

Oregon Investment Council
MINUTES
September 25, 2002

The Oregon Investment Council was called to order at 9:05 a.m. by Gerard Drummond.

OIC Members Present: Gerard Drummond, Randall Edwards, Mark Gardiner, Diana Goldschmidt and James Voytko.

OIC Member Absent: Jerry Bidwell

Staff Present: Rhonda Bachmann, Darren Bond, Jay Fewel, Steve Gruber, Linda Haglund, Curt Hartinger, Norma Harvey, John Kreft, Perrin Lim, Michael Mueller, Kevin Nordhill and Cesar Porte.

Consultants Present: Greg Nordquist, Frank Russell Company
John Ilkiw, Frank Russell Company
Michael Russell, Pacific Corporate Group
Allan Emkin, Pension Consulting Alliance
Nori Lietz, Pension Consulting Alliance
Randall Doser, Compass Advisors

Legal Counsel: Dee Carlson, Oregon Department of Justice

I. Review and Approval of Minutes - 8/28/2002

MOTION: Randall Edwards moved approval of the 8/28/2002 minutes. The motion was seconded by Mark Gardiner and passed unanimously by the Council.

II. Green Equity Investors IV, L.P. - Presentation & Recommendation

Jay Fewel addressed the Council and reminded them that in the mid '90s', the pension fund's primary exposure in the buyout arena was in the upper-end of the buyout market, represented by firms such as KKR and TPG. At that time, Treasury staff made a concerted effort to identify funds in the middle-market buyout space to complement the large buyout fund exposure. Green Equity Investors was one of those middle-market groups, funded with \$50 million in 1998. They are currently in the market with a subsequent fund, Green Equity Investors IV, L.P. Mr. Fewel introduced John Sokoloff of Leonard Green and Partners.

Green Equity Investors IV, L.P. (the Fund) is being formed by Leonard Green and Partners to pursue the investment strategy of Green's three prior funds of making control investments in a diversified portfolio of established companies, principally through acquisitions. The Fund will target equity investments between \$50 million and \$250 million per transaction in middle market companies with enterprise values of \$200 million to \$1 billion. Continuing the strategy pursued in prior funds, investments will likely be weighted towards established consumer-oriented companies in the western United States. The Fund's target gross internal rate of return on investments is at least 30%. The proposed Fund has a target commitment size of \$1.5 billion and will not exceed \$2.0 billion. The General Partner will make a commitment of \$40 million to the Fund, equivalent to 2.7% of the fund, assuming a total fund size of \$1.5 billion. Green expects to hold an initial closing in the early autumn of 2002.

Mr. Sokoloff discussed the returns of current Green Funds from 1990 through June 30, 2002 and outlined some of the consumer-related investments in the western US, including Rite-Aid and Petco. Questions from the Council were addressed by Mr. Sokoloff.

Jay Fewel and Michael Russell addressed questions from the Council regarding available funds for investment in the current proposal as well as future alternative equity investments.

It was agreed that Staff would initiate a semi-annual "cash-flow" pacing analysis for presentation to the OIC.

MOTION: Diana Goldschmidt moved that the OIC authorize a commitment to Green Equity Investors IV, L.P. in the amount of \$100 million. Said commitment is subject to satisfactory negotiation of the requisite legal documents by legal counsel working in concert with the Oregon State Treasury Staff. The motion was seconded by Randall Edwards and passed unanimously by the Council.

III. OPERF International Equity Search

Jay Fewel reminded the Council of the termination of Nomura Capital in August 1999 and the rebalancing that followed. These monies were transferred into the BGI EAFE index fund. Staff conducted a manager search and had Arrowstreet and Lazard make presentations to the Council in June 2000. The Council retained Lazard, but tabled Arrowstreet. Arrowstreet was discussed further in July 2000 and a motion to fund them failed on a split vote. Concern was expressed about Arrowstreet being a start-up company comprised of investment professionals who had previously been employed with PanAgora Asset

Management. Staff again recommended hiring Arrowstreet as past concerns have been mitigated with the passage of time.

Mr. Fewel noted that the other recommended group, Putnam Advisors, is a very well known, established name and both Putnam and Arrowstreet would complement the current OPERF portfolio.

Members of the Council complimented staff on the staff write-ups contained within the presentation.

A. Presentation by Putnam Institutional Management

Jay Fewel introduced Sandy Whiston and Omid Kamshad of Putnam Institutional Management. Putnam is a global business managing \$93 billion for institutional clients worldwide with a 60-year tradition. They have over 300 investment and research professionals with internal, globally integrated research capabilities. They have successfully managed the International Core Equity product for 15 years with excellent relative excess returns for the 3, 5 and 10 year trailing periods. The Core Equity valuation philosophy has no predetermined style bias. Putnam has a Boston-based team of portfolio managers, supported by research analysts worldwide, who share the same investment philosophy and process. They have a three-dimensional investment approach incorporating top-down (country and sector) and bottom-up (stock-specific) inputs.

