastructure and currency. The determination of what is (or is not) an alternative investment will be made by SFERS' investment staff, with assistance from the alternative investment consultant.

E. Secondary Program

SFERS' staff and consultant will seek to improve long term returns and add additional exposure through the acquisition of attractively priced secondary investment opportunities in partnerships in which SFERS is already invested. In addition, the existing portfolio will be actively monitored and managed to take advantage of attractive market pricing in order to maximize the potential returns for each portfolio partnership. Dispositions may take place after significant evaluation of market pricing in comparison to potential future returns. The impact on manager relationships will also be considered.

Information regarding SFERS' secondary program is attached as **Appendix A.**

III. INVESTMENT PROCEDURES

The System will always act to protect capital and generate returns commensurate with risk. The following identifies how significant risks will be mitigated and monitored.

A. Annual Investment Plan

Each year the staff and consultant will provide the Board with a proposed Annual Investment Plan for Board approval and subsequent implementation. The Annual Investment Plan includes the following: Asset Allocation Levels, Diversification Targets, Prospective Investments, Secondary Program, Monitoring and Exiting.

B. Investment Due Diligence Process

SFERS' due diligence process will be conducted by SFERS' staff and consultant to determine that each investment opportunity meets the investment selection criteria. No investment will be recommended to the Board without the completion of full due diligence. SFERS' investment due diligence process is summarized below.

All prospective investments are analyzed in five stages:

Stage 1: Preliminary Screening
Objective: To review current market opportunities and future market opportunities to determine, through preliminary conversations and from the private placement memorandum, whether the proposed investment has the potential to meet SFERS' required investment objectives. During the preliminary screening stage the following investment issues are addressed:

(1) What is the quality and background of the general partner?

(2) Is the investment objective desirable and will the stated strategy accomplish the objective?

(3) Can the required returns be achieved given the proposed structure of the investment?

All prospective investment opportunities are reviewed by staff and the consultant. Investments that clearly do not meet SFERS' objectives are rejected.

If it is determined during Stage 1 that a proposed investment has a reasonable probability of addressing these key investment criteria, then the investment advances in the due diligence process to Stage 2.

Stage 2: Preliminary Due Diligence
Objective: To determine through face-to-face meetings whether the general partner's strategy is valid and timely and will meet the required investment objectives of SFERS. During this preliminary due diligence the following investment issues are addressed:

(1) Is the general partner's presentation of the offering consistent with the offering memorandum?

(2) Does the general partner respond productively and honestly to probing questions about its investment history, commitment to the success of the partnership, chemistry of the investment team and the ability to repeat successes of the past in current environments?

(3) Does the general partner make a strong and convincing case that its strategy will outperform its peers and will meet SFERS' return objectives?

If it is determined during Stage 2 that a proposed investment has a reasonable probability of addressing these key investment criteria, then the investment advances in the due diligence process to Stage 3.

Stage 3: Final/Comprehensive Due Diligence

Objective: To determine through comprehensive due diligence whether the potential investment meets the key investment criteria.

(1) Through interviews with the management team and staff, as well as reference checks with other sponsors, previous and prospective investors and management of portfolio companies. The consultant and SFERS' staff will make an appraisal of the management team's depth and breadth of experience, character, motivations and working dynamic. In addition, SFERS' staff and consultant will assess whether the management team has the experience, deal flow and resources necessary to successfully implement the investment strategy.

(2) Perform a careful review of the manager's due diligence process, record keeping, investor reports and audits. Review the manager's financial condition. Review the partnership agreement.

(3) Review and analyze the organization and management team, ownership of the general partner, incentive compensation and employee retention issues.

(4) Determine whether the investment objective can be achieved given the fund's industry focus and investment stage. Will current and expected market conditions allow portfolio companies to be nurtured to a sufficient size such that they can achieve liquidity in a timely manner and accomplish return objectives?

(5) Evaluate whether the proposed terms of the investment are such that there are fair economic incentives to all partners, general and limited, and whether sufficient controls are in place to guide management's activities such that successful investment performance on the part of the management team will accrue equitably to all partners.

(6) Evaluate the results of a litigation questionnaire to determine whether the general partner or any of its partners are or have been involved in any material litigation which would bring into question their integrity, operating methods, financial viability or would disrupt the investment process.

(7) During this stage, the sponsors will make a presentation to SFERS' staff, if staff has not already met or is otherwise familiar with the sponsor.

(8) Ask the manager and their placement agent to complete the SFERS' External Manager Disclosure Form and SFERS' Placement Agent Disclosure Form for staff's review, to verify that they are in compliance with the SFERS' Placement Agent Policy as approved by the SFERS' Retirement Board on June 8, 2010.

If it is determined during Stage 3 that a proposed investment has a high probability of addressing these key investment criteria and with the concurrence of SFERS, then the investment advances in the due diligence process to Stage 4.

Stage 4: Commitment and Documentation

Objective: Given SFERS' investment objectives and diversification issues, determine the appropriate size of the investment and begin the negotiation and documentation of acceptable terms.

(1) Determine the appropriate commitment level relative to the size of the fund and any investment stage, industry focus, and portfolio construction considerations.

(2) Begin negotiation of critical document terms, including key man and clawback provisions, management fees, organizational expenses of the partnership, distribution and carried interest policies of the general partners. Terms will be reviewed individually and in the aggregate.

(3) Partnership terms will also be compared to standards of best practices.

(4) In order to facilitate an orderly review of the terms of the agreement, the consultant will generate a summary of terms.

If it is determined during Stage 4 that a proposed investment's terms, as negotiated, materially address the aforementioned key investment criteria, SFERS' staff and consultant will make the appropriate investment recommendation to the Board. Each recommendation includes a thorough written and oral presentation. Upon the Board's approval, the investment advances in the due diligence process to Stage 5.

Stage 5: Finalizing Documentation and Closing

Objective: To finalize the terms and conditions of the partnership agreement and close on the commitment.

(1) Review investment documents to insure that all negotiated terms and conditions are incorporated therein.

(2) Review documentation with outside counsel for their concurrence on compliance with material terms and structural protection of SFERS.

(3) All investments must be underwritten and assets managed by a qualified investment manager acting in a fiduciary capacity to SFERS. Once retained, an investment manager must acknowledge in writing the manager's fiduciary responsibility to the System and agree that these objectives and policies will be observed. It is expected that, at all times, the manager(s) will conduct themselves as fiduciaries in conformance with the California Constitution, Article XVI, Section 17 and Charter Section 12.100, unless a lesser standard of fiduciary duty is necessary because of generally prevailing industry standards for an investment of that type and nature. Any such generally prevailing industry standard shall be established upon the written advice of the investment consultant.

(4) All closing documents, the consultant's summary of terms, as well as the review letter from outside counsel will be provided to the City Attorney to confirm completion of the review processes. SFERS' staff will prepare and present closing documents to the appropriate person or persons for execution.

(5) Upon closing the investment, organize the completed due diligence file.

After closing the investment, active monitoring of the fund's compliance with the partnership agreement and the progress of portfolio investments begins.

C. Review of Industry Best Practices

Even though SFERS' Alternative Investment Program is one of the more successful and mature institutional investment programs, SFERS' staff and consultant continue to review and evaluate research, surveys and suggestions of best practices for the investment management and execution of the program. To this end, SFERS will take into consideration the suggestions of best practices put forth by the Institutional Limited Partners Association ("ILPA") in the 2009 ILPA Private Equity Principals Report intended to serve as a basis for continued discussion among and between the general partner and limited partner communities with the goal of improving the private equity industry for the long-term benefit of all of its participants.

As part of SFERS' due diligence process, each manager shall be asked to provide or complete a thorough due diligence questionnaire (the "DDQ"). To the extent a manager does not have a prepared DDQ, SFERS and consultant will provide the manager with a DDQ to be completed. See **Appendix B** for a sample questionnaire.

IV. CONTROL AND MONITORING

A. General. The deployment of assets within the AIP will be monitored for consistency of the manager's investment philosophy, returns relative to objectives and investment risk as measured by asset concentration, exposure to extreme economic conditions, market volatility, and target allocations. SFERS' staff and consultant will monitor partnerships on an on-going basis. The portfolios of each vehicle will be analyzed in depth at least annually to ascertain consistency with the stated investment philosophy, objectives, asset allocation criteria, and the guidelines and restrictions set forth in this document. Interim internal rates of return for each investment as well as for the total AIP will be calculated on an on-going basis, and evaluated on a five-year horizon.

B. Program Evaluation. Due to the long-term nature of these asset classes, the progress of the total AIP should be evaluated over a minimum of five-year rolling periods, although the progress of the individual investment managers will be monitored at least annually.

C. Reports Provided by Managers. Each investment manager will provide SFERS' staff and consultant with quarterly reports in sufficient detail in order to assess performance of its investment in each entity. Specifically, each manager will provide performance information concerning investment, financial statements for the partnership, and a capital account statement for SFERS. Each manager shall report on a timely basis, all material developments in the portfolio, including but not limited to personnel changes, contractual problems or amendments, distribution issues and other items required for monitoring the AIP.

D. Performance Reporting. On a semi-annual basis, a performance report will be provided to the SFERS Board. Performance measurement will be based upon IRRs. The IRR is based on cash-on-cash returns with consideration for residual value of holdings, calculated net of management fees, expenses, and the general partners' share of carried interest, as contained in the manager's financial statements. The IRR calculation is cumulative, calculated quarterly, and shall serve as

the definitive measurement of a vehicle's performance. The performance of each investment vehicle will be compared against the performance of comparable investments.

E. Cash Flow Projections. On an annual basis, the AIP and its cash flows will be reviewed for the purposes of evaluating target allocations and the upcoming year's commitment level.

F. Monitoring and Evaluation Responsibility. Due to the time-intensive nature of the AIP, staff and consultant will work closely to ensure there are sufficient resources to oversee the planning, implementation, and monitoring of the AIP.

G. Performance. Performance measurement reports will be the responsibility of the consultant in conjunction with the Staff.

H. Review of Investment Objectives, Policy and Guidelines. The Statement of Investment Objectives, Policy and Guidelines will be reviewed at least annually, in order to determine whether there is continued applicability. Changes in policy will be incorporated into revisions to this document.

Appendix A

SFERS – AIP SECONDARY PROGRAM

SFERS' Secondary Program has become an integral part of the Annual Investment Plan and it is reviewed annually by the consultant, SFERS' staff, and approved by the Board.

The Secondary Market - Background

Commitments to private equity funds have grown dramatically during the past decade with close to $1 trillion of capital committed since 1990 and more than 90% of that total having been raised between 1996 and 2007. The size and number of commitments to private equity funds have created a large base of investors that may not be willing or able to hold these illiquid positions to maturity. Early liquidity needs and changes in strategy on the part of some of these investors have led to an increasing volume of secondary activity that is expected to approximate $4 to $5 billion annually for the foreseeable future. The recent economic crisis and illiquidity in the markets have impacted secondary activity.

As the private equity industry matures and grows, institutional investors are increasingly aware of the opportunity to more actively manage their existing portfolios of private equity investments. Some institutions look to rebalance their private exposure, eliminate mature, smaller partnership interests, reduce the number of holdings being administered, generate liquidity, or adjust the risk profile of a portfolio. The awareness among investors that the secondary market provides a viable solution to these needs is rapidly expanding. As a result, an increasing number of institutions are pursuing opportunities to acquire and sell secondary interests in private equity funds.

SFERS' Secondary Purchase Program

The purchase of existing limited partnership interests in the secondary market has become an effective tool in the management of institutional alternative investment programs. The main objective of SFERS' Secondary Purchase Program is to strategically and tactically increase investment exposure to certain existing fund managers in SFERS' AIP with the goal of improving the long term economic returns of the program. Secondary investments would typically consist of acquiring an interest in a private equity limited partnership from an existing investor that is looking to gain liquidity prior to the full term of the partnership. Attractive secondary purchases provide numerous benefits, such as:

- Investing in an existing portfolio, not a blind pool;
- More mature funds have shorter average holding periods due to nearer term realizations;
- Ability to strategically and tactically manage a portfolio's diversification; and
- Possibility of purchasing assets at a discount to current carrying value and a further discount to fair market value.

The increasing supply and broadening access to secondaries has enabled many institutional investors to successfully move beyond the traditional buy and hold mind set and begin to actively manage their portfolios through the acquisition of secondary partnership interests.

Purchase Program – Recommended Investment Guidelines

- All investments must meet SFERS' AIP Objectives.
- Investments would be considered only in funds managed by existing managers. Investments in attractive secondaries of new managers may be considered in later phases of the Secondary Purchase Program.
- All investments must fit within SFERS' investment sectors.
- Both mature secondaries, funds with more than 50% of capital funded, as well as hybrid secondaries, funds with less than 50% of capital funded, would be considered
- Investments would opportunistically focus on single Limited Partnership interests, rather than broad portfolios of multiple interests.
- Staff would have authority to acquire secondary interests in existing partnerships at or below the capital account value, or, where appropriate, at modest premiums to capital account value. Board approval would be required for investments at a significant premium to the capital account.
- Any single fund investment would be no more than $20 million in purchase value, which includes the purchase price plus any remaining unfunded commitment.
- Limit maximum exposure (existing investment plus secondary purchase) to not greater than 10% in limited partnership interest of a single fund and no single partnership investment can constitute more than 5% of SFERS' total AIP adjusted reported value partnership holdings at the time of purchase. Limit maximum exposure (adjusted reported value plus any remaining unfunded commitment) to any sponsor such that the aggregate investment with any sponsor across multiple funds is not greater than 10% of SFERS' total AIP adjusted reported value partnership holdings at the time of purchase.

Percentage of Annual Allocation

SFERS' staff and consultant recommend that secondary investments represent up to 20% of SFERS' annual investment allocation. Additionally, any proceeds from the sale of partnership interests through the secondary sale program would be available for reinvestment in secondary interests.

Purchase Program - Investment Process

SFERS' staff in conjunction with the consultant would implement the Secondary Purchase Program through the following process:

Sourcing: Secondary investment opportunities would be sourced directly from General Partners and Limited Partners of private equity funds where SFERS has existing exposure. Opportunities may also be sourced through secondary managers and intermediaries.

Screening: Investments would be considered in existing partnerships that provide strategic and/or tactical benefits to the overall AIP. This includes partnerships that have the potential to enhance returns and/or help manage sector exposure for SFERS' AIP.

Evaluating: Secondary opportunities that fall within the Secondary Purchase Program's guidelines would be evaluated to determine if a full valuation analysis should be conducted. Those that meet the criteria of enhancing potential returns and/or helping manage sector exposure will be analyzed and valued by the consultant and SFERS' staff. A deal by deal valuation analysis will be conducted to estimate the Fair Market Value of the partnership and provide negotiation strategies - including a bidding range.

Offer and Negotiation: If a secondary opportunity meets all of SFERS' AIP objectives and the guidelines of the Secondary Program, SFERS' staff, supported by the consultant, will have discretion to make an offer, negotiate a final price and execute transfer documents on behalf of SFERS. Since the purchase of specific partnership interests are unique to SFERS, to the extent negotiations of terms and contracts require legal counsel, outside legal counsel would need to be retained and paid for by SFERS.

Reporting: Staff's semi-annual update report to the Board will include a summary of completed secondary transactions. The information provided will include: Fund Name, Vintage Year, Fund Type, Commitment Amount, Date of Transfer, and NAV.

Monitoring: Secondary investments would be monitored along with all AIP investments. Investments would be placed in the appropriate Sector of the AIP based on the investment strategy of the fund. The consultant, through the use of the PRIVILEGe system, has the flexibility to report performance of all secondary investments as a separate grouping to track the specific performance of the Secondary Purchase Program.

SFERS' Secondary Sale Program

Though the potential disposition of existing limited partnership interests in the secondary market can be a complicated process, it can be an effective tool in strategically and tactically managing SFERS' AIP. Selling certain interests in SFERS' AIP can serve to:

- Eliminate lower-impact holdings including mature and non-strategic assets;
- Reduce the number of holdings in the portfolio;
- Provide added liquidity to recycle capital into new private equity investments; and
- Adjust the risk profile of the portfolio by adjusting the asset mix.

The buyer's market today is made up of a growing number of funds and institutions that are interested in acquiring limited partnership interests. Industry estimates indicate that there are more than 225 buyers in the market ranging from other institutions to specialized secondary funds.

Ten of the largest secondary firms collectively have close to $30 billion in assets under management. Because of their size, these firms are able to look for larger transactions made up of portfolios of partnership interests. Sellers looking to sell single interests or smaller portfolios would receive interest from these large players, but also can expect to receive significant interest from outside this group. The top ten secondary firms are currently receiving more deal flow than they have capital available and are experiencing a "buyers market." This allows them to choose deals more selectively and to negotiate attractive purchase discounts. The broader buyer's market also looks to acquire assets at a discount;

however, certain quality partnerships would sell for par (net asset value as reported by the general partner) and a growing number at a premium to net asset value. If sellers do not shop an interest broadly, they would likely receive offers at a discount to the current net asset value.

The secondary sale process is inefficient and resource intensive and often favors the buyer. The best defense against this potentially uneven playing field is for SFERS is to be opportunistic and patient.

Sale Program – Recommended Disposition Guidelines

- All sales must provide strategic, tactical and/or economic benefits that assist SFERS' in meeting the AIP Objectives.

- The program would consider selling non-impact holdings that include both mature secondaries, funds with more than 50% of capital funded, as well as hybrid secondaries, funds with less than 50% of capital funded.
  - *Non-impact* determinations will fall under the following criteria:
    - *Poor Performing*: Poor performing assets that have little to no potential to materially improve the future performance of SFERS' AIP
    - *Tail Ends*: Mature assets that have provided a significant portion of their potential performance, whether attractive or poor, and the remainder of the assets have little to no potential to materially improve the future performance of SFERS' AIP. These assets will typically have little value remaining in the capital account and/or few holdings remaining in the fund.
    - *Non-strategic*: Assets that have an investment focus that is no longer a strategic part of SFERS' investment objectives and there is little to no potential to materially improve the future performance of SFERS' AIP.

