WASHINGTON STATE INVESTMENT BOARD

Board Meeting Minutes
October 16, 2003

The Washington State Investment Board met in open public session at 9:35 a.m. in the boardroom at 2100 Evergreen Park Drive SW, Olympia, Washington.

Present:	George Masten, Chair Debbie Brookman John Charles Jeffrey Hanna Charlie Kaminski Patrick McElligott, Vice-Chair Mike Murphy Bob Nakahara Glenn Gorton Dave Scott Representative Helen Sommers Senator Joseph Zarelli
Absent:	John Magnuson Jeff Seely Paul Trause
Also Present:	Joe Dear, Executive Director Gary Bruebaker, Chief Investment Officer Sue Hedrick, Executive Assistant Paul Silver, Assistant Attorney General

[Names of other individuals attending the meeting are not included in the minutes, but are listed in the permanent record.]

Mr. Masten called the meeting to order and identified the members in attendance.

ADOPTION OF MINUTES – September 18, 2003

> **Mr. McElligott moved to adopt the Board minutes of September 18, 2003.**
> **Ms. Brookman seconded.**
>
> **The motion to approve the minutes carried unanimously.**

PUBLIC COMMENT
There was no public comment.

COMMITTEE APPOINTMENTS

Mr. Masten said that he used the criteria that the Board developed at the Board governance workshop to make the proposed committee assignments described in his memo to the Board.

> **Mr. Charles moved adoption of the committee membership as recommended by the chair. Mr. McElligott seconded.**

Mr. Murphy said that he preferred not to serve as chair of the Public Markets Committee.

> **Mr. McElligott moved to amend the motion by replacing Treasurer Murphy as chair of the Public Markets Committee with Mr. Gorton, and leaving Treasurer Murphy on the committee. Representative Sommers seconded. The motion passed unanimously.**

> **Mr. Masten called for the vote on the proposed recommended committee assignments, as amended. The motion passed unanimously.**

QUARTERLY PERFORMANCE REPORT – REAL ESTATE

Steve Draper, senior investment officer for Real Estate, presented the quarterly performance report for the quarter ending June 30, 2003. He said that gross and net returns of 3.5 percent and 3.2 percent for the quarter are strong. Much of the return in the marketplace is being driven by appreciation due to high pricing. The one-, three- and five-year returns of the WSIB's portfolio remain solid.

Mr. Draper talked about the various spreads of the portfolio's returns over the NCREIF index. For the quarter, there was a 140 basis point spread, for the one-year, a 450 basis point spread, for the three-year, 410 basis points, and for the five-year, a 190 basis point spread. These results incorporate a sharp increase in the portfolio size over the past few years. The majority of the portfolio is subject to the J-curve effect.

There were a number of writedowns in the portfolio, much of which were offset by income. Olympia properties had an $18.6 million writedown for the quarter. Hawthorne Timber had a writedown of $16.7 million. The Pac/SIB portfolio had a $5.7 million writedown, almost entirely offset by income. Lowe NW had a $3.5 million writedown, largely offset by a gain on a property sale. Mr. Draper said that most of the expected bad news in the portfolio for this year has already been received, and he expects we will not have substantial writedowns going forward.

Good news outweighed the negative. Principal Enterprise Capital, our largest investment, had a positive 7.3 percent return. Hometown America had an 8 percent appreciation for the quarter. Lonestar Fund III had a significant writeup for the quarter, 12.1 percent positive. MSREF IV International ended the quarter 6.8 percent positive.

[Dave Scott arrived at 9:52 am]

Mr. Draper said the primary drivers of strong portfolio returns are the operating company strategy and foreign exposure in the portfolio. The most significant news for the quarter is the Hometown

America purchase of Chateau Communities, which should close today. With this purchase, the WSIB will be a leader in manufactured housing communities, with about 90,000 sites nationwide. The total company size is $2.8 billion. Our equity investment will be about $861 million.

