Oregon Investment Council
MINUTES
July 27, 2005

The Oregon Investment Council was called to order at 9:03 a.m. by Gerard Drummond.

OIC Members Present: Paul Cleary, Gerard Drummond, Katy Durant, Mark Gardiner and Richard Solomon.

OIC Member On-Line: Randall Edwards

Staff Present: Brad Child, Jay Fewel, Norma Harvey, Andy Hayes, Wei Huang, Kevin Max, Mike Mueller, Kevin Nordhill, Ron Schmitz and McKenzie Tennent.

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

Legal Counsel: Ted Falk, Oregon Department of Justice

I. Review and Approval of Minutes – May 18, 2005

MOTION: Mark Gardiner moved approval of the May 18, 2005 OIC Minutes. The motion was seconded by Richard Solomon and passed unanimously by the Council.

II. JP Morgan, Asia Opportunity Fund II, L.P. – Presentation & Recommendation

Jay Fewel gave an overview of the proposed investment and discussed the fund's Asia exposure as a complement to CVC Asia. He introduced Andrew Liu and John Lewis of J.P. Morgan Partners Asia Ltd. Asia Opportunity Fund II, L.P. is being formed by J.P. Morgan Partners Asia Ltd. To acquire controlling stakes in medium to large-sized market-leading companies throughout Australia, mainland China, Hong Kong, Taiwan, Japan, Singapore, and South Korea. The firm was co-founded in 1999 by J.P. Morgan Partners, LLC and Andrew Liu to focus on Pan-Asian buyout opportunities. Since inception, the general partner has raised $1.1 billion of capital commitments through one prior fund and invested almost $800 million in the region. Fund I has generated strong returns with gross and net IRR's of 22.7% and 14.1% as of December 31, 2004, respectively. Relative to 1999 vintage year funds in the U.S., Euro Fund I comfortably ranks in the top-quartile of Venture Economics' buyout returns.

Mr. Liu outlined the JP Morgan Asia investment team and proprietary network of industry consultants. He gave an overview of JPM Asia's signature investments spanning industries and territories, discussed Fund I performance and reviewed the investment strategy. Leveraged buyouts and the JPM global integrated network were reviewed. Mr. Liu outlined the JPM disciplined investment process including deal origination, diligence, value creation and exit/liquidity. Country strategies and fundraising plans were discussed. Mr. Liu and Mr. Lewis answered questions from the Council.

Jay Fewel, Tara Blackburn, Wei Huang and Monte Brem answered questions from the council regarding the allocation. Mark Gardiner began a discussion regarding potential opportunities in India and China.

MOTION: Richard Solomon moved that the OIC authorize a $100 million commitment to JP Morgan, Asia Opportunity 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 Katy Durant and passed unanimously by the Council.

III. Aetos Capital Asia Fund II, L.P. – Presentation & Recommendation

Brad Child and Nori Lietz outlined the staff recommendation for Aetos Capital Asia Fund II, L.P. (ACAII) and presented background information. ACAII's strategy is to take advantage of the structural inefficiencies in the Japanese market following the bursting of a real estate asset bubble. As a result of the economic meltdown of the early 1990s, a significant amount of distressed real estate assets remain on corporate balance sheets. Corporate boards and management teams are being forced to address this legacy situation. In the Japanese market today, there are opportunities to purchase real estate assets, portfolios and companies at attractive valuations. ACA II focuses on these types of opportunities as they enable attractive returns to be earned even in the absence of a recovery in either the Japanese economy or its property markets.

ACA II will seek to take advantage of two opportunities in Japan and selectively, elsewhere in Asia. One is the wholesale to retail arbitrage, buying large real estate portfolios, repositioning them and selling on a retail basis. The other is buying assets that have substantial operational issues such as low occupancy, deferred maintenance, capital improvement needs or issues with tenants. These issues often result from poor management rather than an inherent problem with the asset. In these situations, attractive returns can be earned by buying a "troubled" asset at a discount, aggressively managing the property, and then selling it as a stabilized investment. Both strategies take advantage of Aetos' strong, local team for execution.

Mr. Child introduced Suzanne West and Scott Kelley of Aetos Capital Asia. Mr. Kelley gave an overview of the specific opportunity and noted that Japan is undergoing significant restructuring activity and transferring real estate ownership is a key component of this restructuring. He further noted that ACAII will capitalize on two specific arbitrage opportunities when acquiring properties, resulting from the restructuring:

- ❖ Wholesale to Retail Arbitrage
- ❖ Financial or Operational Distress Arbitrage

The ACA track record was discussed as well as management teams in New York and Japan.

Questions from the Council were answered regarding competitors and opportunities in other Asian countries.

Council discussion followed regarding the possibility of making a higher commitment to ACAII. Ms. Lietz noted that the fund is currently oversubscribed, but a higher commitment may possibly be negotiated.

MOTION: Richard Solomon moved approval of staff recommendation to authorize a commitment of $75 to $100 million to Aetos Capital Asia Fund II, L.P. The motion was seconded by Katy Durant and passed unanimously by the Council.