- The sale program would opportunistically consider the sale of single Limited Partnership interests as well as portfolios of interests. Portfolio sales will be considered when the aggregated benefit to the AIP is more attractive than individual dispositions.

- Approving the disposition of portfolio assets within SFERS' disposition guidelines:
  - SFERS' Board will pre-approve the sale of an unspecified pool of funds that together would aggregate to a certain dollar amount (the consultant recommends the initial amount be $30 million). Staff would then have discretion within the guidelines of the Secondary Sale Program to dispose of assets up to the established dollar amount. Once the pool has been fully disposed, staff would make a progress report to the Investment Committee and the Board. The Board would then make a determination if another pool should be pre-approved.

Sale Program – Disposition Process

SFERS' staff, in conjunction with the consultant, would implement the Secondary Sales Program through the following process:

Identify assets for disposition – Analysis of AIP's investments would be conducted annually to determine if any assets are appropriate to introduce to the secondary market for potential sale and whether the resources are available to conduct a disposition process over the following year. The assessment would be done based on the non-impact criteria noted above.

Analysis of individual partnerships: The next step in the process is to gather information on each fund and the underlying portfolio companies for analysis. Further due diligence will be conducted with the general partner to estimate the fair market value of the underlying holdings. Discussions with the general partner to determine transferability of each partnership interest will also occur. The result of the analysis will be a determination of the desired value range for the portfolio of assets.

Coordinating offers: At this stage third party market makers should be contacted to evaluate the marketability of the portfolio and offer their own value assessment. The consultant recommends that more than one market maker be interviewed to ensure best execution. The preliminary pricing expectations should be compared to SFERS' valuation range and a determination will be made on whether the process should continue and a market maker hired. At this stage, consideration will also be given to the attractiveness of the portfolio mix and make-up. Adjustments may be made to improve marketability. Examples of possible adjustments would be to add more attractive assets to peak buyer interests or to expand the portfolio's size to appeal to potentially larger buyers.

Facilitating due diligence: Once SFERS, the consultant and the market maker agree on the partnerships to be sold, the market maker will organize due diligence material, screen potential buyers and solicit bids. The market maker will provide potential buyers with access to pertinent information and data within a defined time frame with the objective of maximizing SFERS' value.

Negotiations: At the end of the defined due diligence time frame, final terms and prices will be collected and a preferred buyer will be selected to begin negotiating transfer and purchase/sale agreements. If the value does not meet SFERS' expectations, the process may be halted.

Since the sale of specific partnership interests are unique to SFERS, to the extent negotiations of terms and contracts require legal counsel, outside legal counsel may need to be retained and paid for by the market maker or SFERS.

Approval: Staff has discretion within the established guidelines of the disposition program to finalize terms and pricing and execute the transaction.

Completing transfer process: Final legal documents will be reviewed and executed and the transaction closed.

Reporting: Once this pool of assets has been fully disposed, staff would make a progress report to the Investment Committee and/or the Board. The report will include a summary of the completed secondary transactions. The information provided will include: Fund Names, Vintage Years, Fund Types, Commitment Amounts, Dates of Transfer, the aggregate GP reported NAV, the aggregate estimated FMV and the aggregate sale value.

SFERS – AIP SECONDARY PROGRAM - Appendix B

Examples that meet the disposition criteria

Poor Performance:
Seasoned partnerships that are under-performing the Venture Economics median return for the funds vintage year and fund type would be reviewed in consideration of including them in a portfolio of funds for disposition.

Tail Ends:
Seasoned partnerships where the adjusted reported value is less than 20% of the original commitment would be reviewed in consideration of including them in a portfolio of funds for disposition.

Non-Strategic
Partnerships that are through sponsors not likely to be core relationships in the future based on non-core strategic focus, organizationally stability, sector performance or other reasons would be reviewed in consideration of including them in a portfolio of funds for disposition.

Appendix B

SFERS – AIP INVESTMENT QUESTIONNAIRE

I. Organization

1. **Please provide the following information for the sponsor's main office as well as all branch offices, if any:**

   Address:
   Phone:
   Fax:
   E-mail:
   Website:

2. **Fill in the following general fund information:**

   Legal name of fund:

   Name of general partner and/or investment sponsor:

   Legal structure of fund:

   Date and jurisdiction of fund formation:

3. **General Partner/Fund Sponsor General Information:**

   Full legal name of the general partner:

   Legal structure of the general partner:

   Date and jurisdiction of the general partner's formation:

4. **Name of all placement agents with their compensation structure. Is there any affiliation between the general partner and a placement agent? If so, describe.**

II. General Partner Structure and Background

5. What is the current structure of the firm? Please include employees at all levels.

6. What is the ownership structure of the general partner entity? (Include percentage ownership.)

7. How are the fees and carried interests allocated among the principals and others? Please be specific. How is this split determined? What provisions are in place to promote the retention of principals, and change allocations over time?

8. What, if any, are the carried interests and ownership interests in the General Partner or Management Company held by individuals or business entities not employed by the firm?

9. What is the firm's compensation structure? What are the vesting provisions? Are there vesting provisions for future general partner additions?

10. What is the general partner's capital commitment to the fund? What is the amount committed by each participant in the general partner? What is the source for each contributor's funds?

11. Please provide a detailed three year budget for the general partner.

12. Please describe the firm's professional turnover for the last five years, citing reasons for each departure and contacts for departed partners.

13. Are any new hires expected in the near term? Please explain at what level these new hires are expected, and their anticipated compensation (salary, bonus, participation in carried interest).

14. What is the decision-making process internally among the principals for (i) internal matters, (ii) new partners, and (iii) partnership operations and management decisions?

15. Does the firm have a succession plan in place? If so, please describe.

16. Who are the principals of the general partner? How long has each of the principals been a participant of the general partner?

17. Please complete the following table which addresses the principals' relationship with each other prior to becoming principals of the general partner.

Principals	Number of Years Worked Together Prior to Forming General Partner	Nature of Relationship

18. Identify all prior funds each principal has been involved with in any capacity. What is the status of those funds, and how much of the principals' time is committed to each fund?

19. Do any of the principals have any conflicts of interest with the current fund?

20. Is the firm or any of its principals involved in, or a partner in, any other businesses outside of the firm's activities? Please describe.

21. Has the firm or any of its principals (including former principals) ever been involved in <u>any</u> litigation? Please describe. Are any cases still open or pending? Please have each principal complete the <u>Litigation Questionnaire</u> attached as Schedule A.

22. Do any of the principals have <u>any</u> health or personal issues that should be of concern? Please explain.

III. General Partner Qualifications

23. Please provide seven (7) references for each principal. Include, at a minimum, references from investors, co-investors, management representatives and consultants.

24. Please provide the internal rate of return (IRR) of all prior funds which the firm has managed. Be sure to show gross and net returns for each individual fund and in the aggregate for all funds. Also, provide returns for realized and unrealized investments for each fund and in the aggregate.

25. Please provide cash flows for each previous fund, with each cash event labeled by date and investment.

26. For each principal of the general partner, please provide the following information for every investment considered a part of that individual's investment record.

Name of Investment	$'s Invested and Date of Investment	Individual(s) Responsible for Sourcing Deal	Individual(s) Responsible for Monitoring	Individual(s) Responsible for Exit	Total Value Realized from Investment and Date of Realization	IRR

27. Please identify each principal's area of expertise. Identify the number of years each principal has worked in his/her area of expertise.

28. Please complete the attached table regarding board memberships.

Name of Principal	Current Board Memberships	Prior Board Memberships

29. How many board seats will each principal be expected to hold for this fund? How does this compare to prior funds?

30. **Using the table below, identify the amount of time (in percentages) that each principal will dedicate to each role for this fund.**

Name of Principal	a	b	c	d	e	f	g	h	Total

a. generating deal flow; b. reviewing opportunities; c. conducting due diligence; d. negotiating and structuring; e. administrative/other internal activities; f. outside activities; g. monitoring portfolio investments in prior funds; h. monitoring portfolio investments in current fund.

31. **How does the investment committee for the fund operate? How are decisions made? Is consensus required from each partner, or is a simple majority sufficient?**

32. **How often do the principals meet as a group? Are meetings typically held in person or telephonically? What forum do the principals use for information and idea sharing?**

33. **What is the investment capacity for the firm with its current structure and staff?**

34. **What is the average number of opportunities reviewed by the firm annually?**

35. **Has the general partner warehoused or otherwise specified or targeted any deals for this fund? If so, please provide information on all such deals.**

36. **What are the proposed funds' investment strategy(s) and objectives? What is the anticipated investment range in terms of size for the fund's investments? Are these the same as the objectives, strategies, and average size implemented in prior funds? If not, explain the differences.**

37. **What is the targeted rate of return for the fund? Please provide both gross and net return targets. Why does the general partner feel such returns are achievable?**

38. **Who are the firm's competitors? Which are currently viewed by the general partner as the leading firm(s), and why?**

39. **How do you differentiate your fund from competitive funds?**

40. **To what extent are outside consultants used for due diligence and monitoring of portfolio investments? Please list consultants used over the last three years and the nature of their engagement with the firm.**

41. **What outside resources and strategic relationships does the general partner rely on?**

42. **Will the partnership participate in hostile investments?**

43. **What restrictions are proposed for starting new partnerships?**

44. **What are the firm's documentation procedures? Please attach a sample of each of the following documents: due diligence checklist, deal log, a typical investment term sheet that you would use, and a summary investment memorandum.**

45. **What is the firm's valuation policy and methodology?**

46. **Is the firm AIMR compliant?**

47. **Is the partnership permitted to re-invest proceeds? What rules govern those re-investments?**

48. **What is the fund's approach to UBTI related investments?**

IV. Limited Partners

49. Please complete the following table for all limited partners, for the current fund and all prior funds.

Limited Partner	ERISA (Y/N)	Contact Name/Phone	Name of funds committed to	Commitment amounts	Commitment to this fund or explanation for opting out of this or future funds

50. Have you entered into any side letter agreements or other arrangements with any limited partners? Do you anticipate doing so prior to or at the final closing? Are there any 'most favored nations' provisions? Are there 'special' limited partners or limited partners who also have investments in, or special rights from, the general partner or manager?

51. Does the fund currently have or expect to receive commitments from any "strategic" limited partners? What are the expectations of these LP(s)' investment(s) in this fund?

52. What co-investment rights are afforded the limited partners of the fund? What about GP co-investment rights?

V. Legal and Accounting

53. **Who is the partnership's legal counsel? Who is the general partner's legal counsel? How does counsel address conflicts between the partnership and the general partner?**

54. **Which firm will audit the partnership at year-end? Provide copies of the last four quarterly reports and the last three years' audited year-end financials for your prior fund. Also include any investor communications distributed during that period.**

55. **Please provide contact names with addresses and phone numbers for all legal counsel and the accounting firms the sponsor has engaged over the past 5 years. Please provide a brief description of the nature of the engagement.**

VI. Principal and Key Personnel Profile

Please complete this page for each principal and all key personnel who will be involved directly or indirectly in the partnership.

1. **Name:**
2. **Home address:**
3. **Home phone:**
4. **Date of birth:**
5. **Do you have any health issues that may impair your ability to perform your responsibilities as they relate to the partnership?**
6. **What professional licenses, if any, do you hold?**
7. **Please attach a detailed biography for each of the principals. Include complete month and year employment information for the last 10 years.**

END OF QUESTIONNAIRE

SCHEDULE A
SFERS' LITIGATION QUESTIONNAIRE
(To be completed by each individual General Partner)

RESPONDENT NAME: _____

INVESTMENT PROPOSAL NAME: _____

Note: Please provide details of any "Yes" answers on a separate sheet.

1. Are you now, or have you ever been, a party to any criminal action or civil action involving a claim of more than $250,000?

   Yes_____ No_____

2. Has any organization of which you have been a member of senior management, or in which you have had a meaningful ownership interest (greater than 5%), ever been a named defendant in any criminal action or civil action involving a claim of greater than $500,000?

   Yes_____ No_____

3. Have you or any organization in which you have had a meaningful ownership interest (greater than 5%), or of which you are, or were, a member of senior management ever filed voluntarily, or had filed against you involuntarily, a bankruptcy petition?

   Yes_____ No_____

4. Has any licensor, franchisor, or master distributor ever initiated proceedings to terminate a business relationship with you or any organization of which you have ever been a member of senior management?

   Yes_____ No_____

5. Has any business partner, joint venture, or subcontractor ever sought injunctive relief or arbitration to terminate any business or contractual relationship?

   Yes_____ No_____

6. Are you aware of any prospective litigation to be filed in which you, your firm or any principal in your firm will be a party?

   Yes_____ No_____

Date:_____ _____
Signature

Tab 5

San Francisco City and County Employees' Retirement System

Alternative Investment Program

Annual Investment Plan
For
Calendar Year 2013

Presented
December 12, 2012

Prepared
By

Portfolio Advisors, LLC

Confidential

Table of Contents

Annual Investment Plan Period: January 1, 2013 through December 31, 2013

I. EXECUTIVE SUMMARY

The San Francisco Employees' Retirement System's ("SFERS" or the "Trust") Annual Investment Plan (the "Plan") is intended to address the investment pace and strategy for the Alternative Investment Program (the "AIP" or the "Portfolio") in calendar year 2013. Overall, the AIP is a large, mature and well-diversified portfolio that is within the established ranges but below the allocation targets for each portfolio sector (Buyout, Venture Capital and Special Situations). The Portfolio's current investments and unfunded commitments will provide exposure to these various sectors over the next three to five years. **The recommended investment pace in calendar year 2013 is $375 million with a range of $325 million to $425 million**.

In order to accomplish this goal, four key strategies will be employed in 2013. These strategies are not mutually exclusive:

- **New investments with existing managers.** As detailed in this Annual Investment Plan, some of SFERS' existing managers will be raising new funds in the upcoming year. Portfolio Advisors and SFERS' staff will identify the quality managers with whom to maintain relationships. These re-ups are expected to account for a significant portion of the 2013 annual allocation (*page 16*).

- **Emerging managers**. Portfolio Advisors and SFERS' staff will continue to opportunistically review funds being raised by emerging managers. This initiative will target quality next generation funds that meet the return and diversification objectives outlined in the AIP Objectives, Policies and Procedures ("OPP") document.

- **Secondaries.** Portfolio Advisors and SFERS' staff will continue to implement the Secondary Investment Program allowing SFERS to strategically and tactically add new funds or sell existing funds from the Portfolio within the guidelines approved by the Board (*page 18).*

- **New relationships.** Portfolio Advisors and SFERS' staff will continue to identify experienced managers that SFERS does not currently have an investment with to enhance the Portfolio (*page 13*). These new relationships will emphasize:

    - Small/Middle Market Buyouts
    - Venture Capital
    - International

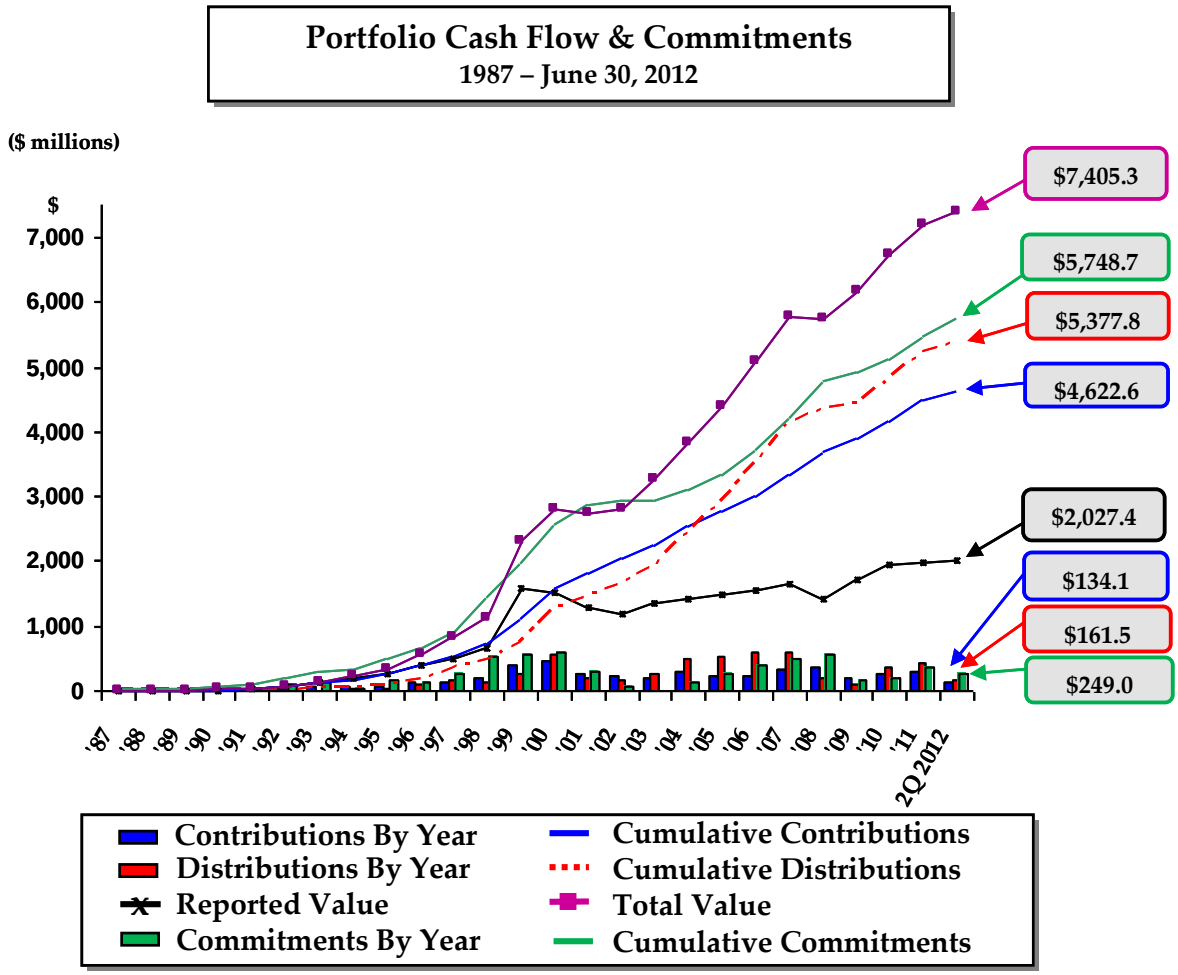
The aforementioned strategies are explained in greater detail below.

