**WASHINGTON STATE INVESTMENT BOARD**
**Board Meeting Minutes**
**June 21, 2007**

The Washington State Investment Board met in open public session at 9:30 a.m. in the boardroom at 2100 Evergreen Park Drive SW, Olympia, Washington.

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| Present: | Pat McElligott, Chair<br>Glenn Gorton, Vice Chair<br>Charlie Kaminski<br>John Magnuson<br>Allan Martin (for Treasurer Mike Murphy)<br>George Masten<br>Bob Nakahara<br>David Nierenberg (via teleconference)<br>Mason Petit<br>Judy Schurke<br>Dave Scott<br>Jeff Seely<br>Representative Helen Sommers |
| Absent: | Senator Lisa Brown<br>Sandy Matheson |
| Also Present: | Joe Dear, Executive Director<br>Gary Bruebaker, Chief Investment Officer<br>Diana Will, Senior Investment Officer – Asset Allocation<br>Kristi Haines, Executive Assistant<br><br>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.]

Chair McElligott called the meeting to order and roll call was taken.

## ADOPTION OF THE MAY 17, 2007, MINUTES

**Vice Chair Gorton moved to adopt the May 17, 2007, meeting minutes.**
**Mr. Scott seconded and the motion carried unanimously.**

## PUBLIC COMMENT

There was no public comment.

## EXECUTIVE DIRECTOR'S REPORT

Mr. Dear provided his monthly report for June on Board governance, investments, budget, operations, public affairs, and open procurement activities. The proposed agenda for the July off-site meeting was distributed. Mr. Dear briefed members about the Yale School of Management Forum on Governance both he and Mr. Nierenberg attended last week. He noted the importance of board governance, adding that perhaps the best thing the WSIB can do to improve corporate governance is to provide a positive example in its own practice.

## ADMINISTRATIVE COMMITTEE REPORT

The Administrative Committee met just prior to the Board meeting.

### Agency Request Legislation

Chair McElligott reported that the Administrative Committee received a recommendation from staff for agency request legislation to provide liability protection for voting members and staff against legal action. Mr. Dear said that a change to the Board's liability statute has become urgent due to increasing complexity in agency operations. This same proposal was presented and approved by the Board two years ago, but was not pursued during the 2006 Legislative Session for tactical reasons. Mr. Dear explained that nonvoting members acting in good faith and within the scope of their duties currently have the same protection as other state employees, who are covered by a general statute. The proposed legislation would extend an equivalent level of protection to voting members and staff that is provided other state employees.

Mr. Martin asked if the same standard applies to school teachers, fire fighters, etc. Mr. Dear said the proposed legislation does not give more protection for voting members and staff than other state employees. Mr. Martin said he considers staff to be more knowledgeable about agency operations than Board members. Mr. Silver pointed out that the proposal provides the same level of protection to voting members and staff as all other state employees and officers. He explained that Board and staff duties are similar in that both make decisions. Staff does so through delegation from the Board. When the Board delegates responsibilities to staff, it does so with due care and with sufficient guidelines and parameters. Staff has the responsibility to act with good faith and due diligence within their scope of duties. Mr. Silver said the proposed legislation eliminates a gap in the current WSIB statute.

Mr. Masten voiced his concern that the agency loses control of the proposal after it is submitted to the Legislature. He understands that staff needs more protection, but said that should not relieve voting members of responsibility and liability.

> **Mr. Scott moved that the Board accept the Administrative Committee's recommendation to direct that staff move forward with agency request legislation in the 2008 Legislative Session subject to review by the Office of Financial Management and the Governor's Office. Vice Chair Gorton seconded the motion. The motion failed with Ms. Schurke, and Messrs. Martin, Masten, and Petit voting no.**

Mr. Dear asked for further Board discussion on the matter. He emphasized that WSIB staff currently have less protection than other state employees. Chair McElligott said he wants staff and members to have as much security as possible. He deferred the matter to a future Board meeting. Representative Sommers observed that only one member expressed their opinion and she would like other members to comment when the matter is brought back.

