WASHINGTON STATE INVESTMENT BOARD
Board Meeting Minutes
June 19, 2008

The Washington State Investment Board met in open public session at 9:46 a.m. in the boardroom at 2100 Evergreen Park Drive SW, Olympia, Washington.

Members Present:	Glenn Gorton, Chair Sandy Matheson, Vice Chair Charlie Kaminski John Magnuson George Masten Pat McElligott Bob Nakahara (via teleconference) David Nierenberg (via teleconference) Mason Petit Mike Ragan Representative Helen Sommers (via teleconference)
Members Absent:	Senator Lisa Brown Treasurer Mike Murphy Judy Schurke Jeff Seely
Also Present:	Joe Dear, Executive Director Gary Bruebaker, Chief Investment Officer Theresa Whitmarsh, Chief Operating Officer Steve Draper, Senior Investment Officer – Real Estate Tom Ruggels, Senior Investment Officer – Private Equity Diana Will, Senior Investment Officer – Asset Allocation Celina Verme, Finance and Administrative Services Director Teresa Eckstein, Human Resources Director Kristi Haines, Executive Assistant Brian Buchholz, Assistant Attorney General Steve Dietrich, Assistant Attorney General Dave Woolford, Capital Dynamics

[Names of other meeting attendees are listed in the permanent record.]

Chair Gorton called the meeting to order and took roll call.

ADOPTION OF THE APRIL 17, 2008, MINUTES

Mr. Petit moved to adopt the April 17, 2008, Board meeting minutes. Mr. Ragan seconded the motion.

Mr. Kaminski asked for the record to reflect that he took part in the discussion detailed on page 11, following the Board's motion on Proxy Voting Policy 2.05.200 Revision. Mr. Bruebaker asked for correction of the misspelling of Mr. Ragan's name within the Proxy Voting Policy 2.05.200 Revision motion on page 11.

The above motion to adopt the minutes, as amended, carried unanimously.

PUBLIC COMMENT

There was no public comment.

EXECUTIVE DIRECTOR'S REPORT

Mr. Dear provided his monthly report for June on Board governance, staff, investments, operations, public affairs, meetings, and open procurement activities.

CTF CURRENCY EXPOSURE

Ms. Will introduced a review of the currency exposure of the Commingled Trust Fund (CTF). Currency exchange rate is the price of one country's currency expressed in another country's currency. It can be expressed as the number of foreign currency units per U.S. dollar, or number of U.S. dollars per foreign currency unit. She described "spot rate" as the rate of exchange at the current moment; and "forward rate" as an exchange that takes place in the future, and is adjusted for the interest rate differential to cover the cost of carry. She said that economic factors, political conditions, and market psychology can affect exchange rates. Ms. Will then reviewed major changes occurring in exchange rate history.

Ms. Will described risks relating to currency, including the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates, the uncertainty that currency fluctuations may affect the value of foreign investments or profits when converting them into the investor's local currency, and the uncertainty that currency fluctuations may affect the value of future committed capital. She described the complexities surrounding currency exposures, how future commitments act as natural hedges, and the current exposures within the CTF.

[Representative Sommers was in attendance via teleconference at 10:07 a.m.]

Ms. Will described the affect currency exposure has on the portfolio and the basic ways to manage currency risk, which is to do nothing, passively hedge all or part of the foreign currency back to U.S. dollars, or actively manage the currency. Staff does not have a consensus opinion on which way to manage currency exposure at this time, and hopes to get feedback from the Board on what, if anything, the Board would like staff to pursue.

Mr. Masten said the described risk is not great and he believes the Board would be fine doing nothing. A discussion ensued how the cyclical nature of returns and increase in emerging markets could affect the risk. Mr. McElligott asked staff to brief Treasurer Murphy on the topic and solicit his feedback, as he had originally raised the matter. Chair Gorton asked staff to continue looking at the risk. Mr. Dear said staff would provide an update at the November Board meeting.

ADMINISTRATIVE COMMITTEE REPORT

2009-2011 Biennial Budget and Six-Year Resource Plan

Mr. Dear reported that the Administrative Committee reviewed the budget in detail. He noted the contribution of Mr. Kaminski, who suggested that a longer planning horizon would be helpful to members and staff. Mr. Dear said staff attempted to gauge how existing programs would grow and identify resource requirements for that, taking into consideration the strategic framework and Board-approved strategic plan, and discussions from the May 1 Administrative Committee meeting. He noted that Mr. Nakahara had requested baseline staffing and budget information, which was distributed to members. Staff seeks Board approval of the 2009-2011 biennium budget proposal and Fiscal Year 2009 non-appropriated budget.

