Oregon Investment Council
MINUTES
March 2, 2006

The Oregon Investment Council was called to order at 9:00 a.m. by Richard Solomon, Chair.

<u>OIC Members Present</u>: Paul Cleary, Harry Demorest, Katy Durant, Randall Edwards, Mark Gardiner and Richard Solomon.

<u>Staff Present</u>: Brad Child, Jay Fewel, Linda Haglund, Norma Harvey, Andy Hayes, Wei Huang, John Kreft, Perrin Lim, Kevin Max, Kevin Nordhill, Ron Schmitz and McKenzie Tennent.

<u>Consultants Present</u>: Mike Beasley, Strategic Investment Solutions (SIS)
John Meier, Strategic Investment Solutions
Tom Keck, Pacific Corporate Group (PCG)
Allan Emkin, Pension Consulting Alliance (PCA)
Nori Lietz, Pension Consulting Alliance
Mike Moy, Pension Consulting Alliance

<u>Legal Counsel</u>: D. Kevin Carlson, Oregon Department of Justice

<u>I. 9:00 am: Review and Approval of Minutes – 1/18/06 & 2/17/06</u>

MOTION: Randall Edwards moved approval of the January 18, and February 17, 2006 OIC Minutes. The motion was seconded by Mark Gardiner and passed unanimously by the Council.

***Item #3 was moved ahead on the agenda.**

<u>III. 9:03 am: TPG Partners Fund V – Presentation & Recommendation</u>

Jay Fewel reviewed the favorable relationship between Texas Pacific Group (TPG) and OPERF since 1994. He introduced David Bonderman of TPG. The OIC and OPERF have had a longstanding relationship with TPG dating back to the early 1990s, having made a $50 million commitment in 1994, a $300 million commitment in 1997, a $300 million commitment in 2000 and a $300 million commitment in 2003 to all TPG's prior funds, TPG Partners I, TPG Partners II, TPG Partners III and TPG Partners IV, respectively. Since inception, the General Partner has invested $10.3 billion in over 90 investments, across various industries in North America, Europe, and Asia and in different types of investment environments. Overall, TPG has produced a gross (net) overall IRR of 28.9% (22.5%) and a gross (net) total value multiple of 2.0x (1.7x), as of December 31, 2005. The most recent fund, TPG IV, formed in 2003 has completed twenty investments totaling approximately $3.5 billion and has returned approximately $1.6 billion, through December 31, 2005. The estimated remaining value is approximately $3.5 billion which would generate a net IRR of 45.4% and a net multiple of 1.3x, respectively. These results, according to Venture Economics, have positioned TPG as a consistent top performer in the large cap space.

Mr. Bonderman reviewed the proposed investment and answered questions from the Council.

Jay Fewel and Tom Keck answered questions from the Council regarding co-investment opportunities and deals in the pipeline.

MOTION: Katy Durant moved that the OIC authorize a $300 million commitment to TPG Partners V, L.P. as well as up to $300 million for Co-Investments. Said commitment is subject to the satisfactory negotiation of the requisite legal documents by legal counsel working in concert with OST Staff. The motion was seconded by Harry Demorest.

Votes:	Harry Demorest	Aye
	Katy Durant	Aye
	Randall Edwards	Aye
	Mark Gardiner	No
	Richard Solomon	Aye

The motion passed.

II. 9:43 am: Pictet Asset Management – Emerging Markets Equity

Kevin Nordhill and John Meier outlined staff recommendations. Staff and SIS recently conducted a search to identify a possible replacement manager for Wells Capital that would improve the expected risk/return profile of OPERF's Emerging Market sub-asset class. The result of the search is a recommendation to replace the Wells Capital Emerging Market product with Pictet Asset Management. Staff and SIS believe the Pictet product is a better fit with Genesis because:

- Pictet has a value bias that is not concerned with typical growth metrics. Wells Capital and Genesis both tend to look for companies with good growth prospects.
- Pictet has deeper staffing and is better resourced than Wells Capital.
- Pictet's investment process casts a much wider net in researching companies than Wells Capital, providing more investment opportunities.
- Pictet's investment process is diversified and should produce better risk adjusted returns as measured by information ratios. Periods of significant underperformance are far less likely.