**Fiscal Year 2008 Operating Budget**

Chair McElligott said the Administrative Committee discussed the 2008 operating budget, and forwarded the matter to the Board for approval.

Mr. Dear said policy requires Board approval of the agency budget. Historically, the Board has only approved the appropriated budget; non-appropriated expenses were reported after-the-fact in the annual report. It makes sense to look at whole budget, which combines $9 million in appropriated funds already approved by the Board and Legislature, with $339 million in non-appropriated funds for a total operating budget of $348 million. Mr. Dear reported that investment management fees for real estate, and public and private equity comprise 85 percent of the budget. He emphasized that investment management fees are not easily controlled as they are negotiated and finalized upon contract signature. The non-appropriated budget estimate is based on assets under management and existing programs. Staff will look back next year to see how the expenses compared to the estimate. WSIB expenses will also be compared to other pension organizations via the Cost Effectiveness Measurement (CEM) annual survey.

In response to Board member questions, Mr. Dear said the increase in estimated non-appropriated expenses from 2007 to 2008 is due to increased assets, expenses related to the Innovation Portfolio, fees paid to outside managers, advisory services, and anticipated fees for the private-placement consultant.

Mr. Masten observed that voting members can only control the non-appropriated budget with specific decision-making and fluctuations are not within their control. Board approval simply validates that the Board has reviewed the operating budget.

Mr. Nierenberg asked staff to find out which two organizations outperformed the WSIB in the CEM survey, so the Board can learn what they do differently. Mr. Dear said one of the organizations is known to staff. Their higher return resulted primarily from a heavy weighting to energy companies. Staff will ask about the other organization. Mr. Nierenberg said he would like to explore natural resource investment opportunities, including energy, for the Innovation Portfolio.

Mr. Kaminski pointed out that the Board has an indirect effect over the non-appropriated budget by achieving good performance and having a higher asset base.

**Chair McElligott moved that the Board accept the Administrative Committee's recommendation to approve the Fiscal Year 2008 operating budget. Vice Chair Gorton seconded and the motion carried unanimously.**

**Assistant Attorney General's Report**

Chair McElligott said there was nothing to report.

## PRIVATE MARKETS COMMITTEE REPORT

The Private Markets Committee met on June 7, 2007.

### Private Equity

Investment Recommendation – Asia Opportunity Fund III, L.P.

> **Vice Chair Gorton moved that the Board approve an investment of up to $125 million, plus fees and expenses, in Asia Opportunity Fund III, L.P., subject to continued due diligence and final negotiation of terms and conditions. Chair McElligott seconded the motion.**

Vice Chair Gorton reported that the fund, with a target size of $2.5 billion, will be managed by CCMP Capital Asia Ltd. and will continue the successful strategy of its predecessor funds, making control investments in medium to large sized companies in Asia. The core markets for the fund will be Australia, Greater China (including China, Hong Kong, and Taiwan), Japan, Singapore, and South Korea. He said that recommendation is based, in part, on the following: (1) CCMP has a strong and experienced multinational management team with complementary operational and financial skills; (2) The firm's extensive networks in the Asian region generate significant quality deal flow; (3) The fund will focus on control buyouts in the five core markets where the firm has been successful in the past. The firm's operationally-focused strategy contributes to significant value creation in portfolio companies post-investment; (4) Since 1999, CCMP has drawn $2.2 billion for investment in two prior funds, producing an aggregate net IRR of 8 percent, including $773 million of distributions. The Fund II portfolio is very young and largely held at cost, although the fund appears to be well-positioned; and, (5) The fund's strategy is an excellent fit in the WSIB private equity portfolio, providing pan-Asian exposure and diversification benefits.

> **The above motion passed unanimously.**

Investment Recommendation – Endeavour Capital Fund V, L.P.