Jim Voytko left the meeting at 10:30am

Discussion followed regarding the long-term time horizon, the size of the fund and trading volume.

B. Presentation by Arrowstreet Capital

Jay Fewel introduced Peter Rathjens and Bruce Clark, founders of Arrowstreet Capital. He noted that Arrowstreet International Equity is a relatively new firm created by the investment staff that left PanAgora Asset Management. He expressed his opinion that Arrowstreet is a bright group of thinkers who use a quantitative investment style.

Mr. Rathjens and Mr. Clark presented Arrowstreet's valuation as of 6/30/02 and discussed other institutional investors and clients. Their International equity strategy has the objective to consistently outperform the MSCI All Country World Index. Their Core-style investment process was outlined, explaining how they evaluate the attractiveness of stocks across multiple dimensions.

Mr. Rathjens summarized the organizational structure and noted the consistent value-added, while maintaining flexibility and style neutrality.

Mr. Rathjens and Mr. Clark answered questions from the Council.

Jay Fewel and Greg Nordquist returned to discuss the two potential investments.

Ms. Goldschmidt expressed concern about hiring new managers, in general, rather than giving more money to the proven best performing existing managers.

Mr. Fewel addressed the question and noted that most of the existing money managers are moving to the upper end of their target ranges and that Treasury staff determined it best to hire new managers due to capacity issues regarding current allocations to individual managers in the international asset class. He further noted that the international portfolio currently does not have any manager that utilizes Arrowstreet's type of investment process and their ability to garner assets in a very difficult market has been exceptional, thus making them an excellent complement to the international portfolio.

Mr. Fewel and Mr. Nordquist discussed their confidence in Putnam's management team, particularly, Omid Kamshad.

Discussion followed regarding the vacancy in the portfolio causing a 6% overweight to the passive international product. If authorized, the funding would come from the passive area, rebalancing back into compliance between active and passive.

MOTION: Mark Gardiner moved that the OIC fund Arrowstreet Capital with \$175 million (3% target +/- 2%) as an International Market-Oriented Equity Manager. The motion was seconded by Randall Edwards.

Votes:	Gerard Drummond	Aye
	Randall Edwards	Aye
	Mark Gardiner	Aye
	Diana Goldschmidt	No

The motion was passed by the Council.

MOTION: Diana Goldschmidt moved that the OIC fund Putnam Advisors with \$175 million (3% target +/- 2%) as an International Market-Oriented Equity Manager. The motion was seconded by Randall Edwards and passed unanimously by the Council.

Members of the Council complimented staff on the report format and the presentation of due diligence.

IV. Fortress Investment Fund II, LLC – Presentation & Recommendation

Steve Gruber introduced Wes Edens and Allison Thrush of the Fortress Investment Group.

Ms. Thrush gave an overview of the firm and Mr. Edens reviewed the current fund. Fortress Investment Fund II LLC (the Fund) is a commingled real estate limited partnership. The proposed investment is a real estate “opportunity” fund sponsored by Fortress I investment Group LLC which will include a broad range of real estate and real estate-related investments located in the US and Western Europe (primarily the United Kingdom, Italy and Germany). The Fund is expected to produce overall net returns exceeding 20% with portfolio-level leverage not to exceed 65% of total value. The Fund strategy reflects the principal’s truly opportunistic investment style, wide range of skills and demonstrated ability to find and execute complex transactions and unlock embedded value.

Ms. Thrush and Mr. Edens answered questions from the Council regarding the proposed investment

Mr. Gruber noted that Fortress’ principals have demonstrated expertise in all of the areas within the program targeted in Fortress Fund II. He outlined their expertise in structured finance, corporate mergers and acquisitions, acquisition of non-performing loans, bankruptcies and restructuring of real estate related tangible assets. Three themes of the Fund were stressed: 1) control investments in US real estate operating and finance businesses, 2) direct investments in non-performing loans and 3) privatization opportunity.

The current Real Estate asset allocation was discussed and the manner in which this proposed investment fits into the portfolio.

Discussion followed regarding the conservative \$50 million proposed allocation and the break on fees if the OIC were to commit an amount up to \$100 million. Mr. Gruber noted that a due diligence visit was scheduled for October in Rome for an investor meeting. He suggested the OIC approve a “range” of commitment contingent upon his due diligence visit in next month.

MOTION: Mark Gardiner moved that the OIC authorize a commitment to Fortress Fund II, LLC in the amount of \$50 million up to \$100 million, subject to completion of due diligence by Pension Consulting Alliance and Oregon State Treasury Staff and satisfactory negotiation of the requisite legal documents by

legal counsel working with OST Staff. The motion was seconded by Randall Edwards and passed unanimously by the Council.