II. ASSET ALLOCATION LEVELS

A. Current Funding Position – as of June 30, 2012

Total SFERS Fund Value:	$15.3 billion
% Target for Alternatives:	16.0%[1]
Total Alternatives Allocation:	$2.4 billion
Portfolio Adjusted Reported Value:	$2.0 billion
Current Adjusted Reported Value Deficit/(Surplus):	$400 million
Amount Targeted for New Commitments in the 2013 Investment Plan Period:	**$375 million** (+/-$50 million)

As of June 30, 2012, SFERS allocation to the AIP was approximately 13.3% of the overall pension fund market value[2], placing the allocation below its long term target of 16% and within the authorized range of 12% to 20%. The following graph summarizes the 25 year history of the AIP from a cash flow and commitment perspective through June 30, 2012.



Since the inception of the Portfolio in 1987, AIP has committed $5.75 billion of capital, contributed $4.6 billion and received distributions of $5.4 billion. As of June 30, 2012 the reported value is $2.0 billion and there is $1.2 billion in unfunded commitments representing 20.9% of the original $5.75

[1] Effective 10/1/2011, the allocation to alternative investments was increased from 14% to 16% of total plan assets.
[2] Assumes a pension fund market value of $**15.3** billion as of 6/30/12.

billion in committed capital. New commitments approved during the 1st half of calendar year 2012 represent $158 million and are included in the $1.2 billion of unfunded capital.

B. Projected Funding Position[3]

Five Year Projected Funded Market Value at 2018	
Total SFERS Fund Market Value[4]:	$22.2 billion
% Target for Alternatives:	16%
Total Alternatives Allocation:	$3.6 billion
Amount Targeted for New Commitments over the next five years of the AIP:	$1.5 to 2.0 billion

The following chart provides a closer look at SFERS' cumulative pace of commitments and contributions to the AIP over the past ten years. Specifically, the chart shows that the historical dollar amount of the unfunded capital (capital which has been committed to the asset class, but has not been called down for investment) has been within a range of approximately $600 million to $1.2 billion and has remained fairly steady over the past three years. This trend reflects the maturity of SFERS' program whereby capital drawn and invested is being replaced by new partnership commitments. More than 50% of unfunded capital is concentrated in funds committed to from 2008 to 2012. Many of these managers were prudent in not deploying capital and have held significant reserves to support existing investments. As these funds reach the end of their investment periods, some will extend (their investment period), but Portfolio Advisors expects that a portion of this capital will not be drawn. There is also approximately $246 million of unfunded capital from funds prior to 2008 and the expectation is that a portion of this capital will also not be drawn. The level of unfunded commitments is expected to decline as private equity investment activity increases and certain managers release unfunded commitments. SFERS should be aware that as new commitments are added to the Portfolio, they typically have a performance "J-curve"[5] which can diminish interim net returns earned by the AIP.

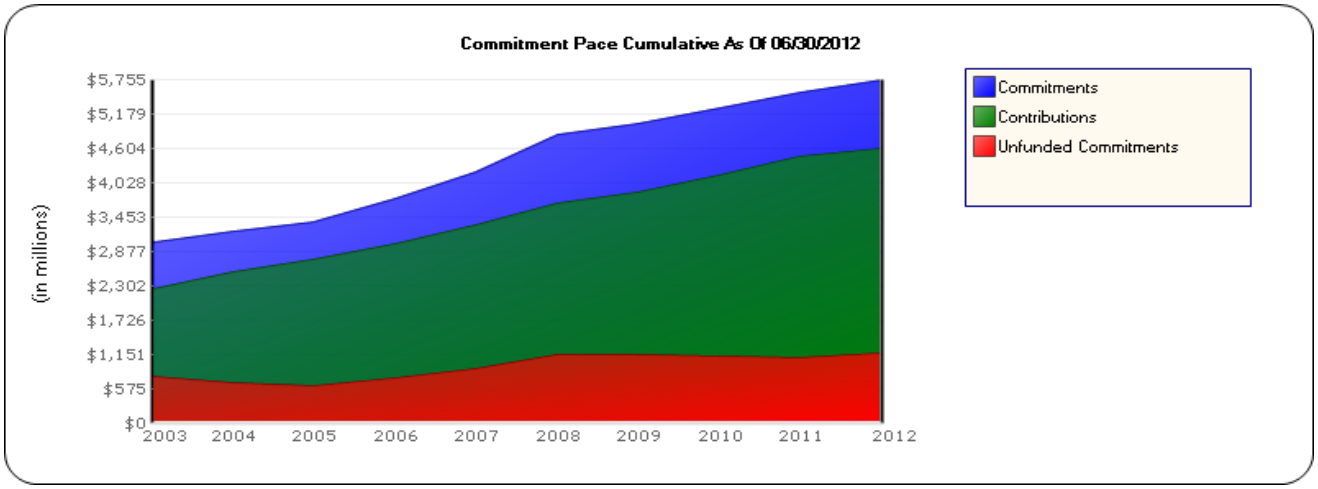


Chart Source: PRIVILEGe

[3] Source: Portfolio Advisors investment pacing model. Summary provided as Appendix A.
[4] Assumes a 7.75% growth rate on total assets under management.
[5] Alternative investments typically follow a "J-curve" pattern of exhibiting negative returns during the early years of a fund's lifecycle as management fees are not yet offset by increases in portfolio valuations. Returns will typically turn positive in year three or four as each fund investment matures and successful portfolio companies emerge.

The following chart illustrates the impact on the Portfolio of the liquidity experienced between 2003 and 2007, the contraction in 2008 and 2009 and the 2010-2012 recovery in the private equity markets. SFERS' cumulative distributions from AIP continue to be higher than cumulative contributions.

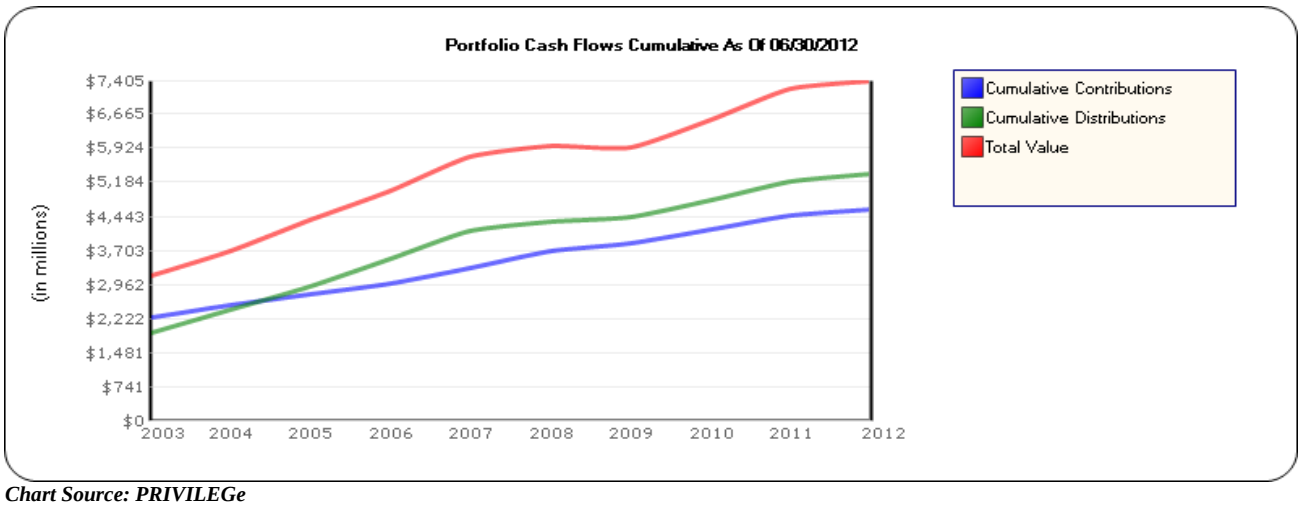


Chart Source: PRIVILEGe

To continue to grow SFERS' exposure to private equity in the future, **Portfolio Advisors recommends a commitment pace of $375 million per year with a target of 10 to 14 commitments in 2013**. Individual partnership commitments should range in size between $10 million to $40 million. Smaller commitments of $10 million to $20 million will be reserved for emerging mangers and first time funds as well as attractive venture capital funds with limited allocations. Commitments of $20 million to $30 million will be reserved for new and existing proven managers and a larger commitment size of $30 million to $40 million should be reserved for top ranked existing managers that have performed well for the Retirement System. The size and distribution of commitments, however, will be driven by the opportunities available in the market.

C. Funding by Strategy Analysis Table – as of June 30, 2012

The table below classifies SFERS' private equity portfolio into the three major categories outlined in the AIP OPP[6]. International investments are classified according to their underlying investment strategies.

($ Millions) Portfolio Strategy	# of Funds	Mid-Range Targets	NAV $ Target(1)	Existing Commitments	Undrawn Commitments	Reported Value	Target Variance(2)
Venture Capital	**99**	**30.0%**	**$734**	**$1,972**	**$394**	**$571**	**$163**
Seed/Early	39	10.0%	$245	$741	$156	$208	$37
Late/Expansion	25	10.0%	$245	$529	$99	$194	$51
Balanced	35	10.0%	$245	$702	$139	$170	$75
Buyouts/Corp. Fin	**113**	**50.0%**	**$1,224**	**$2,770**	**$587**	**$977**	**$247**
Small/Mid Mkt	56	25.0%	$612	$1,236	$371	$457	$155
Large	57	25.0%	$612	$1,534	$216	$520	$92
Special Situations	**49**	**20.0%**	**$490**	**$1,007**	**$188**	**$480**	**$10**
Totals	**261**	**100%**	**$2,448**	**$5,749**	**$1,169**	**$2,027**	**$421**

(1) Per Total Alternatives Allocation – Section II. A
(2) Variance is the difference between NAV $ Target and current Reported Value

[6] Alternative Investments Program Objectives, Policies and Procedures.

D. Accomplishments in 2012

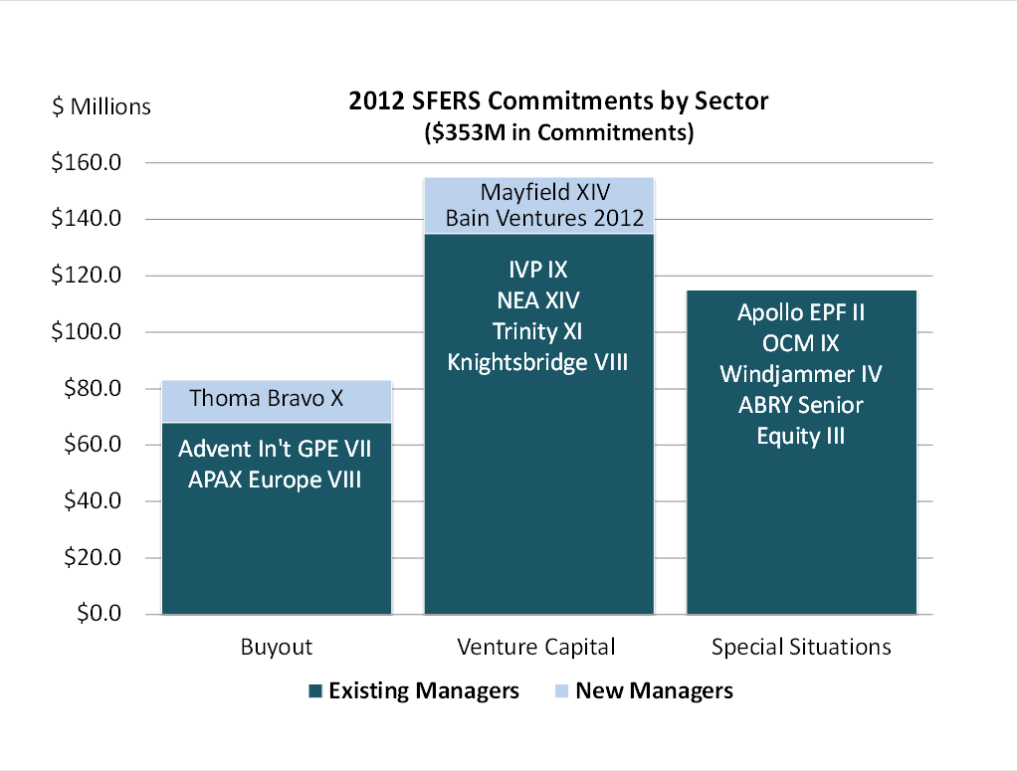
SFERS has executed well against the three central initiatives set out in the 2012 Annual Investment Plan. Those initiatives were:

- Review all reinvestment opportunities and select quality managers
- Add select new managers to the Portfolio with a tactical emphasis on venture relationships, middle market buyouts and international
- Opportunistically review emerging managers and select new high quality opportunities

SFERS' target commitment pace for 2012 was $350 million with a range of $300 million to $400 million. SFERS' commitments for the year totaled approximately $373 million, representing 10 new partnerships with existing managers and 3 new managers introduced to the Portfolio. In total, six out of thirteen commitments in 2012 were made to venture capital funds.

The chart below lists the commitments approved by the Board for 2012 through November.

	Partnership	**SFERS' Commitment (USD $ millions)**	**Sector**
1	Thoma Bravo X *(new)*	15	Buyout – Sm/Mid Market
2	Bain Ventures 2012 *(new)*	10	Venture Capital - Balanced
3	Apollo EPF II	25	Special Situations
4	OCM IX	30	Special Situations
5	Windjammer IV	30	Special Situations
6	IVP IX	30	Venture Capital -Late Stage
7	Mayfield XIV *(new)*	10	Venture Capital - Early Stage
8	NEA XIV	20	Venture Capital - Balance
9	Advent In't GPE VII	38	Buyout – Sm/Mid Market
10	Trinity XI	20	Venture Capital - Balance
11	APAX Europe VIII	30	Buyout – Large
12	Knightsbridge VIII	65	Venture Capital - Early Stage
13	ABRY Senior Equity III	30	Special Situations
	Total	**$353**	



Illustrated by the chart above, in 2012 SFERS selectively re-invested with high quality mangers and tactically added new managers to the Portfolio.

E. Comparison to Other Large Institutional Programs

Buyout funds worldwide continue to attract the largest share of private equity commitments among institutional investors. This is consistent with SFERS' target allocation.

It is important to note that large public pension plans have lowered their target exposure to venture capital. A significant factor in this statistic is that most large public plans continue to have difficulty accessing top tier venture capital funds. Consequently, many of these plans have not generated the returns commensurate with the risk taken in venture capital investing and have elected to reduce their target weighting to this sector. Others, like SFERS, have utilized strategic and tactical means of gaining access to top tier venture capital funds including investing in specialized fund-of-funds and opportunistically investing directly into top tier venture capital funds. Examples of these efforts within SFERS' program are the historical investments with Horsley Bridge, Knightsbridge and Weathergage. In recent years, SFERS has pro-actively pursued, built and maintained relationships with high quality venture firms resulting in recent opportunities to invest with DCM, Draper Fisher & Jurvetson, NEA, Sofinnova, Summit, Trinity Ventures, InterWest, IVP, TCV, Canaan Partners and Menlo Ventures. Portfolio Advisors and SFERS' staff will continue to maintain existing and foster new venture capital relationships in order to preserve and enhance SFERS' long-term exposure to this sector.

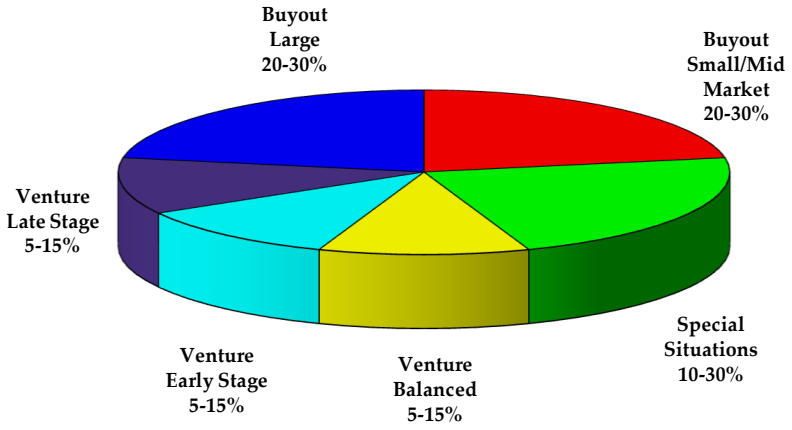
III. DIVERSIFICATION

A. Strategy

Proper diversification is necessary when investing in an asset class with a large disparity between the returns of top-quartile and lower-quartile performers. SFERS has implemented a program that has built a portfolio of quality fund investments diversified by investment strategies, managers, vintage years (time), geographies and industries. Going forward, SFERS' staff and Portfolio Advisors will continue participating with high-quality funds capable of producing returns in the upper quartile of the private equity asset class and that meet the AIP's objectives as presented in the AIP OPP. Furthermore, SFERS' staff and Portfolio Advisors will seek to identify both emerging and established managers that have the experience and ability to produce attractive absolute and relative long-term returns through various economic conditions.