**Vice Chair Gorton moved that the Board approve an investment of up to $100 million, plus fees and expenses, in Endeavour Capital Fund V, L.P., subject to continued due diligence and final negotiation of terms and conditions. Mr. Scott seconded the motion.**

Vice Chair Gorton reported that the fund has a target size of $425 million, and will focus on the less efficient, lower middle market, leveraging the team's extensive network of relationships to source established growth companies in the western United States and Canada. Although staff and Capital Dynamics had each recommended an investment of up to $75 million to the Committee, both are comfortable with the $100 million recommendation. The recommendation is based, in part, on the following: (1) The Endeavour team is talented and stable, with complementary expertise, extensive regional networks, and a strong reputation. The team has experienced no turnover at the partner level in the firm's 16-year history; (2) Endeavour's lower end middle-market buyout investment strategy leverages the firm's deep and extensive network of long-term relationships to create attractive and diversified first-look opportunities, gain a significant advantage in due diligence, and create value in portfolio companies post-acquisition; (3) Since 1993, Endeavour has produced a strong investment track record. The firm has drawn $321.5 million, investing in 23 portfolio companies through four funds, generating distributions of $354.3 million, a combined net IRR of 23.3 percent, and a net value multiple of 1.9x as of December 31, 2006; (4) Endeavour's strategy is an excellent portfolio fit, complementing WSIB's participation in funds that invest in larger value entities. The fund's western regional coverage and focus on the small end of the middle market have minimal overlap with other WSIB partners.

Mr. Nierenberg announced that he would recuse himself from discussion of the investment recommendation as two of the firm's partners are also investors in his fund.

Mr. Petit said he was pleased to see an investment with western U.S. and Canada, but has a concern with a particular holding in Endeavour's Fund III, which focuses on privatization.

The company outsources child support, government health, and employment services, which are public employee jobs. He said he has been assured that particular company would not be included in Fund V. Mr. Petit conveyed that any investment in this particular company creates a conflict for him. Mr. Masten shared the concern. He said that there is no guarantee the general partners would not invest in similar companies, and the Board would be taken back if such an investment became a large part of the fund, or took over jobs within Washington State. Mr. Dear reported that the WSIB is not invested in Fund III, and that company does not conduct nor solicit business within Washington. He confirmed the Board has no discretion over investments after a commitment is made, and can only consider the general partners' fund strategies. Chair McElligott said he is also concerned with the issue, and said that investments could be watched.

**The above motion passed unanimously.**

Pathway Capital Management Contract Extension

**Vice Chair Gorton moved that the Board approve a one-year extension of the Pathway Capital Management contract. Mr. Petit seconded the motion.**

Vice Chair Gorton reported that the Pathway Capital Management contract will expire June 30, 2007. This will be the second of five possible one-year extensions. The WSIB originally hired Pathway in 1996 and again in 2001 following a Request for Proposals (RFP) process to invest in venture capital partnerships on behalf of the WSIB. To date, Pathway has committed $789 million to 48 partnerships (including two secondaries) on behalf of the WSIB. Pathway has $286 million available for new commitments.

**The above motion passed unanimously.**

INVESCO Private Capital Contract Extension

**Vice Chair Gorton moved that the Board approve a one-year extension of the INVESCO Private Capital contract at a rate of $56,650. Mr. Petit seconded the motion.**

Vice Chair Gorton reported that the contract with INVESCO Private Capital is scheduled to end on June 30, 2007. This will be the second of five possible one-year extensions. The WSIB originally hired INVESCO in 1996 and again in 2001 following an RFP process to invest in venture capital partnerships on behalf of the WSIB. From 1996 to 2006, the Board allocated a total of $325 million, which INVESCO committed to 35 partnerships. In 2006, INVESCO's contract was modified to limit the scope of services to accounting and performance reporting on the existing partnerships with no authority to make new commitments on behalf of the WSIB.