In terms of portfolio diversification by property type, the focus will continue to be on long-term growth markets. The California, Northwest, Southeast and Southwest markets are all likely to be overweighted. Mr. Draper said the foreign exposure in the portfolio may go above the 25 percent guideline, but he feels that is the right thing to do. He said he will continue to seek appropriate non-domestic opportunities on the Board's behalf. The benefit of doing so is clear when one looks at this quarter's results. He said we will continue to underweight low- and non-growth markets.

Mr. Draper summarized by saying the return over all periods is strong. We had good returns despite significant writedowns. Outperformance is directly related to the WSIB's commitment to investing using the operating company and global diversification strategies.

CALLAN FIXED INCOME REVIEW

Gary Bruebaker said the WSIB's fixed income assets under management of about $20 billion are held in 14 different funds. Half of that is in the Commingled Trust Fund; the other half is invested in four Labor and Industries' funds, the intermediate bond fund, the savings pool as well as a number of other trust funds. Callan Associates was hired to conduct a review on the structure and processes employed by the WSIB fixed income investment staff to determine if the assets are being prudently managed. The evaluation examined the staff's investment philosophy, investment process, internal staff capabilities, organizational structure and investment performance.

Mr. Bruebaker introduced Michael O'Leary, executive vice president of Callan Associates. Mr. O'Leary said Callan issued their report on May 12, 2003. He said the WSIB staff was exceptionally responsive and open to working with them, and he complimented them on the speed with which they got Callan information.

Mr. O'Leary said the WSIB's resources are limited, but staff has added more value by using a lower turnover focus. The Callan report concluded that the structure and processes by the WSIB fixed income staff are appropriate and sufficient to ensure prudent management of WSIB assets. It also concluded that staff is sufficiently qualified and has the requisite experience to manage the assets. The report determined that internal staff has produced strong returns that compare favorably both with other public funds and private investment management organizations. The results have also been competitive on a risk-adjusted basis. They suggested four items for improvement in the next 12 to 24 months.

Mr. Kaminski complimented Mr. O'Leary on the thorough job his staff did on the report, and said he concurred with the recommendations. Mr. Dear recognized the fixed income staff for their superior performance, and thanked them all for doing an outstanding job.

ADMINISTRATIVE COMMITTEE REPORT – BUDGET UPDATE
Mr. Masten reported on the Administrative Committee's meeting in the morning. He said the Committee looked at a draft public disclosure policy that will be distributed to all Board members and will be back before the Administrative Committee and Board in November.

Mr. Dear gave an update on the budget. He said the request to the Administrative Committee was that he be authorized to submit a supplemental budget request to the Office of Financial Management (OFM). He said that while we have authorization for 60 FTEs, we only have the financial capacity to fund 58.

Mr. Dear said he would like to ask for permission to take the Financial Control Systems contract off budget and to use part of the savings to finance two FTEs for investment operations support. He said if it is not necessary to submit a supplemental budget, we won't.

> **Mr. Masten moved the Administrative Committee's recommendation that the Board authorize the Executive Director to request a supplemental appropriation, if necessary. Mr. McElligott seconded.**
>
> **The motion passed unanimously.**

AUDIT COMMITTEE REPORT
Internal Audit 2004-01, Private Equity

Treasurer Murphy said Internal Audit 2004-01 was conducted by Beth Vandehey and presented to the Audit Committee, which had a fairly lengthy discussion about it.

> **Mr. Murphy moved to approve the Board approve the Internal Audit 2004-01, Private Equity. Mr. Charles seconded. The motion passed unanimously.**

Code of Conduct Compliance Review
Treasurer Murphy said the second item was a report from the Attorney General's Office on our annual code of conduct for FY 2002.

> **Treasurer Murphy recommended approval of the report. Mr. McElligott seconded.**

Treasurer Murphy said this report was discussed at committee level, and there are no issues in it. He urged the Board's adoption.