The Target Portfolio for SFERS' AIP is illustrated in the graph below.

Target Portfolio



The reasons for a range for each of the allocations are as follows:

- Commitments are made opportunistically, which at times will cause the Portfolio to appear over/under weighted in certain sectors
- Differences in the drawdown profiles between each of the sectors
- Differences in the performance and valuation standards between each of the sectors
- Differences in the realization profiles between each of the sectors

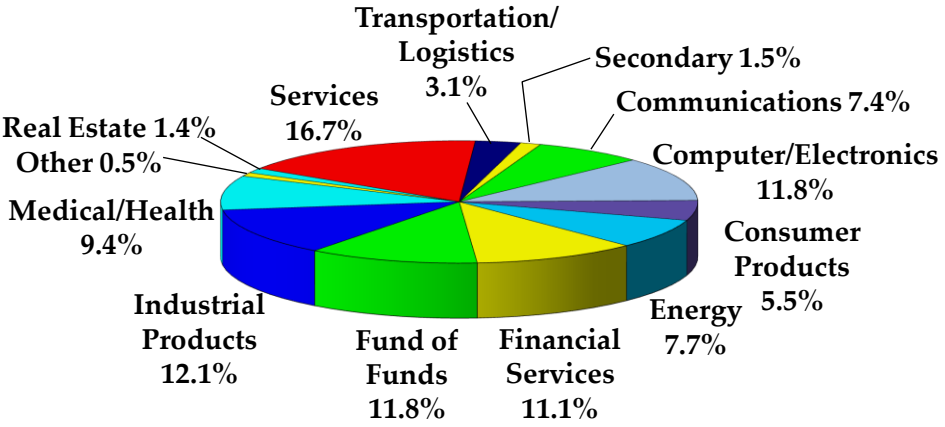
From the Portfolio's inception through June 30, 2012, SFERS has committed to 261 funds. In the aggregate, SFERS' portfolio has exposure to 107 separate fund managers that target investments in Venture Capital, Buyout and Special Situations globally. In addition, 11.8% of AIP's reported value is in fund-of-funds that provide additional diversification exposure to several hundred more funds. Looking ahead, the Portfolio's diversification will be driven by the following four events: (1) commitment pace, (2) capital invested by the fund managers, (3) valuation changes in underlying investments, and (4) exits from underlying investments. The interaction of these four factors will cause the diversification at any reporting date to differ from the target portfolio diversification that is presented in Section III "Stage of Investment".

B. Industry Diversification

Through its 261 fund commitments, SFERS' AIP currently has exposure to 2,932 underlying investments (of which fund-of-funds representing approximately $231 million of reported value). Portfolio Advisors estimates that SFERS has exposure to over seven thousand portfolio companies in total. The pie charts that follow illustrate the AIP's industry diversification as of June 30, 2012.

INVESTMENTS BY INDUSTRY

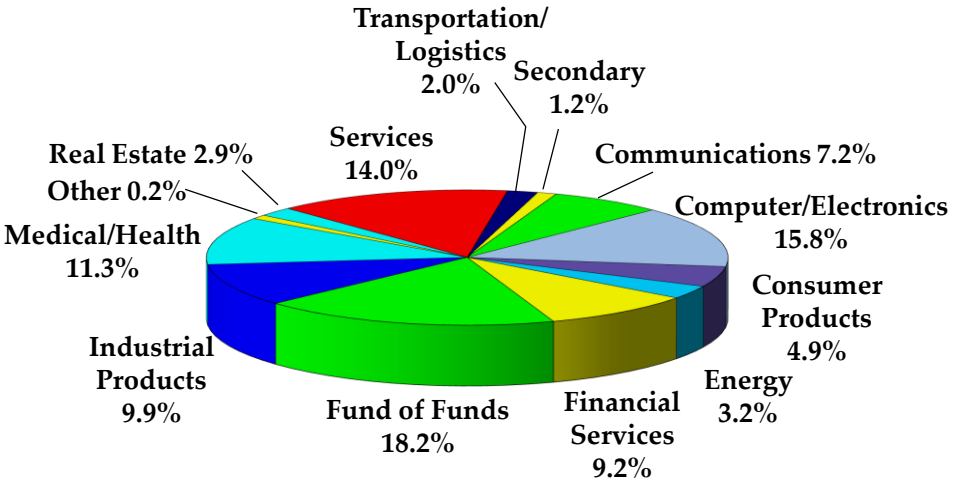
By Reported Value ($1.95 Billion) & By Number of Investments (2,932)



Reported Value

INVESTMENTS BY INDUSTRY

By Reported Value ($1.95 Billion) & By Number of Investments (2,932)



Number of Investments

SFERS' AIP portfolio continues to be well diversified across all major sectors in the economy with the largest exposure by reported value to business services 16.7%, industrial products 12.1%, followed by computer/electronics 11.8% and financial services 11.1%. SFERS' staff and Portfolio Advisors have determined that no material changes are needed.

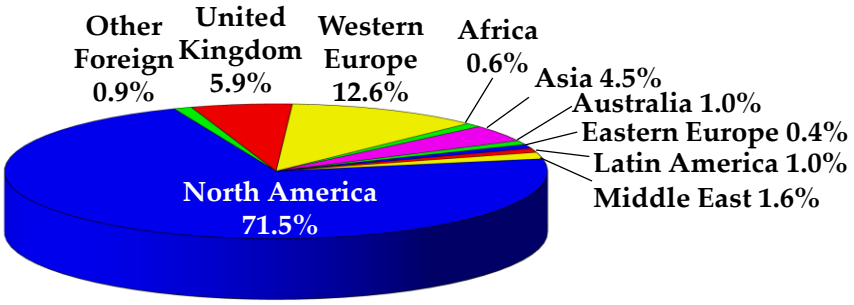
Specialization in certain industries can enhance a manager's ability to add value to its portfolio companies and reduce risk through the application of deep domain knowledge and operating expertise. Examples of these areas would be healthcare, financial services and energy. This can result in more attractive and potentially more consistent returns for limited partners. In these instances, specialized managers that meet SFERS' rigorous investment criteria will continue to be considered for the AIP.

C. Geographic Diversification

SFERS' AIP is primarily comprised of U.S. based companies; however, international investments represent approximately 28.5% of reported value. In aggregate, this is slightly below the 30% target but within the target allocation range of 20% - 40% of reported value as approved in the AIP OPP. Significant contributors to this exposure are the U.S. funds investing a portion of their funds outside of North America. The following pie charts illustrate the Portfolio's geographic diversification based on the underlying portfolio investments as of June 30, 2012.

INVESTMENTS BY REGION

By Reported Value ($1.95 Billion) & By Number of Investments (2,932)



Reported Value

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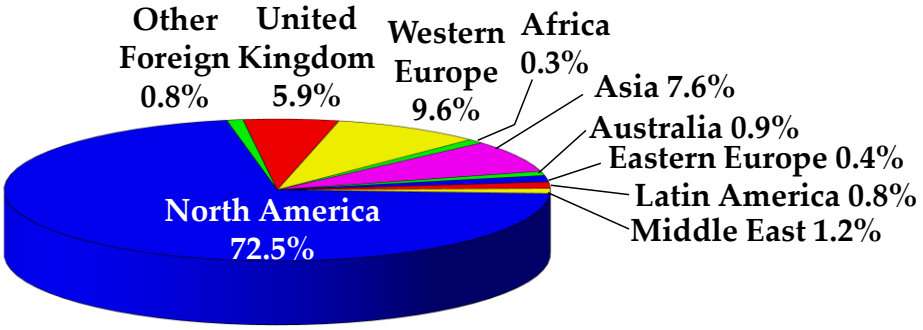
INVESTMENTS BY REGION

By Reported Value ($1.95 Billion) & By Number of Investments (2,932)



Number of Investments

The number of international investment opportunities for private equity investors has increased substantially over the last few years as private equity markets around the globe mature, introducing more transparency and consistent rules of law. However, in private equity, emerging market strategies have historically not provided the returns necessary to outweigh the higher risk exposure in these areas.

Portfolio Advisors recommends that SFERS maintain international exposure focus on the mature and maturing international private equity markets predominately in Europe and Asia.

Asia is a growing economy that is maturing and developing the infrastructure and expertise needed to foster attractive private equity risk adjusted returns. The long term prospects of investing in Asia continue to merit attention from both staff and consultant.

D. Stage of Investment

The target ranges for SFERS' AIP allocations, as approved in the AIP OPP, are illustrated in the chart below. When SFERS' unfunded commitments are added to the Reported Value, the following sectors remain below the AIP's target exposure but within the target range: Late Stage Venture, Balanced Venture and Large Cap Buyout. The chart below illustrates that SFERS should continue to emphasize high quality large cap buyout, late stage and balanced venture funds, while remaining opportunistic in selecting the highest quality funds.

Stage of Investment	6/30/12 Reported Value	6/30/12 Unfunded Commitments	6/30/12 RV + Unfunded	SFERS' Target Portfolio	
Sectors	%	%	%	Target	Target Range
Buyout/Corp Finance	48.17	50.29	48.94	50.0%	40%-60%
Large	**25.63**	**18.52**	**23.03**	**25.0%**	**20%-30%**
Small/Mid	**22.53**	**31.77**	**25.91**	**25.0%**	**20%-30%**
Venture	28.17	33.65	30.17	30.0%	20%-40%
Seed/Early	**10.25**	**13.36**	**11.39**	**10.0%**	**5%-15%**
Late/Expansion	**9.55**	**8.44**	**9.14**	**10.0%**	**5%-15%**
Balanced	**8.36**	**11.86**	**9.64**	**10.0%**	**5%-15%**
Special Situations	23.67	16.06	20.89	20.0%	10%-30%
Total	100.0%	100.0%	100.0%	100.0%	

E. Current Portfolio Strategies: Risk and Return

Private equity assets are attractive in institutional portfolios because they have historically generated high rates of return with a relatively low correlation to more traditional asset classes. Consistent long-term attractive returns can be achieved in private equity through careful investment selection, and the inherent risks can be minimized through reasonable stage, manager, vintage year (time), geographic and industry diversification.

SFERS' AIP is dedicated to providing long-term returns primarily through capital appreciation. The objective of the program is to create a portfolio of private equity investments that will provide consistent, long-term, risk-adjusted returns that exceed the public equity market returns by 500 basis points and provide a minimum return target of 15%. While venture capital and buyouts are expected to generate the highest returns in the Portfolio (> 18%), the lower risk strategies associated with special situations investments such as distressed debt, mezzanine and secondary fund-of-funds offer expected returns of at least 15% and add diversification, quicker return of capital and more predictable cash flows. It is important to note that the returns for each of the individual fund investments will typically follow a "J-curve" pattern of early negative returns as management fees are not offset by any increases in portfolio valuations. Returns typically will turn positive in year three or four as each fund investment matures and successful portfolio companies emerge. Below is a brief discussion of each of the categories.

1. Buyout (Target weighting 50% with a range of 40% to 60%):

Buyout funds acquire companies through the purchase of controlling interests of preferred and common equity. Transactions generally utilize some degree of leverage. Target companies are mostly established businesses in more mature industries. The typical holding period of a buyout investment is four to seven years. Exit strategies are less dependent on the public market and usually involve strategic sales. This reduced reliance on the public market allows for liquidity events to occur continually throughout the life of a fund. Buyout investments have lower overall business risk than venture investments; however, depending on the amount of leverage in the capital structure of the investment and general economic conditions, buyouts can have meaningful total risk.

2. Venture Capital (Target weighting 30% with a range of 20% to 40%):

Venture capital investing involves the financing of start-up, growth or expansion stage companies focused primarily on the information technology, healthcare and clean technology sectors. The holding period for most venture capital investments generally is longer than that of buyout investments because companies are in the early stages of the product life cycle, requiring multiple rounds of financing before achieving sufficient critical mass and a positive exit. Both strategic sales and the public market are used as the exit mechanisms for venture capital investments. Long-term returns in a diversified venture capital strategy are expected to meet or exceed SFERS' AIP objectives. The specific categories within venture capital are addressed below.

- Early-stage funds focus on creating new, entrepreneurial companies (usually within high growth sectors such as information technology and healthcare). Companies may be at the product idea stage or may be in the early stages of product development. Early-stage funds are generally considered to be the riskiest of the private equity investment strategies because the business, financing and technology risk surrounding this type of venture capital investing is extremely high. However, the corresponding rewards for success are also expected to be higher.

- Later-stage funds focus on companies that are experiencing rapid growth through the sale of more proven products. Capital is usually targeted at the last rounds of financing before a company's initial public offering. Later-stage investing is considered the least risky of the venture capital stages because the technology risk has been eliminated, company products are more proven and revenues are growing. Consequently, companies are better positioned to go public or to be sold to an industry buyer. Risk is associated more with valuation and timing considerations in later stage deals.

- Multi-stage or balanced funds invest across all of the venture capital stages. Firms take this barbell approach to minimize the effects of the "J-curve" and provide earlier liquidity to investors than would be the case with only early stage investments. Many times, a fund will be labeled based on its primary strategy as opposed to the ultimate makeup of the fund. For example, if the majority of a fund's capital has been invested in early stage investments, the fund will be labeled early stage, even though it may have a few later stage investments in the portfolio as well.

3. Special Situations (Target weighting 20% with a range of 10% to 30%):

Special Situations funds typically: (i) execute distressed debt trading strategies or invest in distressed principal transactions; (ii) invest in mezzanine securities; (iii) purchase diversified secondary interests; (iv) focus on specific industry niches such as commodity based oil and gas exploration; or (v) co-invest along side standard funds. Long-term returns in a diversified special situations strategy

are expected to meet or exceed SFERS' AIP objectives. The following is a brief description of several special situations strategies.

- Restructuring or Distressed Debt funds are part of the Special Situations Sector targeting investments in under-performing companies. A typical company may have filed for bankruptcy protection or be in the process of a reorganization. The targeted debt instruments are senior in the capital structure. Some managers seek to gain control of the bankruptcy or reorganization process so they have more influence on the ultimate outcome. Funds may also seek to arbitrage the value of the debt security with newly issued equity or to liquidate the value of the company through a negotiated workout. Distressed Debt trading strategies tend to be more cyclical than control strategies and therefore are not as attractive under all market conditions.

- Subordinated Debt or Mezzanine funds are characterized by lower risk, higher capitalization and cash flow-oriented assets. An investment is characterized by debt instruments with current pay cash coupons and warrants which allow the portfolio to share in the appreciation of the equity of the company. The securities are typically unsecured junior obligations.

- Secondary Fund Investments allow investors to gain the positive attributes of private equity investing while mitigating many of the risks. Listed below are several reasons why institutions invest in secondary funds:

    - From a portfolio management perspective, secondary fund investments reduce the length and severity of a portfolio's "J-curve."
    - Investing well into a partnership's life and analyzing its assets eliminates much of the uncertainty and risk associated with a "blind pool."
    - The market's illiquidity combined with the liquidity needs for the sellers often allows for a price discount from net asset value.
    - Buying into partnerships at a later stage results in a significant time discount, shortening the holding period and resulting in earlier distributions.
    - Buying into a series of mature funds provides immediate diversification across vintage years, industries and geography.

IV. PROSPECTIVE INVESTMENTS

A. Investment Objectives

Through calendar year 2013, the AIP will look for quality investments (both re-ups and new) in each sector of the program. Emphasis will be on select small/mid market buyouts, special situation and international investments. SFERS' venture capital investing in calendar year 2013 is expected to incorporate some re-ups to top quality managers. SFERS will also seek to opportunistically invest with new top quality venture managers. SFERS' small/middle market buyout investing will incorporate select new managers and a number of re-ups to top performing managers. Special situations will focus on top-quality distressed and mezzanine investment strategies with existing and new relationships for SFERS in addition to select secondary transactions.

1. Types: Strategies to receive foremost attention

a. Small/Middle Market Buyout/Corporate Finance:
While market conditions have meaningfully decreased the gross return of the Buyout sector, we still believe the Portfolio remains sound and expect it to perform well as the economy and public markets continue to stabilize and improve. Buyout fund managers with strong operating expertise are well suited to maximize value for their investors in these challenging

times. The breadth and depth of opportunities that will be created at lower values with less debt, especially in the middle market (broadly defined to include companies with between $50 million and $1 billion of enterprise value), will provide talented and focused buyout firms with clear, disciplined and differentiated strategies the opportunity to successfully invest their funds in buyouts, growth financings and industry consolidation/roll-up opportunities.

b. Venture Capital:
A judicious mix of both early, multi and later stage venture capital funds invested across a spectrum of rapidly growing and emerging industries, while diversifying risk over multiple sectors, technologies, market cycles and managers, is prudent in achieving attractive returns without excessive risk. The long term prospect for early stage venture capital is improving but continues to be subject to multiple market cycles. With a finite number of high quality opportunities and changing market demand from institutional investors, 2013 may provide opportunities to selectively establish relationships with and gain access to premium groups. SFERS' staff and consultant will continue to proactively build and maintain long-term relations in the venture arena and continue to evaluate and leverage strategic and tactical means of investing with the very best managers.

c. Special Situations:
Given recent capital markets events, Portfolio Advisors recommends investing in premier groups with flexible mandates that can take advantage of market dislocations and invest in the best assets, industries and geographies at an attractive basis. Although there are a smaller number of top quality managers investing in subordinated debt, restructuring, distressed securities and secondary fund-of-funds sub sectors, there are excellent opportunities in these areas. These funds will often provide a shorter investment period, current portfolio cash income and shorter holding periods. The attributes of special situation funds are attractive elements for a well-diversified portfolio particularly given the dislocations in markets.

d. International – Asian Private Equity:
Portfolio Advisors believes there should be an increased emphasis on Asian private equity within SFERS' AIP. Asian private equity revolves around continued strong economic growth throughout the Asian region (specifically the tremendous growth of the middle class) and the maturation of the Asian private equity managers. Government reforms, generational transition of family owners and active industry consolidation have created an attractive source of deal flow for new investments at attractive valuations. As a result, Portfolio Advisors has developed a specific investment strategy for prudently and tactically building SFERS Asian exposure over time.