Mr. Nordhill introduced Steven Burrows and John Maratta of Pictet. Pictet is a Swiss partnership formed in 1805, and currently has eight active partners managing $136 billion. Most international equity products are managed in London where a dedicated Emerging Markets equity team manages $10.5 billion. The dedicated Emerging Market equity team is well staffed with 13 investment professionals and two dedicated traders. They sit adjacent to the Emerging Market debt team and share ideas and research. Pictet employs a bottom-up stock picking process that focuses on "capacity priced below replacement cost." This is a very unique investment approach. Most managers focus on prospective earnings, free cash flow, dividends, or book valuations. The investment process has a value bias which is deemed complementary to Genesis. Pictet's database covers 6,100 emerging market companies in 60 countries, whereas the MSCI Emerging Markets Index contains only 800 companies in 26 countries. SIS has included a far more detailed description of Pictet's investment process in their presentation. The investment team is quite competent and the product's historic returns have been very good and consistent. Capacity is an issue, and they have been closed in the past. They currently have a soft opening for approximately $500 million, and are selective about new clientele. Capacity issues are lessened by the low turnover of stocks, higher diversification levels at 150-200 holdings, and the fact that they invest in many companies outside of the benchmark.

Mr. Burrows and Mr. Marratta outlined the Pictet investment process, investment philosophy and reviewed the emerging markets equities team. The stock selection process, risk control and performance was also discussed and questions from the Council were answered.

Jay Fewel, Kevin Nordhill and John Meier addressed questions from the Council regarding differences between Pictet and Genesis.

MOTION: Randall Edwards moved that the OIC authorize the termination of Wells Capital Management's Emerging Market product, the hiring of Pictet's Emerging Market Equity Product and the approval of amendments to OIC Policy 4.05.12. The motion was seconded by Mark Gardiner and passed unanimously by the Council.

Mark Gardiner complemented Pictet for their diverse team and encouraged staff and Council going forward, to look for management teams that reflect such diversity.

IV. 10:16 am: Focus Ventures III – Presentation & Recommendation

Mark Gardiner declared a potential conflict of interest and noted that he would not participate in any discussion or voting. He further noted that he has investments in companies that either currently have or may have a future conflict of interest.

Jay Fewel addressed the Council and noted that Focus is a smaller commitment to a newer relationship. He indicated that this proposed investment is a result of an effort to boost exposure to venture capital. He further noted that such investments are often not open to new investors. He introduced Steven Bird and Kevin McQuillan of Focus Ventures, LLC. Focus Ventures III, L.P. is being formed by Focus Ventures, LLC to invest exclusively in expansion and later-stage technology companies. The firm was established in 1997 with seed funding provided by GM Pension and the Cha Group, a large multi-national family controlled investment company based in Hong Kong. Since inception, the General Partner has invested approximately $431 million in 86 companies across its two previous funds. As of December 31, 2005, the portfolio has realized $557 million with a remaining value of $114 million and a gross IRR and total value multiple of 276.2% and 1.6x, respectively.

According to PCG's detailed analysis, the outlook for Fund II is promising due to its post-2000 investments. The fund has already realized four successful deals. Additionally, the General Partner expects four liquidity events in 2006. Based on these expected realizations, a conservative net estimate for Fund II's post-2000 portfolio return is 11.4% or 1.3x. This brings the post-2000 portfolio into the top-quartile. PCG believes that this is more indicative of what can be expected from the team in terms of investment discipline and capital preservation for the portfolio, going forward.