**The above motion passed unanimously.**

**Real Estate**

Investment Recommendation – Evergreen Real Estate Partners, LLC, Follow-On Investment and Geographic Expansion

**Vice Chair Gorton moved that the Board approve an additional investment of up to $500 million, plus fees and expenses, in Evergreen Real Estate Partners, LLC, and expansion of the Partnership's target geography to a global mandate, subject to ongoing due diligence and final negotiation of terms and conditions. Mr. Petit seconded the motion.**

Vice Chair Gorton said that Evergreen's primary focus will continue to be on owning controlling interests in REOCs. The recommendation is based, in part, on the following: (1) Investing in real estate through REOCs is an attractive strategy and is the WSIB's primary real estate investment focus; (2) Expanding Evergreen's geographic reach is a significant and important step in the progression of the WSIB's real estate investment program, as highlighted in the 2007 Real Estate Annual Plan; (3) This group has considerable experience providing capital to REOCs, having been involved with marrying billions of dollars of capital to REOCs over the past 14 years.; (4) They have demonstrated excellent underwriting and negotiating skills; (5) Evergreen will have exclusive access to this strategy from M3 as long as the partnership has capital available to invest. To retain this exclusivity is another compelling reason to add to Evergreen's capital commitment at this time; (6) The returns to date for Evergreen, while not providing enough history to be very meaningful, have been very good -- a net 54.8 percent IRR from inception; and, (7) Evergreen will provide good diversification for the WSIB real estate portfolio. Each REOC investment owns many properties, and each is diversified by geography and property type. Expanding to a global mandate will add to this diversification. Evergreen also has considerable experience working with REOCs in non-traditional property types, some of which are underrepresented in the WSIB real estate portfolio.

**The above motion passed unanimously.**

Investment Recommendation – Hometown America Holdings, LLC, Strategy Expansion and Restructure

**Vice Chair Gorton moved that the Board approve an expansion of the investment mandate of Hometown America Holdings, LLC, to include apartments and to include investments outside the U.S., and to change the carried interest structure of the company as confidentially included in the materials provided to the Board members. Mr. Scott seconded the motion.**

Vice Chair Gorton said that the company is a REOC focused on owning and operating manufactured housing communities. Their primary business is leasing land to homeowners in communities owned by the company. Ancillary to that are activities such as home sales and financing. These two changes to the company's strategy are natural extensions of their existing business. Management is expert in residential property, having experience in apartments and single-family housing projects prior to joining Hometown, in addition to manufactured housing communities. The recommendation is based, in part, on the following: (1) Hometown is among the best of the WSIB's REOC management teams. They have proven to be excellent investors and operators on our behalf; (2) The management team is very knowledgeable about the demographics of an aging populace. Understanding this demographic trend and amending their strategy to get in front of it is an important merit of this recommendation; (3) This management team has produced outstanding risk-adjusted returns over an extended period, having provided a 19.7 percent net IRR over the past 9 years; (4) The company's strategy of owning and operating properties over extended time periods to generate a long-term, high-quality, stable income stream is consistent with the goals of the WSIB. The age-qualified apartment and the non-U.S. manufactured housing community sectors appear to be attractive investment opportunities consistent with this strategy, and have relatively less competition for capital at this time. Hometown has the opportunity to take advantage of early-mover status in these strategies; (5) The new terms and conditions as proposed are still better than market, especially given the target returns. Making this change is essential to keeping this excellent management team properly incentivized and intact in coming years; and, (6) This proposal represents an opportunity to grow an outstanding organization.

**The above motion passed unanimously.**

Real Estate Investment Program Policy 2.10.600

**Vice Chair Gorton moved that the Board approve the proposed revisions to the Real Estate Investment Program Policy 2.10.600. Mr. Petit seconded the motion.**

Vice Chair Gorton reported that the Board approved the formation of the Emerging Markets Fund-of-Funds, LLC, in March 2007, and Global Co-Investment, LLC, in February 2007. The proposed real estate investment policy revision reflects these approvals.

**The above motion passed unanimously**

[The Board briefly recessed at 10:20 a.m. and reconvened in open session at 10:34 a.m.]

**POLICY REVISIONS**

Ms. Will presented proposed revisions to the Permanent Funds Policy 2.25.100 and Other Trust Funds Investment Policy 2.35.200. The WSIB was assigned investment management for four new funds during the Legislative session. The two proposed policy revisions address three of the four new funds. The fourth, the Budget Stabilization Fund, takes effect in 2008. Staff will bring proposed policy revisions to address that new fund to a future Board meeting. The three new funds incorporated into the proposed policy revisions presented today are: Family Leave Insurance Fund, Indian Endowment Scholarship Fund, and Foster Care Endowment Scholarship Fund.