Summary of Asian Investment Strategy
Currently, SFERS has relatively limited exposure to the Asian region and, given the size and maturity of SFERS' AIP program, the AIP would benefit from a disciplined investment plan to continue developing a core Asian private equity portfolio with the use of funds-of-funds on a strategic basis and an increasing number of direct partnership commitments over time.

The number of international opportunities for private equity investors has increased substantially over the last 10 years. However, based on our perception of current market conditions and risk/reward tradeoffs, we are focused on Asia, the UK and Western Europe. Private equity in Asia is an attractive market opportunity given the strong economic growth in the region, improved financial markets and greater regulatory transparency. There has been an emergence of a mature class of private equity fund managers who have invested through multiple business cycles (including the Asian financial crisis) and can capitalize on strong, quality deal flow with low private equity penetration (compared to the US and

Europe). Governmental reform, generational transition of family owners and active industry consolidation are expected to create a very attractive source of deal flow for private equity managers in Asia. The region offers investors attractive risk adjusted opportunities to achieve solid private equity returns.

SFERS' AIP Asian Private Equity Program

SFERS' has begun to construct an Asian private equity portfolio, with prudent diversification across managers, geographies, strategies and vintages. An Asian private equity foundation has been established through Squadron, a diversified funds-of-funds. SFERS' will continue to build out the Asian private equity exposure in the Portfolio with the addition of direct partnership commitments as evidenced by recent investments in Baring Asia, CHAMP and Hony Capital. Where appropriate, the AIP will also continue to develop strategic relationships with top-tier fund-of-funds in the region, which may assist staff broaden their knowledge of market opportunities.

This strategy allows SFERS' AIP to invest with local, Pan-Asian and global managers across each of the private equity strategies to further achieve prudent diversification and to obtain exposure to Asian private equity in a risk-measured manner. Portfolio Advisors has observed that local private equity firms have tended to be more successful in executing growth and expansion capital strategies in the Asian market (with certain exceptions in the case of select Pan-Asian growth and expansion capital funds), and we have found that Pan-Asian private equity funds have tended to be more successful in executing middle-market or large-cap buyout and special situations strategies in Asia (with certain exceptions, particularly with respect to select local buyout funds in China, Japan and Australia).

B. Potential Candidates for Planning Purposes

The following are existing SFERS' managers who, based on their percentage drawn and reserved on their last fund, are expected to have a new fund offering in the market during the 2013 calendar year. All re-ups will be subjected to SFERS' and Portfolio Advisors' complete due diligence process.

Existing Managers Likely to Raise a New Fund in 2013

Expected Next Fund	Prior Fund Vintage Year	% Drawn as of 6/30/12 (Not incl. reserves)	SFERS' Previous Commitment ($ millions)
Venture Capital			
Battery IX	2000 (Fund VI)	100%	30
Clarus III	2008	60%	10
DCM VII	2010	40%	10
Interwest XI	2008	49%	14
Polaris VII	2010	40%	10
TCV VIII	2008	78%	25
Total Venture Capital			**$99**
Buyout/Corp Fin.			
Actis Global 4	2007	74%	30
Apollo VIII	2008	69%	30
Capvis Equity IV	2008	61%	17
Clessidra III	2008	37%	26
Doughty Hanson VI	2007	88%	30
GenEx 360 II	2007	83%	10
Oak Hill IV	2007	74%	40
Towerbrook IV	2008	48%	30
TPG VII	2008	58%	30
Total Buyout/Corp. Fin.			**$243**
Special Situations			
Cerberus Series Five	2006	93%	20
Sun VI	2007	50%	33
Total Special Situations			**$53**
Total Potential Re-ups in 2013			**$395**

Given the potential for approximately $300 million to $400 million (range based on $395 million of previous commitments noted above) in potential re-ups, as compared to SFERS' commitment pace of $375 million in calendar year 2013, it is expected that SFERS will have limited allocation for commitments to new managers. The allocation to new managers may be higher if fewer than all existing managers noted above come to market or are recommended for new commitments. Portfolio Advisors expects at least 2 to 4 possible new manager commitments in 2013.

Some potential new managers that may be considered in 2013 are: ICV Partners, Riverside Company, Nordic Capital and several VC groups. One of these managers is owned by, or focus on the women and minority community. However, that will not be a selection criterion within the evaluation process.

C. Dollar Amount to be Invested

SFERS' annual allocation for calendar year 2013 is recommended to be $375 million of commitments (within a range of $325 to $425 million) depending on the timing of premier funds in the market. Individual commitments will range from $10 million to $40 million. Portfolio Advisors believes that SFERS' AIP can prudently invest in a diversified group of premier funds during 2013 that will meet the current objectives of the program.

Strategy	Number of Commitments
VC-Early	**1-2**
VC-Multi	**2-3**
VC Late	**2-3**
Buyouts-Small/Mid	**2-3**
Buyouts-Large	**1-2**
Special Situations	**2-3**
Total	**10-16**

Portfolio Advisors and SFERS' staff do not have control over the timing of the fundraising of these groups and some organizations may elect to not begin fundraising until 2014. Portfolio Advisors recommends SFERS wait until the best groups return to market.

D. New Initiative

Portfolio Advisors and SFERS' staff will review the risk/return characteristics and assess the resources and expertise necessary to prudently execute a co-investment program for the Alternative Investment Portfolio. Co-Investments are opportunities to invest directly into an underlying portfolio company along side a General Partner. This provides direct exposure to the company typically with little or no fees and GP carry. Co-Investing is a growing area of interest for some institutional investors Investments require additional resources and are typically reviewed by staff, consultant and/or an outside manager. Investing in a co-investment fund sponsored by an experienced manager is one way SFERS can participate in co-investing without acquiring additional resources to implement this strategy.

V. SECONDARY PROGRAM

During 2013, SFERS' staff and Portfolio Advisors will continue to opportunistically seek funds to be acquired at a discount in the secondary market for SFERS' AIP that will provide additional returns and strategic or tactical benefits to the Portfolio. All investments must meet SFERS' objectives and follow the guidelines of the Secondary Program (see Appendix C). At this time, given the mark-to-market valuation declines and significant discounting in the secondary markets, liquidating assets in the secondary market, or securitization of select assets is not likely in 2013. Staff and consultant will continue to monitor the secondary market for opportunities to both acquire and/or dispose of assets.

VI. MONITORING

A. Situations Being Monitored; Under-performing Investments

SFERS' staff and Portfolio Advisors continuously monitor the AIP through telephone conversations, office visits, attending fund annual meetings, actively participating on advisory boards and through the use of Portfolio Advisors' proprietary database, PRIVILEGe. Commitments, cash flow activity and overall manager performance are monitored.

As SFERS continues to re-up with successful managers and invest with new high quality managers over time, these investments will become the core holdings of the Portfolio. Fund managers that are not selected for re-investment will become non-core.

B. Other Specific Goals Related to the Monitoring of SFERS' AIP

SFERS' staff with the assistance of Portfolio Advisors actively monitors the funds in AIP. Many of the funds that are or will be in the SFERS' AIP have advisory or valuation committees. SFERS' staff and Portfolio Advisors will actively participate on many of these committees, which usually meet two to four times per year. SFERS' staff and Portfolio Advisors will also attend annual meetings and regularly communicate with the general partners to keep abreast of the progress of the funds as well as the general partner groups. We believe that this level of interaction with the private equity managers allows both SFERS' staff and Portfolio Advisors to fulfill their fiduciary duties to SFERS and its beneficiaries and to be better prepared from a due diligence perspective on future funds.

VII. EXITING

A. Pending Distributions or Liquidations

As SFERS' AIP matures, more funds will reach full term and enter into extensions and the liquidation phase of their life. More than 110 funds will have reached term prior to 2013. As of June 30, 2012, approximately 43% of SFERS' partnerships are fully or substantially liquidated. In addition, there will be numerous managers that SFERS has discontinued or will discontinue investing with due to manager performance, organizational risk, or strategic fit. These managers are less likely to be considered part of the future core portfolio for the AIP.

SFERS' staff along with Portfolio Advisors will actively monitor the liquidation of these investments, taking advantage of potential opportunities to enhance the returns to the program.

IX. APPENDICES

SFERS Commitment Pace Model – Updated December 2012

Year End December		Total Assets Under Management [1]	Funded Private Equity Target	Commitments Needed to Reach Funded Target		Additional Commitments Required [2]		Annual Commitment Pace Required to Reach Goal by End of Given Year	
Years to Target			*16%*	*Low (135%)*	*High (150%)*	*Low (135%)*	*High (150%)*	*Low (135%)*	*High (150%)*
	2012	$15,300	$2,448	$3,305	$3,672	$109	$476	-	-
	2013	$16,486	$2,638	$3,561	$3,957	$365	$760	-	-
	2014	$17,763	$2,842	$3,837	$4,263	$641	$1,067	-	-
3	2015	$19,140	$3,062	$4,134	$4,594	$938	$1,397	$313	$466
4	2016	$20,623	$3,300	$4,455	$4,950	$1,258	$1,753	$315	$438
5	2017	$22,222	$3,555	$4,800	$5,333	$1,604	$2,137	$321	$427
6	2018	$23,944	$3,831	$5,172	$5,747	$1,976	$2,550	$329	$425
7	2019	$25,800	$4,128	$5,573	$6,192	$2,377	$2,996	$340	$428
8	2020	$27,799	$4,448	$6,005	$6,672	$2,808	$3,476	$351	$434
9	2021	$29,953	$4,793	$6,470	$7,189	$3,274	$3,993	$364	$444
10	2022	$32,275	$5,164	$6,971	$7,746	$3,775	$4,550	$378	$455
							Estimate:	$374	
							Recommended 2013 Commitment Pace:	**$375**	

(1)	*7.75%*	*Actuarial Annual Growth Rate*
(2)	*$2,027*	*Portfolio ARV as of June 30, 2012*
	$1,169	*Unfunded Commitments as of June 30, 2012*
	$3,196	*Column represents commitments required in excess of existing reported value + unfunded as of June 30, 2012 held constant throughout period*
(3)	*$15,300.0*	*Million (SFERS total assets under management as of June 30, 2012)*

B. AIP Objectives

In December 1989, SFERS established long-term investment objectives for the AIP. These objectives are reviewed annually and amended by SFERS' Board. Specifically, the objectives are as follows:

Primary Objective: Provide a total return to the Fund (net of fees and carried interest) that exceeds the annual return of the S&P 500 by 500 basis points over rolling ten-year periods and maintain a well diversified exposure to alternative investments of **16% within a range of 12% to 20%**. Individual investments should have an expected return of no less than 15% net internal rate of return. Unless an investment is expected to meet or exceed the minimum return goal, it should not be considered.

Secondary Objective: To diversify by investment type, manager and vintage year to reduce manager and asset specific risk. Investments will not be undertaken to meet the secondary objective if they do not also expect to meet the primary objectives.

Tertiary Objective: To reduce total portfolio volatility by investing in asset types that have a low statistical correlation with other asset classes. Investments will not be undertaken to meet the tertiary objective if they do not also expect to meet the primary and secondary objectives.

C. SFERS Secondary Program Investment Guidelines

Purchase Program – Investment Guidelines

- All investments must meet SFERS' AIP Objectives.

- Investments would be considered only in funds managed by existing managers. Investments in attractive secondaries of new managers may be considered in later phases of the Secondary Purchase Program.

- All investments must fit within SFERS' investment sectors.

- Both mature secondaries, funds with more than 50% of capital funded, as well as hybrid secondaries, funds with less than 50% of capital funded, would be considered.

- Investments would opportunistically focus on single limited partnership interests, rather than broad portfolios of multiple interests.

- Staff would have authority to acquire secondary interests at or below the capital account value. Board approval would be required for investments at a premium to the capital account.

- Any single fund investment would be no more than $20 million in purchase value which includes the purchase price plus any remaining unfunded commitment.

- Limit maximum exposure (existing investment plus secondary purchase) to not greater than 10% in limited partnership interest of a single fund and no single partnership investment can constitute more than 5% of SFERS' total AIP adjusted reported value partnership holdings at the time of purchase. Limit maximum exposure (adjusted reported value plus any remaining unfunded commitment) to any sponsor such that the aggregate investment with any sponsor across multiple funds is not greater than 10% of SFERS' total AIP adjusted reported value partnership holdings at the time of purchase.

Percentage of Annual Allocation

SFERS' staff and consultant recommend that secondary investments represent up to 20% of SFERS' annual investment allocation. Additionally, any proceeds from the sale of partnership interests through the secondary sale program would be available for reinvestment in secondary interests.

Sale Program – Recommended Disposition Guidelines

- All sales must provide strategic, tactical and/or economic benefits that assist SFERS' in meeting the AIP Objectives.

- The program would consider selling non-impact holdings that include both mature secondaries, funds with more than 50% of capital funded, as well as hybrid secondaries, funds with less than 50% of capital funded.
    - *Non-impact* determinations will fall under the following criteria:

- *Poor Performing*: Poor performing assets that have little to no potential to materially improve the future performance of SFERS' AIP
- *Tail Ends*: Mature assets that have provided a significant portion of their potential performance, whether attractive or poor, and the remainder of the assets have little to no potential to materially improve the future performance of SFERS' AIP. These assets will typically have little value remaining in the capital account and/or few holdings remaining in the fund.
- *Non-strategic*: Assets that have an investment focus that is no longer a strategic part of SFERS' investment objectives and there is little to no potential to materially improve the future performance of SFERS' AIP

- The sale program would opportunistically consider the sale of single Limited Partnership interests as well as portfolios of interests. Portfolio sales will be considered when the aggregated benefit to the AIP is more attractive than individual dispositions.

- Approving the disposition of portfolio assets within SFERS' disposition guidelines:
  - SFERS Board will pre-approve the sale of an unspecified pool of funds that together would aggregate to a certain dollar amount (the consultant recommends the initial amount be $30 million). Staff would then have discretion within the guidelines of the Secondary Sale Program to dispose of assets up to the established dollar amount. Once the pool has been fully disposed, staff would make a progress report to the Alternative Investment Committee and the Board. The Board would then make a determination if another pool should be pre-approved.

Tab 6

CODE OF ETHICS AND STANDARDS OF PROFESSIONAL CONDUCT

PREAMBLE

The CFA Institute Code of Ethics and Standards of Professional Conduct are fundamental to the values of CFA Institute and essential to achieving its mission to lead the investment profession globally by setting high standards of education, integrity, and professional excellence. High ethical standards are critical to maintaining the public's trust in financial markets and in the investment profession. Since their creation in the 1960s, the Code and Standards have promoted the integrity of CFA Institute members and served as a model for measuring the ethics of investment professionals globally, regardless of job function, cultural differences, or local laws and regulations. All CFA Institute members (including holders of the Chartered Financial Analyst® [CFA®] designation) and CFA candidates must abide by the Code and Standards and are encouraged to notify their employer of this responsibility. Violations may result in disciplinary sanctions by CFA Institute. Sanctions can include revocation of membership, revocation of candidacy in the CFA Program, and revocation of the right to use the CFA designation.

THE CODE OF ETHICS

Members of CFA Institute (including CFA charterholders) and candidates for the CFA designation ("Members and Candidates") must:

- Act with integrity, competence, diligence, respect, and in an ethical manner with the public, clients, prospective clients, employers, employees, colleagues in the investment profession, and other participants in the global capital markets.
- Place the integrity of the investment profession and the interests of clients above their own personal interests.
- Use reasonable care and exercise independent professional judgment when conducting investment analysis, making investment recommendations, taking investment actions, and engaging in other professional activities.
- Practice and encourage others to practice in a professional and ethical manner that will reflect credit on themselves and the profession.
- Promote the integrity of and uphold the rules governing capital markets.
- Maintain and improve their professional competence and strive to maintain and improve the competence of other investment professionals.

STANDARDS OF PROFESSIONAL CONDUCT

I. PROFESSIONALISM

A. Knowledge of the Law. Members and Candidates must understand and comply with all applicable laws, rules, and regulations (including the CFA Institute Code of Ethics and Standards of Professional Conduct) of any government, regulatory organization, licensing agency, or professional association governing their professional activities. In the event of conflict, Members and Candidates must comply with the more strict law, rule, or regulation. Members and Candidates must not knowingly participate or assist in and must dissociate from any violation of such laws, rules, or regulations.

B. Independence and Objectivity. Members and Candidates must use reasonable care and judgment to achieve and maintain independence and objectivity in their professional activities. Members and Candidates must not offer, solicit, or accept any gift, benefit, compensation, or consideration that reasonably could be expected to compromise their own or another's independence and objectivity.

C. Misrepresentation. Members and Candidates must not knowingly make any misrepresentations relating to investment analysis, recommendations, actions, or other professional activities.

D. Misconduct. Members and Candidates must not engage in any professional conduct involving dishonesty, fraud, or deceit or commit any act that reflects adversely on their professional reputation, integrity, or competence.

II. INTEGRITY OF CAPITAL MARKETS

A. Material Nonpublic Information. Members and Candidates who possess material nonpublic information that could affect the value of an investment must not act or cause others to act on the information.

B. Market Manipulation. Members and Candidates must not engage in practices that distort prices or artificially inflate trading volume with the intent to mislead market participants.

III. DUTIES TO CLIENTS

A. Loyalty, Prudence, and Care. Members and Candidates have a duty of loyalty to their clients and must act with reasonable care and exercise prudent judgment. Members and Candidates must act for the benefit of their clients and place their clients' interests before their employer's or their own interests.

B. Fair Dealing. Members and Candidates must deal fairly and objectively with all clients when providing investment analysis, making investment recommendations, taking investment action, or engaging in other professional activities.