> **The motion passed unanimously.**

Directed Brokerage Annual Report
Treasurer Murphy said the last item considered by the Audit Committee was the directed brokerage account annual report. A few years ago, this had a significant balance of about $2 million. Through considerable effort on the part of staff, as directed by the Board, we were to utilize some of these soft dollar account balances to cover some of our regular recurring overheads, such as Bloomberg,

Moody's, and other bond analyses. We have made significant improvements in our utilization of this directed brokerage account.

Treasurer Murphy moved that the Board accept the Directed Brokerage Annual Report. Mr. McElligott seconded. The motion passed unanimously.

[The Board took a break at 10:52 a.m. returned to open session at 11:04 am]

PUBLIC MARKETS COMMITTEE REPORT

International Equity Index Investment Manager Competitive Search Process

Ms. Brookman said the Public Markets Committee had five recommendations for the Board, and asked Mr. Bruebaker to give a report on each of them. Mr. Bruebaker said the first item is the International Equity Index Investment Manager Competitive Search Process. State Street Global Advisors (SSgA) is currently the contractor for the international index services and its final contract extension expires on March 31, 2004.

The contract period was outlined as two five-year periods, but they will be revised to something less than that, depending on negotiations with OFM. The WSIB will begin a competition process to select a new manager based on the issues outlined in the transmittal.

Ms. Brookman moved that the Board approve the Public Markets Committee's recommendation to approve the international equity index investment manager concept document. Mr. Scott seconded.

The motion passed unanimously.

International Developed Markets Equity Enhanced Index Investment Manager Competitive Search Process

Mr. Bruebaker reported on the second item. State Street Global Advisors (SSgA), the WSIB's international passive equity index investment manager, and six international equity active investment managers (Artisan Partners, Delaware International Advisers, Dresdner RCM Global Investors, Nicholas-Applegate Capital Management, Putnam Investments, and Pyrford International) provide developed markets international equity investment products for the Commingled Trust Fund and for various other qualified and non-qualified plans used by the WSIB. SSgA's final contract extension expires on March 31, 2004, and the current contracts for the six active managers expire on June 30, 2004. The Board approved structural changes to the international equity program in July 2003, to include consideration of a new enhanced index mandate.

In conjunction with these structural changes, the WSIB will be conducting a developed markets international enhanced manager search during the end of 2003 and the beginning of 2004.

Ms. Brookman moved that the Board approve the Public Markets Committee's recommendation to approve the international equity enhanced index investment manager concept document. Mr. Scott seconded.

The motion passed unanimously.

International Equity Active Investment Manager Competitive Search Process
Mr. Bruebaker said that the contracts for our six international equity active investment managers will expire on June 30, 2004.

Ms. Brookman moved that the Board approve the Public Markets Committee's recommendation to approve the international equity active investment management concept document. Mr. Scott seconded.

The motion passed unanimously.

Investment Consultant Pool Competitive Search Process
Mr. Bruebaker said we currently have a pool of three general investment consultants. We originally had five, but two ultimately dropped out. The contracts for R.V. Kuhns & Associates, Inc. and Watson Wyatt expire on December 31, 2003. Callan's contract had originally expired on the same date, but they were given a short extension to June 30, 2004 to complete a project they began earlier this year.

We issued an RFQQ in July of 2003. Nine consulting firms submitted a total of 23 responses in the following categories: General Investment Consulting Services, Specialty Consulting Services, Actuarial Studies, Investment Personnel Salary Surveys, Investment/Fiduciary Education – Workshops/Seminars, Risk Assessment and Risk Monitoring, and Defined Contribution Consulting.

Mr. Bruebaker said the Board is familiar with most of these firms due to past business relationships. There was only a single response to the Actuarial Studies Pool, but we plan to replenish it later.