Mr. Bird and Mr. McQuillan outlined their access to top VCs, proven selection process and experienced team. They reviewed numerous investments with top-tier early stage VCs and discussed expansion stage investing. Sector analysis, and monitoring were addressed as well as the Asian Network for portfolio companies. Discussion followed regarding performance of Funds I & II.

Jay Fewel, Wei Huang and Tom Keck discussed staff recommendations and answered questions from the Council regarding making a larger commitment.

MOTION: Randall Edwards moved that the OIC authorize a $40 million commitment to Focus Ventures III, L.P. Said commitment is subject to the satisfactory negotiation of the requisite legal documents by legal counsel working in concert with OST Staff. The motion was seconded by Harry Demorest and passed by the Council. Mark Gardiner abstained from voting.

V. 11:05 am: OVP Venture Partners VII – Presentation & Recommendation

Mark Gardiner noted that he would abstain from commenting or voting because he has an actual conflict of interest. He further noted that OVP has invested in one of his companies.

Jay Fewel reviewed OPERF's long-standing relationship with OVP and noted that this proposed investment would normally go through the Private Equity Committee, except that he wanted a representative from OVP to come before the Council and discuss what transpired with OVP V, which has been a considerable disappointment. He introduced Gerry Langeler, David Chen and Chad Waite of OVP. The OIC and OPERF made a $10 million commitment in 1994, a $14 million commitment in 1997, a $25 million commitment in 1999 and a $40 million commitment in 2001 to OVP's prior funds, Olympic Venture Partners III, Olympic Venture Partners IV, Olympic Venture Partners V and OVP Venture Partners VI, respectively. Since its inception back in 1983, the firm has raised over $500 million through six prior funds and has backed over 85 companies. None of the partners who initiated the first two funds are currently active in OVP. Since 1994, the current General Partners have invested approximately $297 million in 62 companies across Funds III through VI. They have had 15 successful IPOs and have had 9 portfolio companies acquired. As of September 30, 2005, the team has realized $348 million and the portfolio is valued at an unrealized value of $85 million. The gross IRR and total value multiple are 36.5% and 1.5x, respectively. The net IRRs and multiple of investment on an individual fund basis are 29.8% and 2.2x for Fund III, 68.7% and 2.2x for Fund IV, -23.8% and 0.4x for Fund V, and -0.9% and 0.9x for Fund VI, respectively. OVP III and OVP IV have been solid performers with OVP IV ranking in the top-quartile of the Venture Economics universe for funds formed during 1997 and OVP III ranking just below the top-quartile. On the other hand, OVP V has been a great disappointment not only because of the vintage year, but also due to the crossover investments the General Partner made from Fund IV and their inability to attract strong syndicate partners. On a positive note, that experience has taught OVP some lessons. The General Partner no longer entertains crossover investments and will always look to invest as part of a syndicate. To date, OVP VI appears to be a promising portfolio, although it is too early to have a meaningful assessment of its performance given the typical "J-Curve effect" on venture capital funds.

Mr. Langeler and Mr. Chen discussed northwest VC opportunities in computational biology, communications, software and electronics. They discussed returns of previous funds and lessons learned from the bubble and OVP V. It was noted that OVP VI is off to a great start. Their OVP active portfolio and commitment to Oregon was reviewed.

Mr. Langeler and Mr. Chen answered questions regarding possible competition with the Oregon Investment Fund.

Jay Fewel, Wei Huang and Tom Keck answered questions regarding regional importance,

Randall Edwards suggested increasing the commitment to $50 million.

Mr. Huang noted that the Oregon Growth Account had committed $7 million to OVP Fund VII.

MOTION: Randall Edwards moved that the OIC authorize up to a $50 million commitment to OVP Venture Partners VII, L.P. Said commitment is subject to the satisfactory negotiation of the requisite legal documents by legal counsel working in concert with OST Staff. The motion was seconded by Harry Demorest and passed by the Council. Mark Gardiner abstained from voting.