C. Suitability.

1. When Members and Candidates are in an advisory relationship with a client, they must:
   - **a.** Make a reasonable inquiry into a client's or prospective client's investment experience, risk and return objectives, and financial constraints prior to making any investment recommendation or taking investment action and must reassess and update this information regularly.
   - **b.** Determine that an investment is suitable to the client's financial situation and consistent with the client's written objectives, mandates, and constraints before making an investment recommendation or taking investment action.
   - **c.** Judge the suitability of investments in the context of the client's total portfolio.
2. When Members and Candidates are responsible for managing a portfolio to a specific mandate, strategy, or style, they must make only investment recommendations or take only investment actions that are consistent with the stated objectives and constraints of the portfolio.

D. Performance Presentation. When communicating investment performance information, Members and Candidates must make reasonable efforts to ensure that it is fair, accurate, and complete.

E. Preservation of Confidentiality. Members and Candidates must keep information about current, former, and prospective clients confidential unless:

1. The information concerns illegal activities on the part of the client or prospective client,
2. Disclosure is required by law, or
3. The client or prospective client permits disclosure of the information.

IV. DUTIES TO EMPLOYERS

A. Loyalty. In matters related to their employment, Members and Candidates must act for the benefit of their employer and not deprive their employer of the advantage of their skills and abilities, divulge confidential information, or otherwise cause harm to their employer.

B. Additional Compensation Arrangements. Members and Candidates must not accept gifts, benefits, compensation, or consideration that competes with or might reasonably be expected to create a conflict of interest with their employer's interest unless they obtain written consent from all parties involved.

C. Responsibilities of Supervisors. Members and Candidates must make reasonable efforts to detect and prevent violations of applicable laws, rules, regulations, and the Code and Standards by anyone subject to their supervision or authority.

V. INVESTMENT ANALYSIS, RECOMMENDATIONS, AND ACTIONS

A. Diligence and Reasonable Basis. Members and Candidates must:

1. Exercise diligence, independence, and thoroughness in analyzing investments, making investment recommendations, and taking investment actions.
2. Have a reasonable and adequate basis, supported by appropriate research and investigation, for any investment analysis, recommendation, or action.

B. Communication with Clients and Prospective Clients. Members and Candidates must:

1. Disclose to clients and prospective clients the basic format and general principles of the investment processes they use to analyze investments, select securities, and construct portfolios and must promptly disclose any changes that might materially affect those processes.
2. Use reasonable judgment in identifying which factors are important to their investment analyses, recommendations, or actions and include those factors in communications with clients and prospective clients.
3. Distinguish between fact and opinion in the presentation of investment analysis and recommendations.

C. Record Retention. Members and Candidates must develop and maintain appropriate records to support their investment analyses, recommendations, actions, and other investment-related communications with clients and prospective clients.

VI. CONFLICTS OF INTEREST

A. Disclosure of Conflicts. Members and Candidates must make full and fair disclosure of all matters that could reasonably be expected to impair their independence and objectivity or interfere with respective duties to their clients, prospective clients, and employer. Members and Candidates must ensure that such disclosures are prominent, are delivered in plain language, and communicate the relevant information effectively.

B. Priority of Transactions. Investment transactions for clients and employers must have priority over investment transactions in which a Member or Candidate is the beneficial owner.

C. Referral Fees. Members and Candidates must disclose to their employer, clients, and prospective clients, as appropriate, any compensation, consideration, or benefit received from or paid to others for the recommendation of products or services.

VII. RESPONSIBILITIES AS A CFA INSTITUTE MEMBER OR CFA CANDIDATE

A. Conduct as Members and Candidates in the CFA Program. Members and Candidates must not engage in any conduct that compromises the reputation or integrity of CFA Institute or the CFA designation or the integrity, validity, or security of the CFA examinations.

B. Reference to CFA Institute, the CFA Designation, and the CFA Program. When referring to CFA Institute, CFA Institute membership, the CFA designation, or candidacy in the CFA Program, Members and Candidates must not misrepresent or exaggerate the meaning or implications of membership in CFA Institute, holding the CFA designation, or candidacy in the CFA program.

Tab 7

GUIDELINES FOR PUBLIC EQUITY AND FIXED INCOME MANAGER MONITORING AND RETENTION

POLICY OVERVIEW

The purpose of this policy is to establish general guidelines for monitoring investment manager effectiveness and identifying issues of concern, and to provide a systematic and consistent process for the Staff and the general consultant to employ when making decisions and recommendations to the Retirement Board concerning manager retention and evaluation. Copies of this policy shall be provided to all SFERS' Public Equity and Fixed Income Investment managers, and shall be incorporated into its Investment Policy Statement as an Appendix.

The Investment Staff will classify its public market equity and fixed income managers into two categories for review: **Good Standing** or **Under Review.** Managers will be "Under Review" if they meet the criteria defined in section 1 below, and will be notified in writing by SFERS Staff of their status.

- **Good Standing:** Each quarter, managers which have met the performance objectives and other criteria established by these Guidelines and as specified in their investment management contract and guidelines will be considered to be in Good Standing.
- **Under Review:** Managers that fail to meet expectations in any of the five general areas specified below under monitoring procedures will be subject to Review.

While this policy establishes guidelines for manager monitoring, experience has shown that each manager's situation is unique, and must be analyzed on an individual basis, taking into account any unique circumstances affecting the manager or its relationship with SFERS.

Nothing in this policy shall be construed as contrary to SFERS' right to terminate an investment manager at any time, for any reason.

MONITORING PROCEDURES

Managers will be monitored in five areas:

- Investment performance (relative to a specific benchmark and appropriate peer group);
- Adherence to the manager's 's philosophy, process, and stated investment style;
- Organizational and personnel continuity;
- Guideline compliance, and,
- Other.

Managers will be reviewed on a continuous basis by SFERS Staff and the consultant based on custodial holdings reports, attribution analysis, monthly performance, manager announcements, the custodian's compliance reporting, consultant evaluations, and other inputs. These reviews will be summarized in the quarterly report prepared by the performance measurement provider for Board consideration, and shall report on whether SFERS' expectations have been met. Those managers meeting the expectations of the above criteria will be categorized as in Good Standing.

1. **Review Criteria**

A manager will be designated as **Under Review** if one or more of the criteria listed below are met:

- **Under-performance**: A manager's net of fee performance falls below the agreed upon benchmark or gross of fee performance falls below the 50th percentile of an appropriate peer group (also measured gross of fees). The evaluation will focus on trailing 1-, 3- and 5-year periods, and shall also be cognizant of the manager's expected tracking error versus the agreed-upon benchmark. Substantial underperformance for a given period of less than one year may also cause a manager to be placed under review. A manager's expected tracking error will be used as a reference point in the short-term (one-year or less) evaluation.
- **Adherence to Stated Philosophy, Process and Style**: SFERS Staff or consultant believes there has been a material change in the manager's stated investment philosophy, process, or style.
- **Organizational Change**: There has been a material change in the manager's organizational structure, ownership or personnel, which Staff determines requires more intense due diligence. This category shall also include instances where a firm may be under investigation by regulatory agencies.
- **Violation of Guidelines**: The manager is materially out of compliance with any of the criteria established in the manager's Guidelines. Subject to review and discussion with the manager, the manager will be expected to bring the portfolio into compliance. The manager shall provide recommended revisions to the guidelines in writing to SFERS Staff; however SFERS shall be under no obligation to accept such recommendations. Subject to contract terms, the manager shall be responsible for reimbursing the client for any loss resulting from a material violation of guidelines.
- **Other**: Other reasons deemed appropriate by Staff, including insufficient responsiveness to requests for information, attendance at meetings, or for any other reason as determined by SFERS.

The Review process will require certain actions to be taken as described below, in order to return to Good Standing. Managers who are placed "Under Review" are not eligible for additional funding and may also be subject to asset reductions. If Staff determines that either the organizational changes or Guideline violations will adversely impact the manager's ability to provide contracted investment services, the manager may be recommended for immediate probation or possibly termination.

2. **Manager Notification**

SFERS Staff shall notify Managers in writing of their status should they fall Under Review. The notification shall indicate the reasons why the firm is under review, solicit information from the firm on the relevant issues, and ask for the manager's input.

- **Plan of Action:** Once SFERS Staff has notified a manager in writing that it is Under Review, the manager must submit a Plan of Action within 15 calendar days of the notice. The plan should respond to any questions posed by SFERS Staff in its notification, as well as cover the following:

  1) reasons for the problem, including detailed attribution analysis of any performance shortfalls;
  2) corrective steps that will be taken;
  3) the expected time horizon for completion of any corrective actions; and,
  4) any other relevant information which may be useful for Staff and Board assessment.

  Typically Staff and/or the General Consultant should meet with the manager following receipt of this written information from the manager. Following the meeting, Staff, with input from the General Consultant, should determine whether the manager should be retained or terminated. Staff

will also monitor the progress of the manager in implementing the plan on at least a quarterly basis, or more often if appropriate.

- **Length of Time on Review Status:** Depending upon Staff and consultant analysis, and the manager's specific investment style and strategy, the Review period may vary. In no event will a manager be returned to Good Standing until the manager meets the criteria for Good Standing.

- **Termination**

  Staff and/or the General Consultant shall recommend to the Board the termination of a manager's contract if:

  - It is determined that the manager has failed to show evidence of correction of deficiencies;
  - The manager has not shown, in the opinion of Staff and/or the General Consultant sufficient improvement;
  - The deficiencies are perceived to be irresolvable within a reasonable amount of time, or
  - Other pertinent factors

  If Staff and the General Consultant believe that immediate action is necessary due to evidence of a manager engaging in illegal or unethical practices, or for other extraordinary reasons that cause Staff and the General Consultant to believe that continued management is contrary to fiduciary standards of prudence, Staff is authorized by the Board to notify the manager in writing that trading on the account must cease immediately. Notice of such action and the termination recommendation will be presented to the Retirement Board for ratification at its next monthly meeting. Staff and/or the General Consultant may recommend termination of a manager for other reasons than failure to meet Under Review criteria, e.g., after determining that the firm's investment style is no longer relevant to the System's desired portfolio structure.

Tab 8

SFERS Policy on Emerging Managers in Public Markets

Background: This policy outline is developed for the purpose of guiding a search process for an emerging manager program for SFERS. It is expected that this policy will be updated and amended over time as SFERS gains increased experience with emerging managers.

Objectives: The objective of SFERS emerging manager program will be to provide the System with access to a diversified set of emerging firms that it would normally not have sufficient access to (e.g., because of their small asset base, style of management, or because they are in the early phase of their business lifecycle) for the purpose of generating excess return for the System.

Definitions: Emerging firms shall defined by SFERS as firms that have $2 billion or less in assets at time of hire, and that are independent (defined as at least 51% owned by full-time employees of the firm).

The program shall seek to focus on firms that have $1 billion or less in firm assets under management. Emerging products that are launched by larger independent firms may be considered on a case by case basis or to fill a unique need in a portfolio, but would not normally be included.

Women- and Minority-Business Enterprises (WBE/MBE) firms are often emerging firms and it is likely such firm will be considered and included in SFERS emerging manager program. Participation by such firms is encouraged by SFERS. Establishment of an emerging manager program shall not preclude hiring WBE/MBE firms in other searches conducted by the System.

Format of Program: SFERS shall engage a "manager of managers" for its emerging manager program. The purpose of hiring such a firm shall be to ensure sufficient diversification, to delegate full investment authority to hire and fire managers, and to ensure access to specialized knowledge and expertise regarding emerging firms.

The program may invest in specialized sub-asset class mandates, e.g., small cap US equity. SFERS may invest in separate account or commingled funds.

Each manager of managers shall be subject to specific guidelines established for its fund. Each manager shall be expected to maintain a database and expertise in identifying emerging managers, to construct a diversified portfolio of such managers based on the objectives and benchmarks established for the fund, to have authority to contract with and terminate emerging managers, and to monitor and report on the performance of the managers in the fund and the fund's performance. SFERS shall be responsible for evaluating the performance of any fund of emerging managers versus appropriate benchmarks.

Asset Class Coverage: SFERS' emerging manager program may include all public market asset classes, e.g., US equity, international equity, and fixed income. It is expected that in its initial phase the program will focus on US equity emerging managers, and may include a specialized assignment in a sub-sector of the market such as small and/or mid-cap.

Allocation: Up to 10% of any asset class composite may be invested in one or more emerging manager fund of funds. The allocation to emerging managers in individual asset classes shall be approved by the Retirement Board and specified in the sub-asset class targets established by the Board.

Graduation: Criteria for adding managers included in the manager of managers program to SFERS "mainstream" manager lineup shall be established at the time of hire for the manager of managers.

Approved December 9, 2003.

Tab 9

Opportunistic Strategies – Policy Overview

This document is intended to provide broad parameters for investments considered "Opportunistic Strategies" within SFERS' public market composites. Such strategies were approved for inclusion in SFERS' US equity, international equity, and fixed income asset class composites by the Board at its August 8, 2006 meeting.

For each asset class the target for such strategies is 0% of the composite, with an allowable range of 0-5% of each composite for such strategies.

The purpose of such strategies is to take advantage of opportunities that may arise over time. SFERS recognizes that drawing the parameters for such investments too tightly is not in its interest, so as not to foreclose opportunities that may be appropriate for SFERS. Nevertheless, some guideposts for the program are useful to articulate at this time. This policy overview will be subject to review on a regular basis.

General Characteristics of Opportunistic Strategies

SFERS currently has a well-defined investment structure for each of its public market composites, with targets and ranges established for sub-asset classes within each asset class. This investment structure policy is reviewed by SFERS' Board on an annual basis.

The purpose of an additional category of Opportunistic Strategies is to permit investment in investment approaches, managers, or asset types that do not fit clearly within established policy but nonetheless represent a compelling opportunity as an investment for SFERS.

The role of such strategies may include:

- Enhance return versus a composite benchmark;
- Manage risk (volatility, tracking error, or other types of risk) for the composite;
- Allow investment in securities that are hybrids, with characteristics that straddle established asset classes and sub-asset classes.

Examples of such strategies may include:

- Publicly traded real estate (REITs and Real Estate Related Securities)
- Activist Strategies
- Commodities/Natural Resources
- Long/Short Equity, including constrained long/short
- Products that involve leverage
- Global, regional, or country based strategies (equity or fixed income)
- Global balanced fund
- Investment approaches that include private equity or privately placed debt
- Portable Alpha

This list is illustrative of potential candidates for evaluation and inclusion as Opportunistic Strategies in SFERS' portfolio. This list shall not be considered a recommendation in favor of any of these approaches or strategies. This list also is not exclusive, and absence from this list shall not preclude consideration of a strategy not on the list that may be identified in the future.

Selection and Oversight

Opportunistic Strategies shall be subject to SFERS' Investment Policy Statement, including policies on investment guidelines and criteria for manager selection and termination. These strategies shall also be covered by SFERS' Manager Retention and Monitoring policy.

Any Opportunistic Strategy recommended for inclusion in SFERS' portfolio shall be approved by the Board, and subject to due diligence and a search process that will be transparent to the Board. Strategies offered by managers already retained by SFERS will be considered as a means to exploit manager skill that resides in firms in which SFERS already has strong confidence.

Each Opportunistic Strategies investment will be subject to written guidelines (in some cases fund documents) for the investment. Each shall be monitored versus appropriate benchmarks and other factors (including organization and investment process) and included in the composite performance results of their respective asset class. Responsibility for monitoring these investments by SFERS Staff may be shared among Senior Investment Officers (SIOs) based on the characteristics of the investments.

Approved: September 12, 2006

Tab 10

CITY AND COUNTY OF SAN FRANCISCO
EMPLOYEES' RETIREMENT SYSTEM
RETIREMENT BOARD POLICY

THE SOCIAL INVESTMENT PROCEDURES

The Retirement Board adopted the attached list of Social Investment Policies at the Retirement Board Meeting of September 27, 1988.

CITY AND COUNTY OF SAN FRANCISCO
EMPLOYEES' RETIREMENT SYSTEM

THE SOCIAL INVESTMENT PROCEDURES

Since it is necessary for adequate recognition to be given to the social consequences of corporate actions and security and portfolio investment decisions to achieve maximum long term investment returns from System assets, and since the individual decisions of Staff, Managers, Consultants, and other System fiduciaries have to be made within a framework that reflects the particular social situation and concerns of the participants and the System, the following policies shall be followed when investing, managing, or reviewing System assets. Social concerns to be addressed through investment policy shall follow the order of action as outlined in I, II, and III except where the Board has determined that action contemplated in an earlier step has been initiated prior to the adoption of these policies and found to be ineffective or non-relevant. In no event shall these policies take precedent over the fiduciary responsibility of producing investment returns for the exclusive benefit of the participants.

I. Shareholder Voting

The ownership of equity interests in many corporations as an investment of System assets includes the right to vote on the initiation, approval, or denial of major company policies and actions. These voting rights shall be exercised only by specific Board considerations and directions or by authorization under procedures which reflect Board decisions on popular issues.

A. Issues likely to come before shareholders in a proxy "season" will be reviewed prior to the "season" to allow the sense of the Board to be obtained on generic issues to be voted by Staff when received.

B. Issues of non-generic nature will be specifically reviewed by Staff and recommended to the Board for action. Counsel of the external managers shall be sought on issues of immediate investment concern for securities held in the manager's portfolio; i.e., mergers, acquisitions, buy-outs, etc.

C. Determination of the social concerns that should be addressed through exercise of voting rights and subsequent implementation of the balance of these procedures will be made by the Board in full consideration of their responsibilities as fiduciaries of the System and only after Staff review of the

investment and social implications. Additional information from external managers and other outside sources will be sought when necessary.

II. Promoting Social Rights and Interests

The ownership of equity interests, and to some extent of fixed income interests, in many corporations provides an opportunity to act individually or in concert with other shareholders to assure proper recognition of social interests. Social interests shall be promoted only if in the interest of the participants, the community and the corporation as expressed in the preceding section on shareholder voting.