Overall asset allocation was discussed in relationship to committed capital and long-term returns.

V. Oregon Short-Term Fund Annual Review

Mike Mueller informed the Council that, typically, staff does an annual review of the Oregon Short Term Fund. However, due to the retirement of Jim Yasutome in April of 2001, there was no 2001 annual review presented. Therefore, the review presented today would be for the last two fiscal years.

Perrin Lim addressed the Council and extended thanks to Ellen Hanby and Debbie Beyer for steering the fund through turbulent times after Mr. Yasutome retired, (from April 2001 until he came on board in January 2002).

Mr. Lim noted that one of the changes to the fund is that more securities, beyond the one-year time period, have been added to the fund. He further noted that a few well-known names have been added to the approved commercial paper list. The goals of the fund are absolute safety of the principal, liquidity and yield (in that order). The fund follows closely the federal fund rates. He informed the Council of his intentions to propose some subtle revisions to the guidelines, possibly in the first quarter of 2003.

Mr. Lim answered questions from the Council regarding the Oregon Short Term Fund as well as Fixed Income investments.

Mr. Lim noted that the quality of the Fixed Income Fund has remained the same or increased slightly since the PERS plan has been outsourced to five fixed income managers. He further noted that he utilizes the websites and analysts made available by the five managers.

Randall Edwards thanked Mr. Lim for operating in such challenging times.

VI. OIC Consulting Contracts

The consultants were asked to leave this portion of the meeting.

Mr. Mueller outlined the current status of consulting contracts for the Oregon State Treasury. At the December 2001 meeting, the OIC voted to extend the contracts of Frank Russell Company and PCA-Emkin through the end of 2002. This action followed the report presented by Cooper Consultants at the October

31, 2001 meeting. Concurrently, the five-year term of PCA's real estate consulting contract with the OIC expires December 31, 2002. Lastly, Pacific Corporate Group's (PCG's) contract was extended on an interim basis earlier this year to expire on December 31, 2002 as well. The contract with Compass Advisors is not being reviewed at this time, since the current contract term runs through mid-December 2003. As a result, the OIC must take action before year-end relative to the following OIC consulting agreements:

- 1) Pension Consulting Alliance (PCA-Allan Emkin)
- 2) Pension Consulting Alliance (PCA-Nori Lietz)
- 3) Pacific Corporate Group (PCG)
- 4) Frank Russell Company (FRC)

Staff recommendations were for two-year extensions of the contracts. Mr. Mueller outlined options for taking action at this time and discussed software that is currently under review by Staff that will enhance staff's in-house capabilities to calculate performance for real estate and alternative equities.

The Council expressed concern regarding the granting of two-year renewals at this time, pending the new CIO position being filled in December. It was suggested to shorten the contract extensions to one-year terms, allowing the new CIO to become familiar with the process and comment at the end of a year.

Mr. Mueller reminded the Council of the policy mandating the annual rotating audits of each of the five major asset classes. The next scheduled review will be performed by Deloitte & Touche with regards to the Alternative Equity program. They will be reviewing internal controls and financial reporting for the one-year period ending June 30, 2002.

Mr. Mueller recommended retaining Cooper Consultants to perform an in-depth analysis of Pacific Corporate Group and noted that there was a proposal from Cooper Consultants included with the meeting materials. He further noted that Cooper Consultants is the only firm that specifically targets plan sponsors and evaluates consultants or consulting firms.

Discussion followed regarding the evaluation procedure utilized by Cooper Consultants and it was concluded that, if retained, Cooper would have individual conversations with each Council regarding their individual concerns, thus modifying the questionnaire.

Mark Gardiner suggested extending all the four contracts for one year, until the new CIO and staff were able to network with peers and compile OIC concerns and reconsider retaining Cooper Consultants at the end of 2003.

MOTION: Mark Gardiner moved to extend the contracts of Pension Consulting Alliance-Allan Emkin, Pension Consulting Alliance-Nori Lietz, Pacific Corporate Group and Frank Russell Company to December 31, 2003. The motion was seconded by Randall Edwards and passed unanimously by the Council.

VII. Corporate Governance Workshop Agenda

Mr. Mueller presented a semi-final draft of the October Corporate Governance workshop. Council preferences for agenda items and panelists were discussed and noted.

VIII. Asset Allocation

- a. OPERF
- b. SAIF Corporation
- c. Common School Fund

IX. Calendar - Future Agenda Items

X. Other Items

The minutes of the September 16, 2002 Alternative Equity Sub-Committee meeting were presented where a commitment in the amount of \$75 million to Wellspring Capital Partners III, L.P. was approved, subject to satisfactory legal negotiation.

XI. Public Comment

There were no comments from the public.

The meeting adjourned at 1:12pm.

Respectfully submitted,

Norma Harvey
Investment Analyst