Oregon Investment Council
MINUTES
January 30, 2008

The Oregon Investment Council was called to order at 8:58 a.m. by Richard Solomon, Chair.

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

Staff Present: Tony Breault, Andrea Belz, Brad Child, Jay Fewel, Ley Garnett, Sam Green, Linda Haglund, Norma Harvey, Andy Hayes, Martha Kellams, Perrin Lim, Mike Mueller, Kevin Nordhill, Jennifer Peet and Ron Schmitz.

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

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

I. 9:00 am: Review and Approval of Minutes

MOTION: Mr. Solomon brought approval of the December 5, 2007 OIC Minutes to the table. The motion was passed by the Council.

Mr. Solomon recognized Mr. Schmitz for receiving this year's Institutional Investor national award for Excellence in Investment Management.

Mr. Fewel introduced two new Private Equity Investment Officers, Mr. Green and Mr. Hayes, and announced that John Hershey will join the team in the near future.

II. 9:05 am: TPG Partners VI, L.P.

Presentation and discussion of the TPG Fund VI was rescheduled for the February 27, 2008 OIC meeting due to a TPG staff member illness.

III. 9:06 am: Grove Street Advisors, NEV III L.P.

Mr. Fewel provided background and outlined the staff recommendation. The intent of Fund III is to enter into a relationship, with an external entity, to provide discretionary equity management in an effort to build a diversified portfolio of limited partnerships with cap sizes of $500 million or less. Additionally, partnerships in excess of $500 million may be considered for inclusion in the program if the minimum commitment available from the General Partner is not equal to or greater than $50 million, or it is not a relationship currently under consideration by OPERF. This proposed investment will continue to allow OPERF to cast a wider net in the private equity marketplace. It also provides OPERF the ability to monitor more closely partnerships in which it does not have a direct stake. Furthermore, through this monitoring process, possible future investments may be identified where OPERF may invest directly in a subsequent fund.

The flow of information from Grove Street has been excellent and the relationship continues to progress smoothly. The relationship has also given OST Staff an additional resource of which to draw upon. Staff recommended a $400 million commitment be made to Grove Street Advisors' with a mandate similar to previous NEV Funds I and II.

Mr. Fewel introduced Clinton Harris, Managing Partner, and Catherine Crockett and Frank Angela, General Partners, of Grove Street Advisors. Mr. Harris reviewed the details of the proposed investment per their presentation handout. Topics covered during the discussion were that Pacific Corporate Group was a respondent to a previous fund mandate, so was not involved in due diligence for this mandate; qualifications of Grove Street Advisors' staff; charter guidelines; and fund/program philosophies, strategies, and performance.

MOTION: Ms. Durant moved approval of staff recommendation to commit $400 million to Grove Street Advisors, NEV III, L.P. Said commitment is subject to satisfactory negotiation of the requisite legal documents by DOJ legal counsel working in concert with OST Staff. The motion was seconded by Mr. Demorest and unanimously passed by the Council.

IV. 9:54 am: Lone Star Fund VI, L.P. and Lone Star Real Estate Fund I, L.P.

Mr. Child outlined the staff recommendation for approval of a $300 million commitment to Lone Star Fund VI, L.P. and $100 million to Lone Star Real Estate Fund I, L.P. The two global funds target combined equity of $6.5 billion and will be run side-by–side. Their combined portfolios will be "opportunistic" in nature with a target IRR at the investment level of 25%. The two funds represent a continuation of the successful series of funds offered by Lone Star Partners (LS), investing globally in distressed debt, distressed real estate, and real estate entities. Lone Star has elected to bi-furcate their previous strategies into two funds allowing investors the opportunity to allocate to either. LS Fund VI will invest in distressed debt and in asset rich or financially oriented operating companies around the world. LS Real Estate Fund will acquire real estate opportunistically which will be managed directly to add value.

Mr. Child introduced John Grayken, Managing Partner, and Lou Paletta, Executive Vice President with Lone Star. Mr. Grayken gave an overview of their seven offices in Europe, Asia and North America; investment staff, including Hudson Advisors, a Lone Star affiliate with over 750 employees globally; domestic and foreign trends and investment opportunities; and successful firm performance during market difficulties/downturns.