VI. 11:38 am: IL&FS Investment Managers Ltd. – Real Estate Opportunity Fund

Brad Child noted that representatives from the IL & FS Investment Managers had previously made a formal, information presentation to the OIC on February 17, 2006. Ms. Lietz noted that the PCA recommendation is contingent upon getting satisfactory tax opinions from counsel, well versed in India. The Indian economy and real estate markets were discussed briefly.

Ms. Lietz noted that modern technology and education are allowing India to participate in the growing global workplace. Computers and telecommunications are creating new business opportunities and a growing middle class. These changes have created a substantial demand for new modern office, residential and commercial facilities. Recent changes in India law now permit foreign investment in the development of Indian real estate to meet this need.

MOTION: Harry Demorest moved that the OIC authorize a commitment of $100 million to IL&FS India Realty Fund LLC ("IL&FS India"). Such commitment is subject to satisfactory review by staff and DOJ of the fund documents and completion of any final due diligence items. The motion was seconded by Katy Durant and passed unanimously by the Council.

Randall Edwards thanked Ms. Lietz and Mr. Child for their work on this new investment.

VII. 11:43 am: OPERF Real Estate Annual Plan

Brad Child presented the OPERF Real Estate Annual Review. Mr. Child noted that the 2005 OPERF real estate target allocation was 70% core and 30% opportunistic investments. He outlined the 2005 activity sales and commitments and reviewed 2006 allocation targets as follows:

- 50% Core Investment Target
  - 30% Privately Held Investments
    - Debt Restricted to 50% of Value
  - 20% Public REITs
- 20% Value Added Real Estate Investments
- 30% Opportunistic Investment Target
- Ranges are 5 or 10% +/- from Targets

2006 activity to date was discussed and the 2006 Plan was outlined. Performance, policy guidelines, ranges and benchmarks were reviewed.

Nori Lietz presented the PCA 2006 Real Estate Market Review. She noted that Real Estate continues to produce stellar returns when compared to other asset classes. Capital flows into real estate hit record levels in 2005, which has led to a build-up of committed but not yet invested capital that should keep real estate returns buoyant in 2006. She discussed real estate versus other asset classes and economic trends. She answered questions from the Council regarding foreign REITs.

Ms. Lietz thanked Eliza Bailey, Jeff Zier and Austin Carmichael for their assistance in preparation of the PCA report.

Allan Emklin commented on assuming risk, the global index and global REITs.

VIII. 12:30 pm: Fortress Investment Fund IV – Real Estate Opportunity Fund

Brad Child introduced Wes Edens of Fortress. OPERF has made a total of $325 million in commitments to three prior Fortress sponsored funds: $100 million to Fortress Residential Investment Deutschland ("FRID"), $125 million to Fortress Investment Fund III ("Fund III") and $100 million to Fortress Investment Fund II ("Fund II"). Fund IV will follow the same successful investment strategy followed by Fund's II and III in that it will target a broad range of real estate and other asset backed investments located in the US and Western Europe (primarily the United Kingdom, Italy and Germany). The Fund will seek to realize an internal rate of return of at least 20%, net of fees, using leverage of up to 65% of total portfolio value. Net IRR yields on previous Fortress funds, over the past decade, have ranged from the high teens to almost 60%. This track record shows a consistent ability to source opportunities and then execute financial and management strategies to produce profits. In North America, they seek to take advantage of rising interest rates and energy prices. In Europe, they will look for opportunities created by corporate and government restructuring.

Ms. Lietz and Mr. Child answered questions regarding the oversubscribed fund.

MOTION: Mark Gardiner moved that the OIC authorize a commitment of $125 million to Fortress Investment Fund IV, L.P. Such commitment is subject to satisfactory review by staff and DOJ of the fund documents and completion of any final due diligence items. The motion was seconded by Randall Edwards and passed unanimously by the Council.