Ms. Will reported that the Family Leave Insurance Fund created a task force to implement the fund and identify which agency would administer it. The fund is currently planned to be administered by the Department of Labor and Industries. The first payouts will occur in October 2009. The Permanent Funds Policy 2.25.100 revisions are needed now because the legislation mandated that the Board would have investment authority upon bill signing, which occurred on May 8, 2007.

Ms. Will reported that Substitute Senate Bill 5039, relating to investment of scholarship endowment funds, assigns investment authority to the Board for two existing endowments. The Indian Endowment Scholarship Fund has been in place since 1990, and the Foster Care Endowment Scholarship Fund was created in 2005. The Office of the State Treasurer had investment management authority; funds are being transferred to the WSIB. Investment of the endowments is limited to government securities.

The Family Leave Insurance Fund has been incorporated into Other Trust Funds Investment Policy 2.35.200, with very few revisions. The fixed income duration was removed as the funds will be invested in a money market which is not described in terms of duration. While the Reclamation Revolving Fund covered by the Other Trust Funds Investment Policy has municipal bonds, they are not marketable at this time. All Other Trust Funds are in money markets. The addenda to the policy was modified to remove language that does not pertain to investments and to list the Fund's asset allocation, which is 100 percent government fixed income securities. Short-term liabilities are anticipated for the new Family Leave Insurance Fund; therefore, a 90-day benchmark will be used.

Ms. Will said that since endowments are permanent in nature, the two scholarship funds are being incorporated with Permanent Fund Policy 2.25.100. The principal of permanent funds cannot be used, only the investment earnings. Legal counsel has advised that endowments are "permanent in nature" but cannot be considered permanent funds based on constitutional definition. Permanent funds have different investment authorities. The Common School Fund allows corporate bonds and equity investments. Other permanent funds can only be invested in government securities, although a proposal to invest in equities will be put to voters this fall. The new endowments are comprised of both state funds and private donations. State funds can only be invested in government securities; private funds can be invested in any investment instrument deemed prudent. The proposed revisions do not change investment authorities, but clarify what is permissible. The policy addenda are specific to each fund. Other policy revisions are for consistency reasons. The asset allocation for state funds is 100 percent government securities, and private funds are unrestricted.

Monies for the Indian Endowment Scholarship Fund will be received on July 22, 2007, and put into money markets. Payouts are expected to occur quarterly. The Foster Care Endowment Scholarship Fund currently does not have any assets.

The policy revision also includes placeholder language in anticipation of the fourth new fund.

Ms. Schurke said that the title of the Family and Medical Leave Insurance Fund was changed to Family Leave Insurance Fund. Staff will make the correction.

In response to Mr. Nakahara's questions, Ms. Will said that receiving investment authority for four funds within one Legislative session is not typical. The WSIB is asked to prepare fiscal analyses for legislation that affects it. The work involved in these smaller funds is relatively small and does not create major cost or require additional staff.

**Chair McElligott moved that the Board adopt the recommended changes to the Other Trust Funds Policy 2.35.200 and the Permanent Funds Policy 2.25.100. Vice Chair Gorton seconded and the motion carried unanimously.**

Mr. Dear said that the approval also covers the addendums and that the title of the Family Leave Insurance Fund would be corrected.

## BOARD DISCUSSION

Chair McElligott announced that the Board would go into executive session at 10:50 a.m. to review and discuss the performance of Board members and of the Board. He said the executive session was expected to last until 11:10 a.m., at which time the Board would reconvene in open session.

The executive session concluded at 11:19 a.m.

## OTHER ITEMS

There was no further business to come before the Board. The meeting adjourned at 11:19 a.m.

Pat McElligott
Chair

ATTEST

Joseph A. Dear

Joseph A. Dear
Executive Director