The Council discussed, with input from Mr. Child, Ms. Lietz, Mr. Carlson, and Mr. Emkin, fund support, strategies, and limits.

MOTION: Mr.Demorest moved approval to commit up to $500 million to Lone Star Fund VI, L.P. and up to $100 million to Lone Star Real Estate Fund I, L.P. Said commitment is subject to satisfactory negotiation of the requisite legal documents by DOJ legal counsel working in concert with OST Staff. Ms. Durant seconded; the motion was unanimously approved.

V. 10:50 am: KTR Industrial Fund II, L.P.

Mr. Child gave an overview of KTR Industrial Fund II as being formed to continue the strategy of Fund I. A majority of the Fund I and II value will be created by acquiring selectively and then improving each property's income stream. The end-game strategy for both Funds I and II is the aggregation of a large institutional portfolio for sale or public offering. Since industrial properties are generally small investments, KTR finds that a premium will be paid by institutional investors to acquire a large investment portfolio in a single transaction. It is possible that Fund I and Fund II portfolios will be sold together to achieve this premium. OPERF is seeking to grow its real estate portfolio in 2008, including the value-add portfolio. At December 31, 2007, the value-add sector of the real estate portfolio was about 11% based on reported net asset values, well below its 20% target. Fund II will be included in the value-add portfolio as was Fund I. Mr. Child explained that the Real Estate Committee had previously approved the investment but stated that the OIC needed to ratify this decision since the Committee action took place without the normal two week advance notice to the OIC.

MOTION: Mr. Demorest moved approval of staff recommendation to commit $100 million to KTR Industrial Fund II, L.P. Said commitment is subject to satisfactory negotiation of the requisite legal documents by DOJ legal counsel working in concert with OST Staff. The motion was seconded by Mr. Edwards and passed unanimously by the Council.

VI. 10:52 am: Public Equity Topics

OPERF Asset Allocation Implementation Update

Mr. Nordhill provided a high level overview of plans to implement the new asset allocation structure adopted by OIC for OPERF in August 2007, which increased private equity and real estate, and reduced public equity. The allocation split public equity 50/50 between U.S. and non-U.S. equity. Staff returned to the OIC in September 2007, with the revised Investment Objectives and Policy Framework, and received clarification that the OIC's intent is for public equity to eliminate the home country bias entirely. The U.S. component of global equities, as measured by the

MSCI All-Country World Index (ACWI), continues to shrink. The U.S. equity component of the index is now at approximately 43%.

The OIC uses a cash overlay program, managed by Russell Securities, to continually rebalance publicly traded asset classes back towards their targets, using manager and OPERF cash. Prior to the new asset allocation structure, U.S. equity was targeted at 33% and non-U.S. equity was targeted at 20%. In November 2007, the cash overlay policy targets were adjusted to 27% U.S. equity and 26% non-U.S., as the first step in implementing the new asset allocation structure. Staff and SIS report that plan continuation requires some restructuring of OPERF's public equity funds, and significant rebalancing of the various public equity managers' accounts.

Mr. Beasley, Mr. Meier, and Mr. Nordhill fielded discussion about index alternatives, indices relative to asset classes, indices evolutions, and target strategies with a decision to return to the topic with more information at the February meeting, although the OIC agreed to use the broad MSCI IMI benchmarks.

<u>Public Equities Variable Account Restructure</u>

Mr. Nordhill explained that the Variable Account was established in 1968 to allow PERS members the opportunity to participate in higher risk investments with the potential to receive higher benefit payments. Oregon Law requires that moneys in the Variable Account shall be invested "primarily" in equities, including common stock, securities convertible into common stock, real property, and other recognized forms of equities. OPERF was managed much differently when the Variable Account was first established, and was invested in fixed income and U.S. equities only. The expected return profile of OPERF has changed significantly over time with the addition of private equity, real estate, and non-U.S. equity.

Implementation of actions taken by the 2003 Oregon Legislature necessitated changes to be made in administrative and custodian procedures. OPERF was unitized in January 2004; until that time, the Variable Account was embedded within the Domestic Equity Fund (DEF) of OPERF.

One change enacted by the 2003 legislation was to "freeze" the Variable Account by eliminating any new contributions and allowing members to make a one-time election to move their Variable Account balance to the Regular Account at or near retirement. In 2004, the Variable Account assets were separated from the DEF as an alternative to unitizing the DEF.