IX. 1:20 pm: 2005-06 Proxy Voting Summary & Outlook

In January 2003, Treasury staff issued a Request for Information that resulted in retaining Institutional Shareholder Services Inc. (ISS) to vote proxies for all actively managed OPERF accounts. An annual voting update has been provided to the OIC since then.

Ron Schmitz introduced Ron Kellogg, Managing Director of ISS Taft Hartley Research Services. Mr. Kellogg discussed ISS policy changes and introduced the new website policy gateway. He reviewed post-Enron reforms, shareholder optimism and boardroom voting.

Included in the OIC materials was a summary of the votes cast by Taft-Hartley Advisory Services (A Division of Institutional Shareholder Services (ISS), Inc.) for 2005, ISS voting policy updates and a summary look back at 2005 and the outlook for 2006. Mr. Kellog answered questions from the OIC regarding divestiture from Sudan.

X. 1:45 pm: Oregon Short-term Fund Annual Review

Perrin Lim presented highlights from the Oregon Short-Term Fund Annual Review, as follows:

- The US economy exhibited continued resilience in 2005 despite surging oil prices.
    - Positive fundamentals: tax rates on capital are quite low and will remain so for at least the next two years; corporate profits are strong; federal revenues are strong; productivity growth is healthy; non-farm payroll gains averaged 166 thousand per month in the past year; unemployment rate is low and declining.
    - Negative fundamentals: housing market appears to be cooling; high oil prices represent a tax on growth; weakness in the auto

sector could spread to other areas of the economy; ex-aircraft orders, capital spending has slowed significantly in the past six months.

- The US Federal Reserve raised official rates another 200 basis points during the year, bringing the target rate to 4.25%. The fed funds rate has increased 325 basis points since the Fed started tightening on June 30, 2004.
- As foreign demand for US fixed income assets continued unabated, long-term interest rates ended the year close to 40-year lows.
- The yield curve ended the year essentially flat, with scant differential between the spreads of 2-year and 10-year Treasuries (versus a positive slope of 115 basis points at the beginning of the year), which has triggered some concern that the curve will invert in 2006 and lead to a weaker economy.
- Credit spreads are relatively tight, but credit metrics and fundamentals remain solid. Still, relative value in credit has diminished as idiosyncratic and system risks have grown.

Questions were answered regarding a possible intermediate fund and local governments.

Mark Gardiner left the meeting at 1:50 pm.

XI. 1:53 pm: OPERF 4th Quarter Performance Review

Mike Beasley distributed the *SIS 2005 Calendar Year Review* and presented a 2005 Global Economic Overview. The following topics were discussed:

- ❖ Market Indices Review
- ❖ Economic Overview
- ❖ Securities Markets
- ❖ Interest Rates
- ❖ US & Non-US Equity
- ❖ Private Equity
- ❖ Annual Asset Class Returns
- ❖ Fixed Income
- ❖ Global Bond Markets

Mr. Beasley presented the OPERF Fourth Quarter 2005 performance report for review and discussion. The OIC Regular Account performance report was reviewed as well as asset allocation.

Allan Emkin commented on the distinction between public and private equity and the level of out-performance.

XII. 2:35 pm: Update on OIC Fund Governance/Delegation Options

Ron Schmitz presented an update to the Council regarding OIC governance and delegation, particularly for private equity and real estate. He noted that this would be an agenda item on the April meeting and asked for feedback from the Council. It was agreed that Staff would present a menu of options for consideration by the Council at the April OIC Meeting.

XIII. 2:40 pm: Calendar – Future Agenda Items

Ron Schmitz reviewed the forward calendar of agenda items.

Paul Cleary distributed a letter regarding the PERS Board's preliminary crediting of 2005 earnings received through investment of the OPERF Regular Account.

XIV. 2:55 pm: Public Comment

There were no comments from the public.

The meeting adjourned at 2:56 p.m.

Respectfully submitted,

Norma Harvey
Investment Coordinator