Staff's proposal is based on current strategies and plans, and continuing the work it is doing. The conclusions reached are that the WSIB should: (1) add or extend investment strategies in emerging markets, tangible assets, and active equity and fixed income; (2) look opportunistically at smaller deals, but not move away from core strategies; (3) consider new opportunities that have the potential to scale; (4) strengthen its disciplined investment approach by improving Board education, staff development, risk management, research and analytics; (5) assure technical systems and functions support investment programs; (6) create a research advisory council; and, (7) expand the corporate governance program slowly and carefully.

[Representative Sommers left the teleconference at 10:39 a.m.]

Staff is also seeking Board approval of the Fiscal Year 2009 non-appropriated budget in the amount of $338.8 million dollars. The bulk of those monies are for investment management fees, but also includes consulting, legal, securities lending, cash overlay, directed brokerage, investment accounting data system, telecommunications, memberships, and research service fees. Mr. Dear said that last year was the first year the Board approved the non-appropriated budget. He described reductions and enhancements occurring since that approval.

> **Mr. McElligott moved that the Board approve the proposed appropriated budget for the 2009-2011 biennium and the non-appropriated budget for Fiscal Year 2009. Mr. Petit seconded the motion.**

Mr. Masten said he would support the motion, but shared his concern with visibility of the large non-appropriated budget, and that it contains items the Board has not voted on. He said that most members are not aware of membership fees, which are not large in the broader scheme of things but substantial to an average person. Vice Chair Matheson said the Administrative Committee discussed the large FTE increase at length, and determined it is tied to good management strategies that strive to achieve return levels of at least 8 percent in the upcoming challenging environment.

Messrs. McElligott and Masten requested details of the memberships paid with non-appropriated monies.

> **The above motion carried unanimously.**

Request for Qualifications and Quotations – Investment Officer Compensation Consultant
Ms. Whitmarsh reported that a revision to the Board's investment officer compensation statute was passed by the Legislature last year that authorizes creation of a performance management system to reward investment officers with incentive compensation. Staff has drafted a Request for Qualifications and Quotations (RFQQ) to search for a consultant to advise the Board on implementing the new legislation.

Mr. Masten clarified the legislation provides for, but does not mandate that the Board develop an incentive program. Vice Chair Matheson pointed out the RFQQ is written generally, not specifically. Ms. Whitmarsh said the RFQQ describes the scope of work including conducting a salary survey, advising on peer universe (the Board retains the decision on which funds to include), setting salary bands, developing classes, and advising on criteria to put into an incentive compensation system. The Board makes the decision on developing the program.

> **Vice Chair Matheson moved that the Board approve the release of the Investment Officer Compensation RFQQ. Mr. McElligott seconded the motion.**

Mr. Masten said that he voted against the motion at the Administrative Committee meeting, but would support the motion now as he would only delay the decision by voting no. He said he feels implementing bonus and merit pay is disruptive to staff morale.

> **The above motion passed unanimously.**

Board Self-Evaluation Process
Chair Gorton said the Board would have a discussion at the July retreat on its performance and make any further decisions on process at that time.

Assistant Attorney General's Report
Mr. Buchholz introduced Mr. Dietrich, who was recently added as an additional Assistant Attorney General to support the WSIB.

[The Board took a recess at 11:04 a.m. and reconvened in open session at 11:14 a.m.]

PUBLIC MARKETS COMMITTEE REPORT
U.S. Money Market and/or Short-term Investment Funds Search Results

> **Mr. Masten moved that the Board select Barclays Global Investors as the investment manager for the money market or enhanced yield option and BlackRock as the investment manager for the general money market and government money market funds, subject to final negotiation of terms, conditions, and fees. Mr. Ragan seconded the motion.**

Mr. Masten said the recommendation is to award the contracts to the incumbent managers whose contracts expire June 30, 2008. The manager search was a joint effort between Callan Associates and WSIB. Callan screened the manager universe for firms that would best meet the requirements of the WSIB, and the WSIB evaluation team thoroughly reviewed the 17 products from the 8 firms which were forwarded by Callan. The team reviewed each product based on organizational structure, performance, cash flow, fees, and value added services. Staff determined and the Public Markets Committee agreed there was no compelling reason to transition to new products.