Ms. Brookman moved that the Board approve the Public Markets Committee's recommendation to approve the following consulting firms in the stated categories (pools):

Pool	Category	Recommended Firm
Pool A	**General Investment Consulting Services**	**Callan Associates, Inc., Pension Consulting Alliance, and R.V. Kuhns & Associates, Inc.**
Pool B1	**Actuarial Studies**	**Aon Consulting**
Pool B2	**Investment Personnel Salary Surveys**	**Independent Fiduciary Services, Inc., and R.V. Kuhns & Associates, Inc.**
Pool B3	**Investment/Fiduciary Education—Workshops/Seminars**	**Cortex Applied Research**

Pool B4	**Risk Assessment and Risk Monitoring**	**No finalist**
Pool B5	**Defined Contribution Consulting**	**Callan Associates, Inc., and R.V. Kuhns & Associates, Inc.**

Mr. Scott seconded. The motion passed unanimously.

International Investment Option Change
Mr. Bruebaker said we have a Daily EAFE Fund A, which is managed by SSgA. It is utilized by the Teachers' Retirement System (TRS Plan 3), the School Employees' Retirement System (SERS Plan 3), and the Public Employees' Retirement System (PERS Plan 3), and is a component of the Short-, Mid-, and Long-Horizon Funds.

SSgA has a new fund, the T fund. It has the same investment team, the same objectives, the same strategy, the same operations and the same manager fees. What's different is the allowable turnover that they will permit in that fund, which is less than 20 percent, and the expected investment performance. In its short history, the T fund has better investment performance, which is anticipated to continue in the future, and it has lower expenses. To ensure that low turnover rates are upheld, it will be necessary to implement a trading restriction on the use of the T fund, which would go into effect on January 2, 2004. The restriction would work as follows: After a transfer is made by an individual participant out of the T fund, the participant cannot transfer back into the fund for 30 days. At the time of each transfer out of the fund, the 30-day clock begins again. Contributions by paycheck deferral are not considered transfers back into the fund. Plan-level transfers can still be made on a daily basis. Mr. Bruebaker said we would like to make the change on January 2, 2004.

Ms. Brookman moved that the Board approve the Public Markets Committee's recommendation to replace the Daily EAFE Securities Lending Fund Series A with the Daily EAFE Securities Lending Fund Series T in all appropriate programs and that a 30-day trading restriction be implemented. Mr. Scott seconded.

Mr. Charles supported the motion and reported that the Department of Retirement System's staff has been working with WSIB staff to develop this recommendation.

The motion passed unanimously.

PRIVATE MARKETS COMMMITTEE REPORT

TPG Partners IV, L.P., Investment Recommendation
Mr. Masten said the Private Markets Committee had three items for action. The first is a proposed investment in TPG Partners IV, L.P. The Committee met in public session, and at that meeting, questions were raised as to whether there was additional opportunity to invest more in this fund. Staff looked into this and drafted a new recommendation for an increased investment. Mr. Masten suggested that the original committee recommendation first be proposed and then it could be amended, if so desired.

Mr. Masten moved that the Board approve the Private Markets Committee's recommendation to invest up to $125 million, plus fees and expenses, in TPG Partners IV, L. P., subject to final negotiation of terms and conditions. Mr. Charles seconded.

Mr. Murphy moved an amendment to the motion to strike the $125 million and insert $175 million. Mr. McElligott seconded.

The amendment passed unanimously.

Mr. Masten moved the amended motion, to invest up to $175 million, plus fees and expenses, in TPG Partners IV, L. P., subject to final negotiation of terms and conditions.

The motion, as amended, passed unanimously.

Silver Lake Partners II, L.P. – Investment Recommendation
Mr. Masten said that the Private Markets Committee recommended a $125 million investment in Silver Lake Partners II, L.P.

Mr. Masten moved that the Board approve the Private Markets Committee's recommendation to invest up to $125 million, plus fees and expenses, in Silver Lake Partners II, L.P., subject to final negotiation of terms and conditions. Mr. Charles seconded.

The motion passed unanimously.

Shott Capital Management

Mr. Masten moved that the Board approve the Private Markets Committee's recommendation to authorize the Executive Director to extend the contract with Shott Capital Management for the first one-year extension through December 31, 2004, as provided in the existing terms of the contract. Mr. McElligott seconded.