IV. Real Estate Portfolio Update

Nori Lietz and Brad Child presented the 2004 Real Estate Portfolio Review to the Council. Ms. Lietz reviewed portfolio investments and performance and noted the following:

- ❖ One and three year performance were positively influenced by:
  - ➢ REIT Portfolio – trailing one and three year returns of 38.9% and 28.8%, respectively.
  - ➢ Direct Properties Portfolio – trailing one year return of 22.9%.
  - ➢ Opportunistic Portfolio – trailing one and three year returns of 21.2% and 17.7%, respectively.
- ❖ OPERF at low end of real estate policy range at 5.7% of composite investment portfolio due to asset sales and difficulty in managers finding accretive investments.
- ❖ OPERF real estate portfolio and sub-portfolios have each exceeded their respective benchmarks over the last five-years.
- ❖ The real estate portfolio and all sub-components are within policy, with the following exceptions:
  - ➢ The apartment sector is slightly below the policy range (-$24mm) and the office sector is slightly above the policy range (+$17mm).
- ❖ The Direct Property portfolio has significant available capacity, with $662 million available to reach policy target, based on an 8% real estate portfolio allocation.
- ❖ In 2004, appreciation played a major role in the growth of NAV comprising over 20% of the total increase in the real estate portfolio's NAV.

Discussion followed regarding the opportunistic space and asset targets. It was the consensus of the Council to discuss these issues during the Fall OIC Workshop. Ms. Lietz noted that she would stay alert to the issues and return with some alternative suggestions.

V. Warburg Pincus Private Equity IX, L.P. – Presentation & Recommendation

Jay Fewel addressed the Council and outlined the difference in the Warburg Pincus opportunity from what Staff normally recommends. He noted that Warburg Pincus does not fit into any one category, but engages in venture capital deals, large buyouts, domestic, and international investments. Therefore, their classification will be “special situation.” Mr. Fewel introduced Steven Schneider and Joseph Landy of Warburg Pincus.

Warburg Pincus Private Equity IX, L.P. is being organized by the General Partner to make venture, growth and buyout equity investments in the healthcare/life sciences, natural resources, financial services, computer software/services, communications hardware/services, media and general industrials sectors. Approximately 70% of the Fund is expected to be invested in North American-based companies and the remaining 30% will be invested internationally (Europe and Asia). Warburg Pincus was founded in 1966 and currently manages approximately $13 billion of capital. Since its inception, the General Partner has invested a total of approximately $17 billion in over 500 companies generating gross and net IRRs of 24.6% and 18.1% as of December 31, 2004, respectively. Over the last ten years, Warburg Pincus has distributed approximately $25 billion to its limited partner investors with a net IRR of 18.7%.

Warburg Pincus Private Equity IX will follow the same investment strategy employed throughout its 39-year history and across its ten previous venture capital and leveraged buyout funds. The Fund will be diversified across stage of life, geography and industry sector. The General Partner maintains the flexibility to adjust its investment approach in response to business cycles, sector developments and technological changes, as well as for macroeconomic, geopolitical and financial market conditions with the support of its strong global presence. As a result, this approach allows Warburg Pincus to provide the best perceived balance of risk and reward, at any given time, and make decisions not to invest in certain stages, sectors or regions when the risk/reward is not deemed appropriate. The General Partner seeks to raise $7 billion in commitments ($7.8 billion hard cap) and to invest in approximately 75 to 100 portfolio companies. Warburg Pincus is committing $150 million to the Fund. Because the General Partner values OPERF as a potential investing partner, they are offering the allocation even though the new fund has already been oversubscribed, and the Fund is targeting a late July 2005 final close date.

After outlining performance, investment professionals and investment strategy, Mr. Landy and Mr. Schneider answered questions from the Council.

Jay Fewel, Wei Huang and Tara Blackburn addressed Council questions regarding an increase in the commitment amount. It was the consensus of the Council to increase the commitment beyond the staff recommendation.

MOTION: Randall Edwards moved that the OIC authorize up to a $200 million commitment to Warburg Pincus Private Equity Fund IX, 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 Mark Gardiner and passed unanimously by the Council.

VI. OPERF Special Situations Fund – OIC Policy

Ron Schmitz led a discussion regarding the pros and cons of establishing a “Special Situations” allocation within the OPERF portfolio and presented a draft policy for consideration. Mike Beasley and John Meier outlined the draft policy to accomodate strategies not fitting any specific asset class or “special situations” such as niche strategies.

Allan Emkin joined the discussion and encouraged the Council to set a minimum investment size and consider time and resources involved. He noted that any special situation fund should be large enough to make a meaningful impact on the portfolio.

Discussion followed regarding the types of investments that would qualify as well as investment objectives.

It was the consensus of the Council that Staff, SIS and Allan Emkin work together on the draft policy to further articulate investment objectives, create barriers and minimum fund sizes and present it at a future meeting.

VII. Asset Allocations & NAV Updates

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

VIII. Calendar – Future Agenda Items

Ron Schmitz reviewed future agenda items.

IX. Other Items

Ron Schmitz noted that the council previously increased the private equity target to 12% and that the policies have been updated. However, he suggested, with respect to total fund benchmark, that the private equity portfolio reach the old 10% target prior to the implementation of the proposed total fund benchmark changes. Further, he suggested moving to the 12% target in 1% increments.

Mr. Schmitz discussed the Fall OIC workshop and encouraged the Council to contact him with any recommended topics.

Mark Gardiner requested guidance and clarification from the attorney general's office on implementation of the new law regarding conflicts and potential conflicts of interest.

XI. **Public Comment**

Bill Parish of Parish and Co. commented on agenda items and potential conflicts of interest.

The meeting adjourned at 12:45 p.m.

Respectfully submitted,

Norma Harvey
Investment Coordinator