

Oregon Investment Council
MINUTES
September 27, 2006

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

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

Staff Present: Brad Child, Tony Breault, Jay Fewel, Curt Hartinger, Norma Harvey, Andy Hayes, Wei Huang, John Kreft, Perrin Lim, Mike Mueller, Kevin Nordhill, Jennifer Peet and Ron Schmitz.

Consultants Present: Mike Beasley, Strategic Investment Solutions (SIS)
John Meier, Strategic Investment Solutions
Mike Moy, Pension Consulting Alliance (PCA)
Nori Lietz, Pension Consulting Alliance

Legal Counsel: Cynthia Byrnes, Oregon Department of Justice

I. 9:00 am: Review and Approval of Minutes – 7/6/06

a. MOTION: Randall Edwards moved approval of the July 6, 2006 OIC Minutes. The motion was seconded by Harry Demorest and passed unanimously by the Council.

b. The July 12, 2006 Private Equity Committee meeting minutes were presented as an information item.

II. 9:01 am: Private Equity Committee Actions – Policy 4.06.01

Jay Fewel and Wei Huang addressed the Council regarding the ratification of three private equity commitments made during the September 22nd Private Equity Committee Meeting. It was noted that due to the increased fundraising activity this year, the aggregate amount committed by the Private Equity Committee to first time funds has reached the policy limit for calendar year 2006.

MOTION: Richard Solomon moved ratification of the following Private Equity Committee commitments:

- \$100 million to Court Square Capital Partners II, a middle market buyout fund managed by a team spun off from Citigroup Venture Capital;
- \$100 million re-up to Collier International Partner V, a secondaries fund managed by a market leading firm with which the OIC has previously invested; and
- Up to \$32.5 million to Sofinnova Venture Partners VII, a life sciences and IT focused venture capital fund managed by a market leader with a longstanding track record.

The motion was seconded by Harry Demorest and passed unanimously by the Council.

Discussion followed regarding proposed changes to Policy 4.06.01 procedures I.C.1 to increase the limit of investing in existing relationships through the Private Equity Committee from 150 percent of the most recent commitment to 200 percent.

MOTION: Randall Edwards moved approval of staff recommended changes to Policy 4.06.01. The motion was seconded by Harry Demorest and passed unanimously by the Council.

III. 9:09 am: Real Estate Committee Actions – Policy 4.04.01

Brad Child and Nori Lietz addressed the Council regarding the ratification of actions taken through the Real Estate Committee.

MOTION: Harry Demorest moved ratification of the following Real estate Committee commitments:

- \$100 million to Rockwood Capital Fund VII, a one billion dollar fund targeting “value-add” real estate investments in North America. The manager has successfully invested over \$6.6 billion in this space since 1980.
- \$100 million to Rockpoint Finance Fund I, a \$750 million fund to finance residential home builder lot inventories. Rockpoint, the sponsor, has received \$360 million of commitments from OPERF for four previous opportunity funds. Their past experience in residential land development includes 70 projects in 20 markets valued at over \$5 billion.
- \$50 million to Windsor Fund VII, a “value-add” fund targeting “flex industrial” properties. This fund is managed by GID, OPERF’s current manager of its direct residential portfolio.

The motion was seconded by Randall Edwards and passed unanimously by the Council.

MOTION: Harry Demorest moved approval of staff recommended changes amending OIC Policy 4.04.01, Real Estate Committee, VII. to: a) change the limit to follow-on investments from \$200 million to 200% of the most recent commitment; b) change the calendar year limit to first time funds to \$300 million from \$200 million; c) change the calendar year limit to follow-on investments to \$600 million from \$400 million and section IV. B. to increase the limit of investing in REIT investments outside US borders from 25% to 50% of the total REIT portfolio. The motion was seconded by Katy Durant and passed unanimously by the Council.