The above motion carried unanimously.

Walden Asset Management Contract Extension

Mr. Masten moved that the Board authorize the Executive Director to extend the contract with Walden Asset Management, Contract Number 03-001, for a 5-year term through June 30, 2013, subject to successful negotiations and any further due diligence. Mr. Ragan seconded the motion.

Mr. Masten reported that Walden should be retained because they do a good job, and it would prevent disruption that a change in managers would cause participants and staff.

The above motion carried unanimously.

PRIVATE MARKETS COMMITTEE REPORT
Private Equity Investment Recommendation – First Reserve Fund XII, L.P.

Mr. McElligott moved that the Board invest up to $400 million, plus fees and expenses, in First Reserve Fund XII, L.P., subject to continuing due diligence and final negotiation of terms and conditions. Vice Chair Matheson seconded the motion.

Mr. McElligott reported that First Reserve XII is an energy industry large buyout fund that will invest in a global portfolio of companies diversified across seven industry sectors. The WSIB has invested in four prior First Reserve funds. The investment was originally expected to come to the Committee in 2009; therefore, it was not included in the 2008 Private Equity Annual Plan approved by the Board. This investment, if approved, would replace other allocations in the 2008 plan that were moved to 2009. This recommendation is based, in part, on First Reserve's deep, experienced investment team; proven investment strategy; solid performance with excellent returns; favorable market conditions; and fit in the WSIB portfolio.

Mr. Masten moved to amend the motion for the Board to invest up to $500 million, plus fees and expenses, in First Reserve Fund XII, L.P., subject to continuing due diligence and final negotiation of terms and conditions. Mr. Petit seconded the amended motion.

A discussion ensued on the affect changing the recommendation would have on the annual plan. Mr. Bruebaker said that staff puts a lot of work into the investment recommendations and stands by the recommended amount. He quoted the Board's standard of care in considering investments, not in isolation but as part of an overall strategy. Messrs. Nierenberg, Masten, and McElligott spoke in support of increasing the recommendation amount. Chair Gorton suggested the matter should go back to the Committee for further consideration, if members felt strongly about changing the amount.

The amended motion failed with Messrs. Petit, McElligott, and Masten voting yes, and Vice Chair Matheson and Messrs. Ragan and Gorton voting no.

Mr. McElligott said he would support the original amount to ensure the investment is committed to in a timely manner.

The above motion for the Board to invest up to $400 million, plus fees and expenses, in First Reserve Fund XII, L.P., subject to continuing due diligence and final negotiation of terms and conditions carried unanimously.

Private Equity Investment Recommendation – Blackstone Capital Partners VI, L.P.

Mr. McElligott moved that the Board invest up to $300 million, plus fees and expenses, in Blackstone Capital Partners VI, L.P., subject to continuing due diligence and final negotiations of terms and conditions. Mr. Masten seconded the motion.

Mr. McElligott reported that Blackstone Capital Partners VI is a buyout fund that will invest in classic leveraged buyouts, corporate partnerships, growth equity, and strategic minority investments on a global basis. The WSIB invested in the prior Blackstone fund, BCP V, and this recommendation is consistent with the 2008 Private Equity Annual Plan approved by the Board. This recommendation is based, in part, on Blackstone's reputation, performance, opportunistic approach, impressive operations team, knowledge base, global presence, and fit in the WSIB portfolio.

Mr. Kaminski said that Blackstone is a large player with a terrific track record. He shared that the Committee discussed at length an allocation of $400 million to the investment. Members commented on the potential for an overweighting in the portfolio. Mr. Kaminski said he supports staff's recommended amount and annual planning process. He encouraged all members to participate in the planning sessions. Vice Chair Matheson noted that Board members play a role in that planning and subsequently in recommendations that are brought forward based on that. Chair Gorton spoke in support of following the plan.

The above motion carried unanimously.

Private Equity Investment Recommendation – Fortress Investment Fund VI, L.P.

Mr. McElligott moved that the Board invest up to $300 million, plus fees and expenses, allocated between Fortress Investment Fund VI, L.P., and Fortress Investment Fund VI Coinvestment Fund, subject to continuing due diligence and final negotiations of terms and conditions. Chair Gorton seconded the motion.