A. Shareholder resolutions will be initiated upon review of previous shareholder votes, discussion with the corporation, and Board determination that the proposed resolution is a reasonable vehicle to influence corporate activities.

B. Other interested shareholders may be actively sought to express common concerns, join in resolutions, and solicit proxy votes.

C. Specific investment programs that benefit the Participants while aiding other persons or entities may be considered provided that expected investment returns are at least equivalent to available alternatives of similar risk.

III. Investment Restrictions

When social concerns have not been or cannot be addressed adequately through discussion, exercising shareholder voting rights, promotion of shareholder initiatives, or participation in active investment programs, it may be necessary to restrict System investment activities in specific areas to promote the interests of the participants. In general, restrictions will be adopted in the following manner:

A. Restrictions will not take precedent over investment considerations but will be used to set standards when dealing with essentially equivalent investment choices.

B. Recognizing that substantial investment flexibility is necessary to maximize returns at an acceptable level of risk, restrictions will be adopted only when exercising voting rights and promoting investment initiatives have not been or would not be successful and alternatives to the restricted securities are available which do not compromise potential investment return.

C. Restrictions will be applied at the lowest possible investment level, either specific issuers or securities, to protect against adverse investment effects and facilitate amendment in response to corporate action or changes in investment or social climate.

D. Restrictions will be analyzed periodically for social and financial consequences and amended or repealed as appropriate.

E. Restrictions will be applied only upon specific decision of the Board based on available information as evaluated by Staff, and after full consideration of the investment ramifications.

Tab 11

City and County of San Francisco
Employees' Retirement System

Memorandum

Date: February 11, 2015

To: The Retirement Board

Through: Jay Huish
Executive Director

William J. Coaker, Jr. – CFA, MBA
Chief Investment Officer

Robert L. Shaw, CFA
Managing Director, Public Markets

From: Mark Coleman
Security Analyst

Subject: Proxy Voting Guidelines - 2015

Background:
On an annual basis, Investment Staff ("Staff"), working with Institutional Shareholder Services ("ISS"), SFERS' Proxy Consultant, reviews the approved Proxy Voting Guidelines and makes recommendations for modifications. For 2015, Staff and ISS are recommending:

a. Changes to seven existing proxy voting policies (Items 1 to 7);
b. Adoption of three new proxy policies (Items 8 to 10); and
c. Approval of the Proxy Voting Guidelines for 2015 (Item 11).

The details of these recommendations can be found starting on page two of this memorandum. In addition to these recommendations, a Glossary of Terms is also attached.

Recommendation:
Should the Retirement Board agree with Staff's and ISS's recommendations, the following motion is required:

Move that the San Francisco Employees' Retirement System approve the Proxy Voting Guidelines for 2015.

Staff and Fassil Michael, Managing Director for ISS, will be present at the February 11, 2015 meeting of the Retirement Board to discuss the recommendations and address any questions.

1. Board of Directors - Voting on Director Nominees in Uncontested Elections

Traditionally SFERS has treated the U.S. domestic market and foreign markets differently. Over the past few years, foreign governance standards relating to the election of directors have become aligned with SFERS' policy and, as a result, ISS and Staff recommending some consolidation of the U.S. and foreign boards of director guidelines.

Key Changes:

- Introduce policy to vote WITHHOLD/AGAINST on compensation committee members or potentially the entire board in certain circumstances – such as when no Advisory Vote on Executive Compensation proposal is presented or in the event of egregious situations;
- Clarify SFERS' policy related to board responsiveness to allow for a more flexible analysis based on various factors rather than a firm adverse vote for failure to respond;
- Adopt a stand-alone policy that codifies the policy application related to unilateral bylaw and charter amendments; and
- Streamline and modernize SFERS' director elections policy in order to maintain flexibility in response to ongoing market specific governance updates:
    - The inability for shareholders to call special meetings;
    - The inability for shareholders to act by written consent;
    - A dual-class structure; and/or
    - A non-shareholder approved poison pill.

2. Compensation: Voting on Equity Based Compensation Plans

This recommendation will streamline and consolidate SFERS' existing policies covering equity based compensation plans. Staff and ISS are recommending that going forward a global approach be used when voting on equity based compensation plans.

Key Changes:

North American Markets

- Provide updated burn rate information for the U.S and Canada.
- Include that certain adjustments to stock options/SARS that impact the value of the award may be considered "repricing," based on typical market standards.
- Include an evaluation of problematic plan administration for Canadian equity compensation proposals.
- Additional policy clarifications include:
    a. Indicating by footnote clarification that foreign private issuers (FPIs) with disclosures comparable to that of U.S. companies will apply the SVT model.
    b. Indicating by footnote SFERS' policy on equity compensation proposals for issuers that are considered to be domestic issuers according to the SEC.
    c. Indicating by footnote that in specific circumstances some plans related to non-employee directors may be permitted to exceed the allowable total cap.

Non-North American Markets

- Provide an updated burn rate table for French companies.
- Indicate by footnote that discounted awards may be mitigated by performance criteria or other justifications related to such discounts.

North American & Non-North American Markets

- Streamline and modernize SFERS' Equity Compensation policy in order to maintain flexibility in response to ongoing market specific governance updates.

3. Compensation - Equity Compensation Plan – Burn Rates

The Retirement System has consistently supported the allocation of stock options to employees. Staff and ISS are recommending a change to ISS's burn rate (the rate at which stock option expense is recognized on a company's income statement) model to take into consideration the company's stock price volatility.

Staff supports the adjustment to the ISS model to take into consideration stock price volatility. Staff also supports the updates to the stock option burn rate table, which is based on the Russell 3000 index of companies.

Key Changes:

- Accounting for stock price volatility in burn rates;

4. Compensation: Say on Pay Proposals and Remuneration

This proposal is a consolidation of SFERS' existing process for Voting on Management Say on Pay ("MSOP") proposals for both the U.S. and global equity markets.

Staff and ISS are recommending adoption of a principles based policy which would allow for current updates to specific countries without bringing the issue up for an annual review.

Key Changes:

- Include policy language to accommodate recently introduced proposals related to binding remuneration policies in certain markets; and
- Streamline and modernize SFERS' language to reflect a more principles based application towards MSOP proposals and policies.

5. Capitalization Related: Issuance of Common Stock and Preemptive Rights

SFERS' current policy is to vote on the elimination or inclusion of preemptive rights on a case-by-case basis. Global markets are now issuing shares of common stock with preemptive rights under some minimal limits i.e. 20 percent of the common shares would have preemptive rights.

Staff and ISS recommend that where there is a country limit on preemptive rights (for example a maximum of 100 percent of the common shares) that the Retirement System would follow the specific country limit. This issue is predominately a European proxy proposal.

Staff and ISS support the new treatment of preemptive rights attached to common stock.

Key Changes:

- Amend the existing policy language related to international share issuances without preemptive rights to allow for a more flexible application of thresholds related to currently issued capital.

6. Report of Political Contributions / Trade Association Spending and Activities

SFERS' current policy supports voting for proposals requesting greater disclosure of a company's political contributions. ISS is recommending that SFERS update the exiting policy on political contribution screening to include trade association spending and activities.

Staff supports the additional screens for company political contributions and trade association spending.

Key Changes:

- Update the current policy to include reference to trade association disclosure.

7. Adoption of Greenhouse Gas Emission Goals

SFERS currently votes on a case-by-case basis with respect to proposals calling for the adoption of Greenhouse Gas ("GHG") reduction goals from products and operations and SFERS' voting guidelines take into account any overly prescriptive shareholder proposals or requests. SFERS considers the company's disclosure relative to industry peers and the feasibility of reducing of GHG emissions given the company's product line and current technology. SFERS also accounts for whether the company is currently the subject of litigation or controversies related to GHG emissions.

ISS is proposing to refine SFERS' current policy to vote case-by-case on proposals calling for the adoption of GHG reduction goals and will add more screens as follows:

- A company's year-over-year GHG emissions performance data;
- A company's actual GHG emissions performance; and
- A company's current GHG emissions policy, oversight mechanisms, and related initiatives.

Staff supports the additional screens noted above and recommends a vote for the proposal

Key Changes:

- Update the current policy to reflect recent investor concerns regarding GHG emission reduction goals; and
- Expand the current policy to include disclosure of year-over-year GHG emissions performance data and GHG emission reduction performance as relevant factors of consideration.

8. Capitalization Related: Investing Idle Funds in Financial Products (China)

This would be a new proxy policy for the Retirement System and would only apply to Chinese non-financial companies.

Chinese law requires non-financial companies to put idle funds investing to a shareholder vote. Staff and ISS believe that a company's management should be better positioned to decide on the usage of idle funds. The law requires the investment of the funds to be presented to a shareholders vote in the proxy. The law stipulates that amounts invested in financial products should not be excessive nor should the investments negatively affect a company's daily operations or business development.

Staff and ISS are proposing to vote this issue on a case-by-case basis.

Key Changes:

- Adopt a formal policy for Chinese companies investing in financial products using idle funds.

9. Director Related – Double Voting Rights (France)

This would be a new policy for SFERS. SFERS supports one vote per common share held and is not in favor of dual class voting stock as multiple class shares can dilute the impact of our one vote.

In 2015, ISS notes that as a result of recent legislative changes in France, unless the Retirement System votes for the one-share-one-vote structure, a company can under French law acquire double voting rights. ISS notes that some French company bylaws are silent on voting rights and action is needed to prevent the automatic granting of double voting rights.

Staff supports the one-vote-one share structure for French companies.

Key Changes:

- Adopt policies to encourage the continuation of one-share, one vote voting rights at French companies whose bylaws are currently silent on the issue, through:

    a. The support of management and shareholder proposals prohibiting double-voting rights, and

    b. By recommending against the reelection of directors; else the approval of discharge, else the approval of annual reports and accounts if the company does not have a bylaw amendment on its ballot, or commit to submitting such a bylaw for shareholder approval. This policy will apply for meetings on or after Feb 1, 2015 until April 2, 2016.

10. Anti-Takeover Measures (France)

This would be a new policy for SFERS. SFERS supports shareholder reviews of company takeover bids. ISS notes that in France sometimes this issue is brought to a shareholder vote, but not always.

ISS recommends support of any bylaw amendment that allows shareholders to review antitakeover provisions. Under French law, company boards will now legally be allowed to use any kind of antitakeover measures without prior shareholder approval, unless the company's bylaws provides otherwise.

Staff supports the ability of shareholders to review antitakeover provisions and recommends a vote for this proposal.

Key Changes:

- Adopt policies to encourage the continuation of specific shareholder approval on anti-takeover measures and protect shareholders from anti-takeover measures, through:

    a. The support of management and shareholder proposals introducing bylaw amendment requiring specific shareholders' approval on anti-takeover measures, and

    b. By recommending against any general issuances authorities unless the company specifies that it cannot be used for anti-takeover purposes. In 2015, this policy is being limited to French CAC40 companies.

11. Summary of Proxy Voting General Guidelines

The Retirement System, with assistance from ISS, maintains a detailed proxy voting policy that cover over 160 separate proxy issues/proposals. Below is a summary of the current policy.

The proxy voting policies that Staff and ISS are recommending for change are highlighted **(RED)**

Both Staff and ISS recommend that these proxy voting guidelines be approved by the Retirement System.

MANAGEMENT PROPOSALS

ROUTINE / GENERAL BUSINESS ISSUES	VOTING POLICY
1. Approval of CPA/Auditor	Case-by-Case
2. International - accept directors' report issue	FOR
3. International - designate newspaper and announcements	FOR
4. Determine auditors' remuneration	FOR
5. International - authorize board to file reports	FOR
6. Routine business related	Case-by-Case
7. Routine business related: Denmark oppose removal of discharge vote	FOR
8. Routine business related: International amendments to Company articles of association	Case-by-Case

DIRECTORS RELATED	VOTING POLICY
1. Election of directors*	**Case-by-Case**
2. Limit directors liability	Case-by-Case
3. Eliminate age restrictions	FOR
4. Set directors' compensation	FOR
5. Support dissident slate of directors	Case-by-Case
6. Authorize board to fill vacancies	Case-by-Case
7. Set board size	Case-by-Case

8. Classify the board of directors	AGAINST
9. Provide for cumulative voting	FOR
10. Directors Performance (Europe)	Case-by-Case
11. CEO's on Supervisory Board (Europe)	Case-by-Case
12. Independent Directors (Europe)	Case-by-Case
13. Director Nominees Timely notice	Case-by-Case
14. Independent Directors (Korea, Japan and Israel)	Case-by-Case
15. Board of Directors Consultant- France	Case-by-Case
16. Impact of Florange Act (France) Double Voting Rights*	**Case-by-Case**
17. Board of Directors Canada- slate vs. individual nominee	Case-by-Case
18. Board of Directors Canada- Majority owned company	Case-by-Case
19. Board of Directors-Taiwan	Case-by-Case

CAPITALIZATION RELATED	**VOTING POLICY**
1. Approve increase in authorized capital	Case-by-Case
2. Eliminate/adjust par value	FOR
3. Expand authority of board on preferred stock	Case-by-Case
4. Reduce the number of authorized shares	Case-by-Case
5. International issue - approve issuance of authorized shares*	**Case-by-Case**
6. Authorize new class of common stock	Case-by-Case
7. Authorize a new class of preferred stock - "blank check"	AGAINST
8. Increase authorized preferred stock	Case-by-Case
9. Increase authorized common and preferred stock	Case-by-Case
10. Approve increase in common stock for purpose of stock split	FOR

11. Issue shares of common upon conversion of convertible preferred	Case-by-Case
12. Create unequal voting rights	AGAINST
13. Create convertible common stock	Case-by-Case
14. Authorize a common stock split	FOR
15. Eliminate preemptive rights	Case-by-Case
16. International - Waive proportional holdings	Case-by-Case
17. International-Spain/Portugal insufficient option information provided	Case-by-Case
18. International-Denmark: Repurchase shares in lieu of dividends	Case-by-Case
19. Netherlands issuing preference shares	Case-by-Case
20. Norway shares issued without preemptive rights	Case-by-Case
21. France poison pills	AGAINST
22. France share repurchases as anti-takeover	AGAINST
23. Capital Structure: share buy-back Europe	Case-by-Case
24. Limit new shares for South African Companies	Case-by-Case
25. China- Non –Financial Companies Idle Funds*	**Case-by-Case**

MERGER / REORGANIZATION RELATED	**VOTING POLICY**
1. Reincorporate in Delaware	Case-by-Case
2. Reincorporate from one state to another via "merger"	Case-by-Case
3. Approve merger with another company	Case-by-Case
4. Other merger/reincorporation issues	Case-by-Case

COMPENSATION RELATED	VOTING POLICY
1. Executive compensation issues*	**Case-by-Case**
2. Repricing stock options	AGAINST
3. Discounted stock options	AGAINST
4. Stock depreciation rights	AGAINST
5. Japan (Option grants without full disclosure)	AGAINST
6. Non-Qualified stock purchase plan	Case-by-Case
7. Stock options burn rate*	**Case-by-Case**
8. International-Report on Dutch compensation plan	Case-by-Case
9. Dividend Equivalent Rights (DER's)	FOR
10. Back dating stock options	AGAINST
11. Equity matching programs: Sweden/Norway	Case-by-Case
12. Japan directors stock options	Case-by-Case
13. Stock options for superior performing companies	Case-by-Case
14. Pay For Performance Europe	Case-by-Case
15. Poor Pay Practices Europe	Case-by-Case
16. Shareholders vote on Executive Compensation: Dodd-Frank	Case-by-Case
17. Golden Parachutes: Dodd-Frank	Case-by-Case
18. Termination Benefits: Australia	Case-by-Case
19. Board of Directors fees- Japan	Case-by-Case
20. Pay for Performance- France	Case-by-Case
21. Compensation Canada- Say-on-Pay*	**Case-by-Case**

ANTI-TAKEOVER RELATED	VOTING POLICY
1. Approve control share acquisition	AGAINST
2. Rescind fair price provision	FOR
3. Allow adjournment for x-days to obtain desired vote	AGAINST
4. Require advance notice of shareholder proposals	Case-by-Case
5. Allow board to enter into severance agreements with company	Case-by-Case
6. Eliminate action by written consent	AGAINST
7. Eliminate ability of shareholders to call a special meeting	AGAINST
8. Require greater percent of shareholder vote to call a special meeting	AGAINST
9. Opting-out of Delaware's anti-takeover laws	FOR
10. Poison Pill put to a Shareholder Vote	FOR
11. Poison pills and amendment to preserve net operating losses	Case-by-Case
12. Anti-takeover: France*	**Case-by-Case**

SHAREHOLDER PROPOSALS

ROUTINE / GENERAL BUSINESS ISSUES	VOTING POLICY
1. Provide for confidential voting	FOR

DIRECTORS RELATED	VOTING POLICY
1. Declassify the board of directors	FOR
2. Restore/provide for cumulative voting	FOR
3. Elect a majority of independent directors	FOR
4. Require all members of a board committee to be independent	FOR

5. Limit tenure of directors to a set number of years	AGAINST
6. Require directors to own company stock	Case-by-Case
7. Require a separate chairman and CEO	Case-by-Case
8. Majority voting threshold voting for directors	Case-by-Case
9. Board of Directors Germany- overboarding	Case-by-Case
10. Board of Directors Italy- board list published	Case-by-Case
11. Board of Directors-France- Minimum number of independent Directors	Case-by-Case
12. Board of Directors Nominee (Emerging Markets)	Case-by-Case
13. Board of Directors France-Term Limits	Case-by-Case

CORPORATE GOVERNANCE RELATED	**VOTING POLICY**
1. Amend bylaws - Allow shareholders to call a special meeting	FOR
2. Restore preemptive rights of shareholders	Case-by-Case
3. Adopt the U.K. Combined Code	FOR
4. Equal access to the proxy ballot	Case-by-Case
5. International-Vote on annual review of company performance (Denmark)	FOR
6. Shareholder Proposals to assess company litigation history	Case-by-Case