MOTION: Randall Edwards moved approval of staff recommendation to reallocate the \$300 million of OPERF funds from existing domestic real estate securities managers to three new international real estate securities managers. The reallocation will provide portfolio diversification and opportunities for yield enhancement. New managers to be approved and initial allocations are:

- | | |
|--|---------------|
| ○ Morgan Stanley Investment Management | \$150 million |
| ○ European Investors Inc. | \$ 75 million |
| ○ Presima Inc. | \$ 75 million |

The motion was seconded by Harry Demorest and passed unanimously by the Council.

IV. 9:25 am: OPERF Equity Manager Recommendations

Domestic Equity:

Jay Fewel, Kevin Nordhill and John Meier addressed the Council regarding the recommendation to terminate Summit Creek from the OPERF Domestic Equity Fund small-cap growth mandate and reallocate the one percent target allocation and assets to Boston Company and AQR Small Cap Value mandates. It was also recommended to change the benchmark for the Wellington Emerging Company mandate from the Russell 2000 Value index to the Russell 2000 index.

MOTION: Randall Edwards moved approval of staff recommended amendments to Policy 4.05.12 as follows:

- Move Wellington's 2% allocation in the Small Cap Value sub-asset class to the Market Oriented sub-asset class.
- Move the 1% allocation for Summit Creek from the Small Cap Growth sub-asset class to the Small Cap Value sub-asset class, increasing the target allocations for AQR and Boston Company from 1% to 1.5%.

The motion was seconded by Harry Demorest and passed unanimously by the Council.

International Equity:

Jay Fewel, Kevin Nordhill and John Meier addressed the Council regarding the recommendation to Hire AQR Capital management for the vacant International Enhanced Index assignment. During the July 2006 OIC meeting, the Council authorized staff to conduct a search for an additional international enhanced index manager, eliminating the 10 percent target allocation to the passive category, and raising the enhanced index category from 20 percent to 30 percent.

MOTION: Randall Edwards moved approval of staff recommendation to hire AQR Capital management for the vacant International Enhanced Index assignment, subject to the negotiation of legal documents in concert with the Oregon Department of Justice. The motion was seconded by Katy Durant and passed unanimously by the Council.

V. 9:45 am: Proxy Voting Agent Recommendation

Jennifer Peet and Mike Mueller reviewed the proposal to revise policy 4.05.06 regarding the exercise of shareholder rights, and to provide the Council a recommendation based on RFPs issued for an agent to provide OPERF research and proxy voting.

During the December 2002 meeting, ISS was retained to vote proxies on behalf of OPERF. As reported to the OIC at the March 2006 meeting, staff planned to return to the OIC with a recommendation on a proxy voting agent in time for the 2007 voting season. The RFP process was discussed and Mr. Mueller invited Kevin Cameron, co-founder and President of Glass Lewis, to report on their process and answer questions from the Council.

Discussion followed regarding the Glass Lewis procedures, the advisory board and the watchlist policy.

MOTION: Randall Edwards moved approval of staff recommendation to engage Glass, Lewis & Company, Inc. to provide proxy research and voting services to OPERF. The relationship will include all aspects of proxy voting including research, recommendations and voting; and storing and reporting OPERF's voting records as needed or requested. The motion was seconded by Katy Durant and passed unanimously by the Council.

MOTION: Randall Edwards moved approval of staff proposed changes to Policy 4.05.06. The motion was seconded by Katy Durant and passed unanimously by the Council.

VI. 10:35 am: Return Enhancement Strategies

Mike Beasley addressed the Council and noted that, at an earlier OIC meeting, staff and the consultants were asked what strategies/asset classes are not in the OPERF portfolio but are found in other institutional portfolios. The initial research on several asset classes and/or mandate expanding strategies within existing asset classes had been started several months ago. In addition, the OIC delegated additional authority to the Private Equity and Real Estate Committees, thus freeing up time for higher level strategic discussions at Council meetings. More recently, staff was asked specifically to look at hedge funds.

