Oregon Investment Council
MINTUES
January 26, 2005

The Oregon Investment Council was called to order at 9:00 a.m. by Gerard Drummond.

OIC Members Present: Paul Cleary, Gerard Drummond, Randall Edwards, Mark Gardiner and Richard Solomon.

Staff Present: Brad Child, Jay Fewel, Steve Gruber, Linda Haglund, Norma Harvey, Andy Hayes, Wei Huang, John Kreft, Perrin Lim, Mike Mueller, Kevin Nordhill and Ron Schmitz.

Consultants Present: Mike Beasley, Strategic Investment Solutions (SIS)
John Meier, Strategic Investment Solutions
Tara Blackburn, Pacific Corporate Group (PCG)
Nori Lietz, Pension Consulting Alliance (PCA)
Allan Emkin, Pension Consulting Alliance

Legal Counsel: D. Kevin Carlson, Oregon Department of Justice

I. Review and Approval of Minutes – December 16, 2004

MOITON: Randall Edwards moved approval of the 12/16/2004 minutes as corrected. The motion was seconded by Richard Solomon and passed unanimously by the Council.

II. Hicks, Muse, Tate & Furst Europe Fund II, L.P. – Presentation and Recommendation

Jay Fewel introduced John Muse, Lyndon Lea and Neil Richardson of Hicks, Muse, Tate & Furst. HMTF Europe Fund II is being formed by the General Partner to make equity and equity-related investments in acquisitions of a diversified portfolio of media, manufacturing, branded food and consumer products, and other businesses located in Europe. As in Fund I, the General Partner will seek to invest in established companies with strong and stable cash flow. The majority of the investments are expected to be in companies that fall into the middle market category (defined as companies with enterprise values less than €500 million), requiring equity investments between €50 and €150 million. Businesses of this size are particularly suitable for HMTF's philosophy of taking a controlling stake in a business, attempting to build value, and creating a strategically attractive company that is a leader in its industry. HMTF's pursuit of middle market businesses also helps it avoid the intense competition for attractive deal flow that is often characterized by larger

European buyouts, while preserving a variety of exit alternatives for each platform company.

Mr. Muse discussed the history of the firm and their record of success since inception in 1998. Mr. Lea gave an overview of Europe Fund II and outlined the investment strategy and sector focus. The track record and performance of Fund I was presented as well as Fund II investments.

Mr. Muse, Mr. Lea and Mr. Richardson answered questions from the Council.

Jay Fewel and Tara Blackburn presented staff recommendations and discussed the potential future separation between the European firm and the US firm of HMTF.

Mr. Fewel and Ms. Blackburn answered questions from the Council.

MOTION: Mark Gardiner moved that the OIC authorize an up to $100 million commitment to HMTF Europe Fund II, L.P. Said commitment is subject to the satisfactory negotiation of the requisite legal documents by legal counsel working in concert with OST Staff and PCG. The motion was seconded by Randall Edwards and passed unanimously by the Council.

III. Alternative Equity – Annual Plan

Jay Fewel and Tara Blackburn presented the Alternative Equity Annual Review. Mr. Fewel noted that the Alternative Equity program saw approximately $2.5 billion in realizations during 2004. Ms. Blackburn gave a recap of the 2004 IPO Market and noted that after a sharp rise and subsequent decline, fundraising is now at normalized levels. She further noted that venture capital and buyouts investment levels are likely to increase in 2005.

Ms. Blackburn outlined the investment management highlights of 2004 as follows:

- 2004 proved to be a very active year with almost $1 billion in vintage year commitments
- Staff conducted 331 partnership preliminary screenings
- 13 funds were approved for further due diligence
- 10 funds were approved by PCG's Investment Committee and OPERF
- 10 funds were closed during 2004

Vintage year benchmarking analysis was presented with strong overall relative performance.

The 2005 strategy was presented with planning objectives and priorities, as follows:

- Objective: To reach and maintain a 10% (+/- 3%) Private Equity target allocation, subject to the availability of attractive investment opportunities.
- Priorities: A top down approach to optimal portfolio diversification.
  1) Diversification by Vintage Year
  2) Diversification by Sub-sector
  3) Diversification by Manager

Conclusions:

- Increase in commitment pace to maintain target allocation to private equity.
- Target commitments of $1.2 billion in 2005, with a range of +/- 20% ($1.0 to $1.4 billion)
- Maintain a philosophy of consistent capital deployment within a prudent range, based on market conditions.
- Manage recommended sub-sector target ranges to maintain proper diversification.