SOCIAL / HUMAN RIGHTS -RELATED	**VOTING POLICY**
1. Adopt, endorse, or implement MacBride Principles on Northern Ireland	FOR
2. Other human rights related issues - company specific	Case-by-Case
3. Report on Maquiladora Operations	FOR

4. Endorse/implement Maquiladora Principles	Case-by-Case

COMPENSATION RELATED	**VOTING POLICY**
1. Cap executive compensation	AGAINST
2. Stock option expensing	FOR
3. Mandatory option holding period	Case-by-Case
4. Supplemental Executive Retirement Reporting	FOR
5. Performance-Based Options	Case-by-Case
6. Extraordinary Benefits	Case-by-case
7. Banning All Executive Stock Options	Case-by-Case
8. Stock option tenure holding periods (Netherlands)	Case-by-Case
9. Shareholder vote on Executive Compensation: Europe	Case-by-Case

GENERAL ECONOMIC ISSUES	**VOTING POLICY**
1. Write off debt of third world countries	AGAINST
2. Restriction on financial institutions and specifically banks that do not provide information about the identity and address of participants in transactions	FOR

HEALTH / ENVIRONMENTAL ISSUES	**VOTING POLICY**
1. Ozone layer issues	Case-by-Case
2. Accidents and environmental practices	Case-by-Case
3. Report on chemical emissions	Case-by-Case
4. Promote recycling	Case-by-Case
5. Report on military contracts	Case-by-Case
6. Report on defense expenditures	Case-by-Case

7. Report on economic conversion of defense business	Case-by-Case
8. Report on nuclear weapons production and transportation	Case-by-Case
9. Report on foreign military sales	Case-by-Case
10. Infant formula related proposals	Case-by-Case
11. Report on nicotine manipulation	Case-by-Case
12. Spin off tobacco subsidiaries	Case-by-Case
13. Report on tobacco-related litigation and costs	Case-by-Case
14. Establish a tobacco-related committee	Case-by-Case
15. Improve smoke hazard advertising	FOR
16. Warning labels for tobacco product advertising	FOR
17. Report on insurance company holdings in US tobacco companies	AGAINST
18. Report on energy resolution	Case-by-Case
19. Drug pricing and reporting	AGAINST
20. Report on U.S. domestic gun sales	FOR
21. Stop animal testing	Case-by-Case
22. Endorse/report on CERES Principles	FOR
23. Greenhouse gas emissions*	**Case-by-Case**
24. Report on company assets subject to terrorism	Case-by-Case
25. Report on company product safety	Case-by-Case
26. Report on internet Privacy	Case-by-Case
27. Report on Hydraulic Fracturing	Case-by-Case
28. Report on work place Safety	Case-by-Case
29. Company Water usage and Environmental effects	Case-by-Case

OTHER / MISCELLANEOUS	VOTING POLICY
1. Invest in training and communication	Case-by-Case
2. Report on affirmative action	Case-by-Case
3. Seek board of directors' diversity	FOR
4. Report on political contributions and trade association spending and activities*	**FOR**
5. Report on company lobby effective costs	FOR
6. Report on contract supplier labor standards	Case-by-Case
7. Bar discrimination based on sexual orientation	FOR
8. Remove genetically engineered products	AGAINST
9. Re-incorporation back to the United States	Case-by-Case
10. Concentrated animal feeding operations	Case-by-Case
11. Link executive compensation to environmental issues	Case-by-Case

Appendix

Glossary of Terms

Censors (France)
In France, certain boards contain "censors," which are essentially advisers to the board without voting rights. Censors are not defined under French law and bear no legal liability toward shareholders, and their duties are oftentimes not clearly disclosed and may vary from company to company. Despite a lack of voting rights or any legally defined responsibilities, censors oftentimes receive pay on par with that of the company's non-executive directors, and because in practice many are ex-directors or senior executives, their influence on the board may be significant.

Corporate Governance
Corporate governance is the framework within which companies exist. Its focus is the relationship among officers, directors, shareholders, stakeholders, and government regulators, and how these parties interact to oversee the operations of a company.

Executive and Director Compensation
Stock-based incentive plans are among the most economically significant issues upon which shareholders are entitled to vote. Approval of these plans may result in large transfers of shareholder equity out of the company to plan participants as awards vest and are exercised. The cost associated with such transfers must be measured if incentive plans are to be managed properly.

Generally Accepted Accounting Principles – GAAP
The common set of accounting principles, standards and procedures that companies use to compile their financial statements. GAAP are a combination of authoritative standards (set by policy boards) and simply the commonly accepted ways of recording and reporting accounting information.

Global Industry Classification Standard (GICS)
The Global Industry Classification Standard categorizes publicly traded companies into industries, and enables company and industry comparisons across countries.

Golden Parachute
A golden parachute is any type of pay (whether present, deferred or contingent) that is based on or related to a merger, acquisition or sale transaction. The justification offered for golden parachutes is that it is in shareholders' best interests that executives faced with a possible takeover should not be distracted by their personal financial fears.

Hedging
Hedging is a strategy to offset or reduce the risk of price fluctuations for an asset or equity. Therefore, hedging of company stock severs the ultimate alignment with shareholders' interests. Any amount of hedging is considered a problematic practice.

Management Say on Pay
Management say on pay (MSOP), mandated by the Dodd-Frank Act, is a non-binding ballot item proposed by the board granting shareholders the right to vote on the company's executive compensation practices. Dissatisfaction with compensation practices can be expressed by voting against MSOP rather than withholding or voting against the compensation committee.

Non-nomination System of Director Elections (Taiwan)
In Taiwan, many companies are still using a "non-nomination" system for the election of non-independent directors, which means that shareholders can literally vote for any person of legal age and companies are not obliged to provide a roster of candidates and their profiles before the meeting.

Overboarding
In view of the increased demands placed on board members, directors who are overextended may be jeopardizing their ability to serve as effective representatives of shareholders. Even if a person were retired and devoted himself or herself full time to directorships, based on a full-time work schedule (1,920 hours per year) and the estimated hours of board service (300 per year), an individual could not reasonably be expected to serve on more than six boards. Service on boards of subsidiary companies, private companies, or non-profit organizations is excluded. If a director sits on several mutual fund boards within the same fund family, it counts as one board.

Directors with full-time jobs have even less time to devote to outside board directorships. Although CEOs benefit from their exposure to other boards, this must be balanced against the time that is taken away from their primary responsibilities to their own companies. Both will suffer if a CEO is over-committed.

Pledging
Pledging involves putting up company stock as collateral for a loan. This may have detrimental impact on shareholders if the officer or director is forced to sell company stock, for example, to meet a margin call. The forced sale of significant company stock may negatively impact the company's stock price, and may also violate company insider trading policies.

Proxy Contest
Proxy contests take different forms. The most common type of proxy contest is an effort by dissident shareholders to elect their own directors. A contest may involve the entire board, in which case the goal is to oust incumbent management and take control of the company. Or, it may involve a minority of board seats, in which case dissidents seek a foothold position to change corporate strategy without necessarily changing control. Proxy contests may also be fought over corporate policy questions; dissidents may, for example, wage a proxy contest in support of a proposal to restructure or sell a company. Many proxy contests are today waged in conjunction with tender offers as a means of putting pressure on a target company's board to accept the tender offer. In a well-financed proxy contest, dissidents usually print and distribute their own proxy materials, including their own proxy card. Proxy contests usually feature letter writing and advertising campaigns to win shareholder support.

Statutory Auditors (Japan)
For Japanese companies employing the statutory auditor board structure (as opposed to the U.S.-type three-committee system), statutory auditors are elected who oversee director performance, monitor the company's outside accounting firm(s) and have their own staff to help them in their work.

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 options grant. Thus, options are usually most valuable at high-growth, low-dividend companies.

TSR

Total Shareholder Return is defined as the total returns that an investor receives for one or more securities held. In the case of stock, this includes capital gains from increases in stock price as well as dividends issued.

Tab 12

CITY AND COUNTY OF SAN FRANCISCO EMPLOYEES' RETIREMENT SYSTEM (SFERS)

INVESTMENT POLICY AND PROGRAM OVERVIEW FOR SECURITIES LENDING

APPROVED: OCTOBER 12, 2010

OBJECTIVES OF SECURITIES LENDING PROGRAM: The primary goal of SFERS' Securities Lending Program (the Program) is to generate income for the System and its beneficiaries by lending securities owned by SFERS to qualified borrowers. The program is designed as a low risk investment function to enhance the portfolio return without interfering with the overall investment strategy. A diagram of securities lending is included as Exhibit A of this document.

BACKGROUND: SFERS has participated in Securities Lending since 1996. Currently, Northern Trust serves as SFERS' master custodian and acts as SFERS' Securities Lending agent ("Agent") as well as the investment manager for the collateral investment portfolio ("Collateral Account"). This policy statement and program overview is meant to summarize key aspects of the Program. If there is any conflict between this document and the August 17, 2010 Securities Lending Authorization Agreement (SLAA) between Northern Trust and SFERS, the SLAA shall be considered authoritative.

As SFERS' Securities Lending agent, Northern Trust is responsible for locating creditworthy securities borrowers, facilitating securities lending transactions, providing daily mark-to-market and acting in a fiduciary capacity in carrying out its lending duties on behalf of SFERS. As SFERS' collateral investment portfolio co-manager, Northern Trust manages the portfolio with the goal to maximize income to the extent consistent with safety of principal, maintenance of liquidity and the investment standards set forth in the Investment Manager Objectives and Guidelines included in the August 17, 2010 agreement.

REINVESTMENT OF LENDING COLLATERAL: In return for the securities borrowed, the Borrowers provide SFERS with cash and non-cash collateral for the loaned securities.

SFERS reinvests cash collateral in securities that yield income to cover the rebate fees[1] paid to borrowers and other expenses, and to earn excess income. SFERS has elected to establish a separate account for securities lending cash collateral investments. This account is known as the "Securities Lending Short Term Investment Account." or "Collateral Account". The Securities Lending Short Term Investment Account holds units of the SFERS STEP Liquidation account whose assets are related to SFERS' previous investment in the Short Term Extendable Portfolio (STEP). The Collateral Account will be the primary reinvestment vehicle for the cash collateral received from the Borrowers.

[1] In securities lending transactions, the lender (e.g., SFERS) pays the borrower a rebate rate, which is interest on the collateral posted by the borrower. If the borrowed securities are easily borrowed and readily available (e.g., S&P 500 securities), the rebate rate is typically close to the cash collateral reinvestment rate. If the borrowed securities are difficult to borrow and in short supply (e.g., illiquid small cap or international stocks), the rebate rate paid by the lender will be lower, or could even be negative, such that the borrower pays the lender an additional rate of interest to borrow the securities.

Non-cash collateral is held in a separate account established expressly for SFERS.

SECURITIES LENDING NET INCOME SPLIT: SFERS and Northern Trust, the Lending agent, split the net income earned from the Program, with SFERS receiving 85% and Northern Trust receiving 15%.

POTENTIAL RISKS: SFERS acknowledges the following primary risks of its securities lending activities:

- **Borrower Default**: This is the risk that a borrower fails to return SFERS' securities on loan. This risk is mitigated by the fact that borrowed securities are over-collateralized (102-105%) and marked to market on a daily basis by Northern Trust. Moreover, Northern Trust provides indemnification in the event of a borrower default where there is a shortfall in collateral. Northern Trust can exercise the term in the Borrowing Agreement with the borrower to apply the collateral to purchase the failed-to-be-delivered securities and pay for any related expenses as a way of indemnifying SFERS against the borrower default. SFERS can restrict lending of its securities to any borrower at any time.
- **Settlements/Corporate Actions/Dividends and Interest:** SFERS' securities lending program is carried out with the goal of not interfering with the investment management process. Trade settlement/operational risks associated with securities lending are generally the same as those inherent in normal trading activities. Corporate actions such as voting rights remain with the security and so will become the right of the borrower when the security is lent out. SFERS can still vote proxies for those shares not on loan or may instruct Northern Trust to return shares so any specific proxy can be voted. Dividends and interest, on the other hand, belong to the lender and will continue to be credited to the lender's account when the security is on loan via a "Substitute Payment" from the borrower for distributions made by the issuer of the borrowed securities during the loan term.
- **Investment Risk:** Investment risk affecting the reinvestment of cash collateral posted by borrowers is the primary risk of securities lending. Typically the lenders (e.g., SFERS) accept all principal losses in a lending program. SFERS' contract with Northern Trust has agreed to provisions that align the interests of both SFERS and Northern Trust should there be realized losses from securities lending activities.
- **Interest Rate Risk:** This is the risk that the rebate rate that SFERS pays to the Borrowers exceeds the return on the cash collateral investments. Northern Trust monitors and manages the interest rate exposure of the cash collateral pool versus Northern's current interest rate forecast by using statistical analysis. Any negative earnings that occur as a result of interest rate risk will be shared between SFERS and Northern Trust at the same percentage as the fee arrangement (85/15).

RESPONSIBLE PARTIES:

SFERS Staff shall be responsible for the following with respect to Securities Lending:

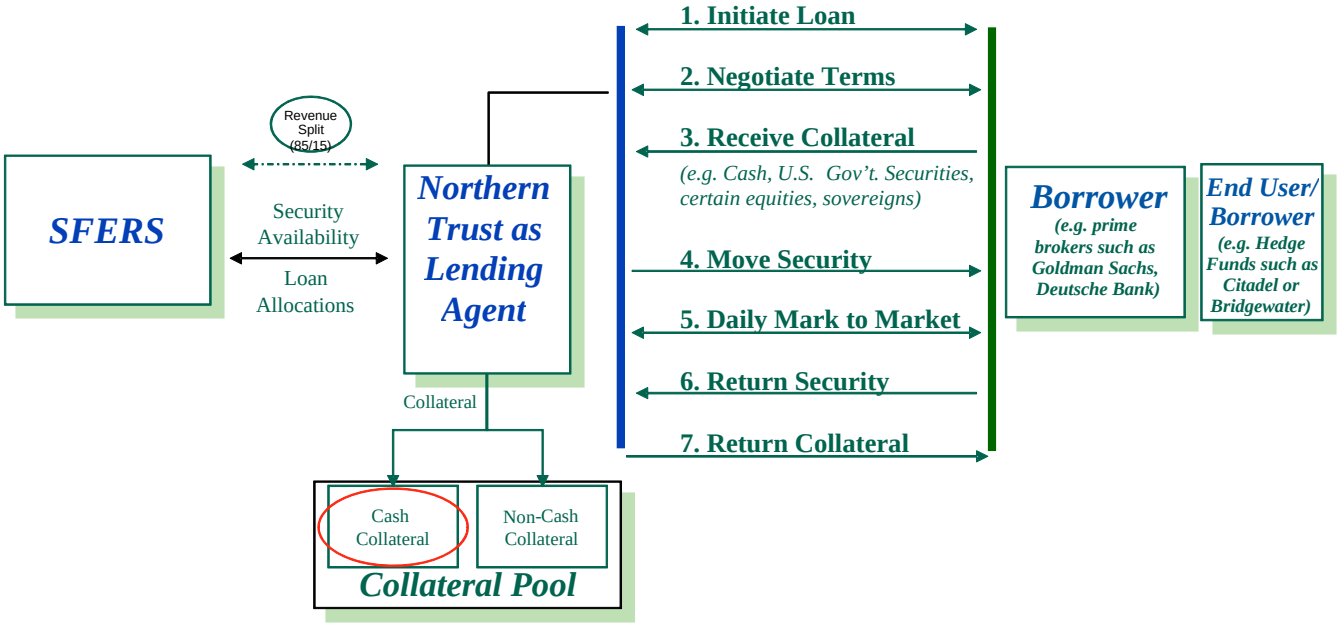
- Reporting to the Board or an appropriate Board-designated Committee at least annually on the operations and earnings of the System's Securitie**s** Lending Program.
- Overseeing the performance of the lending agent and the cash collateral investment manager in carrying out the objectives of SFERS' Securities Lending Program and complying with pre-determined guidelines.
- SFERS has the ability to limit the amount of securities lending with Northern Trust. At present, SFERS has limited the amount to $1.3 billion. This limit shall be established and reviewed regularly by the Deputy Director for Investments. SFERS Staff shall report on any limit on lending to the Board during its periodic reports on the System's Securities Lending Program.

The Northern Trust, the **Securities Lending agent** shall be responsible for:

- Ensuring that entities that borrow SFERS' securities (counterparties) are qualified.
- Indemnifying SFERS against borrower default.
- Reporting in writing to SFERS within 24 hours or less on any borrower default.
- Providing reports on the volume and lending spreads for securities lending on a monthly basis in a format acceptable to SFERS. Total income received by SFERS and by the agent, respectively, for borrowing activity shall also be reported over relevant time frames, including one month and longer periods.
- Reporting in writing to SFERS at least quarterly on trends in the securities lending marketplace.
- Investing collateral according to collateral investment guidelines agreed upon with SFERS.
- Reporting in writing to SFERS within 24 hours or less on any violations of guidelines with a plan for correction.
- Reporting to SFERS Staff in writing on its investment management activities and returns on a monthly basis in a format acceptable to SFERS.

OVERVIEW OF INVESTMENT GUIDELINES: Guidelines for the cash collateral account are provided in detail in the schedules to the Securities Lending Authorization Agreement with Northern Trust dated August 17, 2010.

Exhibit A
Diagram of Securities Lending Transaction



Source: Northern Trust.

Note: In a securities lending cash collateral transaction, SFERS receives reinvestment income from the cash collateral pool. A portion of this reinvestment income is rebated back to the borrower (or the rebate rate can be flat or negative and add to SFERS' income). The net earnings from this activity are split between SFERS and Northern Trust.