Mr. Beasley presented a “laundry list” of topics and a proposed timeline for the many strategy alternatives currently under review. The following topics were mentioned:

- Global Equity
- Long/Short – Relaxation of Equity manager Constraints
- Hedge Funds – Pros/Cons/Recommendations
- Fundamental Indexing
- Real Return Strategies
- Managed Futures
- Global Tactical Asset Allocation
- Portable Alpha
- Commodities/Natural Resources

After discussion it was the consensus of the Council to direct staff to invite guest speakers to report on different strategies, as an educational tool for the OIC.

VII. 11:00 am: Global Equity Investing

Jay Fewel and Kevin Nordhill noted that, over the years, staff, consultants and the OIC have had numerous discussions regarding the merits of global equity products and the broader opportunity set for investing. Many OPERF managers already enjoy some freedom to pursue limited global equity selection.

Discussion followed regarding other public funds and implementation.

It was the consensus of the Council to authorize staff to evaluate the global equity management capabilities of existing OPERF equity managers. Staff shall report back to the Council the results of the review, and make recommendations regarding the existing OPERF equity manager assignments and any structural changes to the Domestic Equity Fund (DEF) and International Equity Fund (IEF), if deemed appropriate.

VIII. 11:22 am: Cost Effectiveness Measurement – Annual Report

Mike Mueller introduced Bruce Hopkins of CEM Benchmarking Inc. (CEM) to present the cost analysis performed by CEM for the five-years ended 31 December 2005 on OPERF's overall investment costs.

Beginning in 2003, staff provided the OIC an independent assessment of the various costs paid for the management of OPERF (e.g., management fees, custody fees, consulting fees, staff costs, etc.), and how those costs (and the resultant performance) compare to other institutional investors.

Mr. Hopkins presented a report comparing OPERF's cost and return performance to CEM's extensive pension performance database and noted the following:

- Policy Return – 5.3%: slightly above the U.S. median of 5.2%
- Implementation Value Added – 1.4%
- Implementation Risk – 1.7%: above the U.S. median of 1.3%
- Costs - \$165.8 million or 33.3 basis points: low cost by -11.4 basis points.
 - Used more external active management than peers (85% versus 59% for peers)
 - Greater use of external active management cost 4.1 bp relative to your peers.
 - Net impact of differences in External Investment Management costs saved 14.7 bp.
 - Differences in Oversight, Custodial and other costs saved 0.8 bp.
 - Low cost primarily because of paying less for Private Equity.
- Cost Effectiveness – for 2005, OPERF was in the desirable high value added/low cost quadrant of the Cost Effectiveness Chart.

Mr. Hopkins answered questions from the Council.

IX. 11:50 am: Asset Allocation & NAV Updates

Ron Schmitz reported on asset allocation, NAV updates and rebalancing.

X. 11:55 am: Calendar – Future Agenda Items

Ron Schmitz presented future agenda items for consideration and discussion.

Other Business:

- a. Wei Huang and Jay Fewel outlined recent changes in personnel at Pacific Corporate Group and informed the OIC that an RFP would be issued.

- b. Ron Schmitz reported on the “best practices” report by Professor McAniff.
- c. Paul Cleary distributed PERS 12/31/2005 Actuarial Valuation Results report by Mercer Human Resource Consulting. He noted that PERS is 104% funded, when including “side accounts.”

XI. 12:10 am: Public Comment

Joe DiNicola and Dennak Murphy of the Service Employees International Union addressed the council regarding the cleaning service provider, Professional Janitorial Services, in Lionstone Group’s West Loop South in Houston. Eleonora Parada spoke through an interpreter regarding allegations of unfair labor practices and requested that the OIC direct Lionstone to look into the matter.

It was the consensus of the Council to contact Lionstone and have a representative address the issue at the next OIC meeting.

The meeting adjourned at 12:40 p.m.

Respectfully submitted,

Norma Harvey
Investment Coordinator