MOTION: Mr. Demorest moved approval of staff recommendation to transfer all monies in the Variable Account to BGI index funds that track the MSCI ACWI index. OIC Policy 4.05.11, 4.05.13, and the OIC's Statement of Investment Objectives and Policy Framework are amended to reflect this change. The motion was seconded by Ms. Durant and passed by the Council.

<u>Public Equity Northern Trust Emerging Manager Program</u>

Mr. Nordhill gave an overview of OIC's relationship with Northern Trust, which was hired to manage a domestic equity emerging manager program beginning in January 1996. The primary objective of this mandate is to generate excess return at a reasonable level of risk, with managers typically below the institutional "radar screen." Northern Trust has done an excellent job identifying emerging managers and structuring portfolios in this program. The risk-adjusted performance for OPERF has been strong. Since inception, they have generated 157 basis points (net of fees) in excess return, annualized. The five-year tracking error is slightly greater than two percent. They have out-performed the index in 8 of 12 calendar years, and two of the years of under-performance occurred in the first three years of the mandate. Northern Trust is initiating a non-U.S. equity emerging manager program. They have identified five managers that will initially be used in structuring the product, which will be benchmarked to the MSCI World ex-US index. Staff recommends using part of the reduction in Northern Trusts' diminishing domestic equity allocation to fund the new Non-U.S. Equity Emerging manager mandate within the International Equity Fund with a 2% target allocation up to $250 million.

MOTION: Mr. Edwards moved approval of staff recommendation. Mr. Demorest seconded; the motion unanimously carried.

VII. 11:37 am: Higher Ed Pooled Endowment Fund

Mr. Mueller covered quantitative investment strategies and allocation adjustment rationale for the equity portion of the HIED pooled endowment fund, including manager-specific changes predicted to enhance performance by introducing diversified investment styles. Discussion followed pertaining to index options, benchmarks, and endowment requirements. The OIC directed staff to explore with the HIED Finance Committee their willingness to index the entire portfolio, and to return with a recommendation at the February meeting.

VIII. 11:54 am: Divestment Initiatives

Ms. Peet gave a general conceptual overview of divestment programs and their impact, then opened the floor for discussion and/or questions. Mr. Carlson provided legal interpretation of the existing policy. Discussion involved existing federal and state laws, potential state legislation, managers' fiduciary oversight and responsibility, and focus on making productive investments.

Staff recommended approval of the proposed divestment policy, OIC Policy 4.01.08, to establish the OIC's position on divestment initiatives, choosing investments solely on their economic merits without regard to social or political influences, absent a legislative mandate.

Mr. Demorest moved to approve the recommendation as discussed. Ms. Durant seconded; the motion unanimously carried.

IX. 12:07 pm: Election of Officers

Mr. Edwards made a motion that Ms. Durant serve as Chair and Mr. Demorest serve as Vice-Chair of the OIC. Mr. Larson seconded the motion. The motion was unanimously approved. Mr. Edwards thanked Mr. Solomon for his contributions as Chair. Discussion ensued regarding a potential policy regulating Council positions, Council member participation on OST Investment Division committees, establishment of additional OST committees, and relative statutory regulations. Staff agreed to return with some recommendations during the annual policy "housekeeping" updates.

X. 12:15 pm: Asset Allocations and NAV Updates

Mr. Schmitz reported that asset allocation and NAV updates are all within policy parameters and target limits.

XI. 12:25 pm: Calendar – Future Agenda Items

Mr. Schmitz presented future agenda items for consideration and discussion.

XII. 12:18 pm: Other Items

Mr. Solomon asked for information pertaining to the last legislation's rewrite of the Ethics Law. The interpretation process is still underway. Guidance for the interim includes maintaining documentation, observing a $50/year per provider limit on gifts, and declining all entertainment. Specific concerns can be referred to the Treasurer's Office or Department of Justice and/or requests for advance clearance should be directed to the Ethics Commission.

X. 12:28 pm: Public Comment

There were no comments from the public.

The meeting adjourned at 12:28 p.m.

Respectfully submitted,

Martha Kellams
Investment Coordinator