Mr. Fewel and Ms. Blackburn answered questions from the Council and discussed co-investment opportunities.

IV. Real Estate – Annual Plan

Steve Gruber and Nori Lietz presented the 2004 Real Estate Portfolio Review and noted that the market is awash in capital, especially in core assets. Investors crave stable yields and are willing to pay significant premiums for near-term certainty. Mr. Gruber reviewed current pro forma IRRs, risk and NCREIF index returns, for the trailing one-year period, as of September 30, 2004. Discussion followed regarding direct property returns and market fundamentals.

Mr. Gruber and Ms. Lietz addressed the question of how much risk should be incurred in the real estate program going forward.

Portfolio review:

- Portfolio is intentionally invested at the low end of the OIC policy range (5.4% vs 8.0% target).
- Portfolio is in compliance with Real Estate Policies.
- Transaction flow and opportunities are numerous, however staff and PCA are of the opinion that current "core" property pricing inadequately compensates for risk.

Discussion followed regarding the direct property portfolio, opportunistic portfolio, and REIT portfolio.

2005 Investment Objectives:

- Continue to judiciously acquire and dispose of Direct Properties.
- Continue to provide capital to successful, existing managers for Direct Properties, Opportunistic Investments and REITs.
- Actively manage the portfolio and seek out new relationships and investments.
- Develop the co-investment program and policies.
- Work out solution to AMC; 10 year rent abatement period ends June 30, 2005.

Mr. Gruber and Ms. Lietz outlined 2005 implementation alternatives and staff recommendations.

2005 Recommendations:

- Staff recommends lowering the return threshold for industrial managers from 10.25% to 8.5%.
  - Return thresholds has been reduced for all other Direct Property Managers.
  - Staff recommends revising the preferred return in the Columbia Industrial Properties operating agreement from 10.25% to 8.5% for all transactions acquired after 12/31/04.
  - Staff also recommends revising the preferred return in the operating agreement with GID from 9.0% to 8.5% for all transactions acquired after 12/31/04.

It was the consensus of the Council to "stay the course" in 2005. Mr. Gruber was advised to notify the Council in the case of any outstanding opportunities and bring them before the Council for approval.

MOTION: Randall Edwards moved approval of staff recommendations to lower return thresholds for Industrial and Multifamily Managers to 8.5% for all transactions after 12/31/2004. The motion was seconded by Richard Solomon and passed unanimously by the Council.

V. <u>SAIF Corporation – Annual Review & Asset Allocation Study</u>

In accordance with OIC Policy 4.09.06 for SAIF: "Review of the asset allocation policy, investment management and performance will occur at least annually with the OIC and more frequently by Treasury staff. These reviews will focus on the continued appropriateness of policy, compliance with guidelines and performance relative to objectives. A formal process shall be established allowing SAIF staff to meet with OIC's consultants on an annual basis to discuss issues of management and asset allocation. In addition, SAIF staff will have the opportunity to address the OIC annually to discuss SAIF's particular views as to the management of the fund."

Mike Mueller addressed the Council and noted that SAIF represents Treasury's second largest customer at $3 billion in assets. He further noted that Treasury Staff and SAIF just completed a four-year phase-in of an asset allocation policy. Overall the portfolio has performed quite well, especially in the fixed income arena. Over the past year, in accordance with OIC policy, Treasury has been working with Froley Revy to continue to reduce SAIF's exposure to convertible bonds, while increasing the fixed income exposure.

Mr. Mueller introduced Brenda Rocklin and Jerry Dykes of SAIF Corporation and noted that SAIF had retained a consulting firm, Conning Asset Management, to complete a strategic asset allocation study based on liabilities. Representatives from Conning were present to present their asset allocation recommendations. It was noted that Treasury staff reviewed the policy recommendations, by SAIF and Conning, with input from SIS, as well as from Western and Wellington, since the changes are most dramatic to the fixed income managers. It was noted that all parties are comfortable with the recommendations.