Mr. Masten said this company manages the timely and orderly liquidation of publicly traded securities that result from private equity investment activities. The contract will expire on December 31, 2003. This recommendation is to extend the contract for one year.

The motion passed unanimously.

EXECUTIVE STAFF'S REPORT
Executive Director's Report
Mr. Dear presented his report for October. The new Board member's handbook, which was distributed at the meeting, incorporates the charters and policies the Board adopted at its board

governance workshop, and the existing policies, modified as necessary to conform with the new policies and charters. It also replaces two volumes with one.

An audit recommendation to expand the number of participants in the Commingled Monthly Bond Fund (CMBF) or close it was made in the Spring. Staff decided to close it, effective September 30, 2003 since there were not enough savings to justify the effort of expanding participation in it.

Monthly Investment Reports

Mr. Bruebaker gave the asset allocation report for the month of September. The second quarter of 2003, the Wilshire 5000 was up 16.5 percent. The third quarter, it was up 7.2 percent, and in this quarter to date, it is up 5.9 percent. In the capital markets environment for domestic equities portfolios, growth outperformed value and small cap outperformed large cap.

In the capital market environment for developed countries on the international side, it's been a great year for these markets. For the emerging countries index, it's also been a great year. In looking at the capital markets for the MSCI indices in both U.S. dollar and local currency, it shows that, contrary to domestic equity markets, in international equity markets, value outperformed growth.

The Lehman Universal is up 2.67 percent for the month, and up 7.12 percent for the year. The emerging markets and the corporate high yield were the best performers within this index.

Assets under management are at $52.8 billion, up more than $615 million from the previous month. In looking at the Commingled Trust Fund (CTF) for September, U.S. Equity markets ended the month down 1.1 percent, as measured by the Wilshire 5000. Our portfolio lost 1 percent, which represents an outperformance of the index by nine basis points. In looking at the international, the weaker dollar meant stronger returns for our unhedged equity investments.

Although our international equity portfolio had a return of 2.4 percent for the month, we still underperformed the index by 44 basis points. The CTF fixed income investment portfolio returned 2.7 percent for the month, and outperformed the Lehman Universal by two basis points. We outperformed the Lehman Aggregate for the same period by four basis points. The CTF fixed income portfolio was hurt by duration. We had a shorter duration during a rising market and our credits underperformed by 11 basis points. We were helped by security selection, and both governments and securitized outperformed.

Private markets for the month returned 3.6 percent. Draws for the month were at $44 million, compared to an average of $67.7 million. Distributions were up at $138.2 million. No investments were approved or closed during September. Real Estate had a return of 0.7 percent for the month.

For asset allocation as of September 30, the CTF is at $39.5 billion, up more than $394 million from the previous month. All asset classes are within range with exception of Cash and Real Estate. Real Estate is below the range, but Real Estate and Fixed Income combined are at 35.5 percent, solidly within the combined range. Cash is a little bit over because of the Hometown Chateau transaction, which was expected to close on September 30, but did not.

Mr. Bruebaker reported on the daily priced investment options for the third quarter 2003. The Savings Pool was at $550 million, up $6.3 million from the previous quarter. The Bond Fund was at $340 million, down from $4.4 million from the previous quarter. Performance for the three months ended September 30, 2003 has not been good. We are down 41 basis points for the quarter. Since inception, we are down 55 basis points. For the three Horizon funds, the Short Horizon is almost $27.3 million, up $3.9 million for the quarter. The Mid Horizon is at $72.3 million, up $14.3 million. The Long Horizon is at $56.3 million, up $10.4 million for the quarter. Performance for the quarter, the Short Horizon is down 26 basis points, the Mid Horizon is down 29 basis points, and the Long Horizon is down 23 basis points, due primarily to the underperformance of the international equity component as well as the Bond Fund component.

ASSISTANT ATTORNEY GENERAL'S REPORT – EXECUTIVE SESSION
There was nothing to report.

There being no further business to come before the Board, the meeting adjourned at 11:58 a.m.

George Masten
Chair

ATTEST

Joseph A. Dear
Executive Director