Ms. Rocklin and Mr. Dykes reviewed the SAIF portfolio, discussed premium rates and recommended policy changes. Ms. Rocklin noted that the recommendations have also been approved by the SAIF Board of Directors.

Mr. Dykes reviewed the historical medical escalation on indemnity claims, and discussed surplus and asset allocation.

Scott Daniels and Robert Painter of Conning Asset Management presented their "SAIF Corporation Investment Strategy Review." They reviewed the financial modeling process used to test alternative strategies and SAIF's strategic objectives. They also discussed a recommended investment strategy developed by Conning and SAIF, and outlined implementation issues.

A summary of key recommended changes are:

1. Eliminate the exposure to convertible bonds (i.e., Froley Revy), within the next two years.
2. Increase the target allocation to passive domestic equities from 10% to 15%, by 2005 year-end.
3. Increase the target allocation to domestic fixed income, from 82% to 85%, over the next two years.

MOTION: Richard Solomon moved adoption of staff recommended changes to OIC policies 4.09.01, 4.09.02, 4.09.03 and 4.09.04. The motion was seconded by Randall Edwards and passed unanimously by the Council.

VI. Oregon Savings Growth Plan Review – Deferred Compensation

Kevin Nordhill and Mike Beasley presented the annual review of the Oregon Savings Growth Plan (OSGP) investments, Oregon's Deferred Compensation Program. Mr. Nordhill noted that the OSGP has performed very well since exiting the variable annuity contracts on October 31, 2001, and performed well in 2004. Since October 31, 2001, all options, except the Short-Term Fixed Option, have exceeded their benchmark. During calendar year 2004, all options, except the Short-Term Fixed Income and the International Equity Options, outperformed their benchmarks. Risk, as measured by tracking error, has been significantly reduced in all but the Intermediate Fixed Income Option.

Mr. Nordhill reviewed the OSGP risk-return comparisons and answered questions from the Council.

MOTION: Mark Gardiner moved adoption of staff recommendations to: 1) replace the Van Kampen Comstock Fund with the LSV Value Fund in the Large Cap Value Option and 2) add the Marsico International Opportunities Fund to the International Equity Option and assign equal target weightings for the funds comprising the International Equity Option. The motion was seconded by Richard Solomon and passed unanimously by the Council.

It was the consensus of the Council to have staff return with a policy to delegate further manager changes to staff, subject to advanced OIC notification and consultant approval, similar to the Alternative Equity and Real Estate Committees.

VII. Alliance Capital Management – Manager Target Allocation

Ron Schmitz addressed the Council and noted that during the domestic equity review in 2004, staff, SIS and the Council discussed the following issues regarding Alliance Capital Management:

- OPERF's total exposure to Alliance Capital Management across all asset classes.
- The mutual fund scandal.
- Performance of the large cap growth portfolio.

The OIC approved the strategic change but deferred the proposed funding of Alliance until the issues could be resolved. Mr. Schmitz noted that the issues have been resolved and staff and SIS are very comfortable with the depth of resources, the process and the decision making procedures at Alliance.

Mr. Schmitz presented information regarding the current performance of portfolio manager, Jim Reilly, versus the 1999 – 2003 former portfolio manager, Al Harrison.

Mike Beasley concurred with staff recommendations.

Mr. Schmitz and Mr. Beasley answered questions from the Council. Mark Gardiner noted his continued concern regarding OPERF's total exposure to Alliance.

MOTION: Richard Solomon moved that the OIC authorize staff to fund Alliance Capital Management Large Cap Growth product with an additional $250 - $325 million. The motion was seconded by Randall Edwards.

Votes:	Gerard Drummond	Aye
	Randall Edwards	Aye
	Richard Solomon	Aye
	Mark Gardiner	No

The motion passed.

VIII. Asset Allocations & NAV Updates

Ron Schmitz reported that asset allocation and NAV updates are all within policy parameters.

IX. Calendar Future Agenda Items

X. Public Comment

There were no comments from the public.

The meeting adjourned at 12:37 p.m.

Respectfully submitted,

Norma Harvey
Investment Coordinator