Mr. McElligott reported that Fortress VI will target control-oriented, cash-flowing investments backed by physical and financial assets that can be acquired at compelling valuations. The Board has invested in all five prior Fortress funds. The investment was originally expected to come to the Committee in 2009; therefore, it was not included in the 2008 Private Equity Annual

Plan approved by the Board. This investment, if approved, would replace other allocations in the 2008 plan that were moved to 2009. This recommendation is based, in part, on the firm's differentiated asset-based strategy; experienced, multi-disciplined management team; excellent performance; alignment of interest; and fit in the WSIB portfolio.

The above motion carried unanimously.

Private Equity Investment Recommendation – Evergreen Pacific Partners II, L.P.

Mr. McElligott moved that the Board invest up to $50 million, plus fees and expenses, in Evergreen Pacific Partners II, L.P., subject to continuing due diligence and final negotiation of terms and conditions. Mr. Masten seconded the motion.

Mr. McElligott reported that Evergreen is a lower middle-market private equity fund that will target control buyout and growth equity investments primarily in Western North American companies. The recommendation is consistent with the 2008 Private Equity Annual Plan approved by the Board and, if approved, will create a new investment relationship. This recommendation is based, in part, on Evergreen's talented, stable investment team; successful performance; proven strategy; and fit in the WSIB portfolio.

The above motion carried unanimously.

Real Estate Investment Recommendation – Washington Holdings Structured Finance, LLC – Follow-On Investment

Mr. McElligott moved that the Board invest an additional $400 million, plus fees and expenses, in Washington Holdings Structured Finance, LLC, subject to continuing due diligence and final negotiation of terms and conditions. Vice Chair Matheson seconded the motion.

Mr. McElligott reported that Washington Holdings Structured Finance pursues low-to-moderate risk, income-oriented, moderate-returning structured finance opportunities. The recommendation is consistent with the 2008 Real Estate Annual Plan approved by the Board. This recommendation is based, in part, on the firm's excellent management team, strong underwriting skills, asset management skills, attractive governance terms of the investment, and fit in the WSIB real estate portfolio.

The above motion carried unanimously.

Real Estate Investment Recommendation – Principal Enterprise Capital Holdings, LLC – Investment, Restructure, and Geographic Expansion

Mr. McElligott moved that the Board invest $400 million, plus fees and expenses, in Principal Enterprise Capital Holdings, LLC, approve the restructuring of the Partnership as explained in the confidential memorandum provided by staff, and approve expansion of the Partnership's target geography to a global mandate, subject to continuing due diligence

and final negotiation of terms and conditions. Mr. Masten seconded the motion.

Mr. McElligott reported that the firm's strategy is to invest in controlling interests of real estate operating companies (REOCs), typically those with a specific product and geographic focus, and provides REOCs with an alternative capitalization strategy not typically available within the marketplace. The recommendation is consistent with the 2008 Real Estate Annual Plan approved by the Board. This recommendation is based, in part, on the firm's long-term relationship with the WSIB, attractive returns to date, exclusivity, and positive governance rights.

The above motion carried unanimously.

Tangible Assets Investment Recommendation – Alinda Infrastructure Fund II

Mr. McElligott moved that the Board invest $400 million, plus fees and expenses, in Alinda Infrastructure Fund II, subject to continuing due diligence and final negotiation of terms and conditions. Vice Chair Matheson seconded the motion.

Mr. McElligott reported that Alinda Infrastructure Fund II will invest in a variety of infrastructure sectors, with investments focused primarily in North America, with up to 25 percent in Europe. The recommendation is consistent with the 2008 Tangible Assets Annual Plan approved by the Board. This recommendation is based, in part, on the firm's experienced team, performance, strategy, and fit in the WSIB tangible assets portfolio.

Mr. Petit shared his concern that some tangible asset investments may move public agencies to private entities. He hopes that Board can have some influence on processes as a limited partner in the fund.

The above motion carried unanimously.

Private Equity Contract Extension – Pathway Capital Management

Mr. McElligott moved that the Board authorize the Executive Director to execute the remaining three 1-year extensions of the Pathway Capital Management contract. Vice Chair Matheson seconded the motion.

Mr. McElligott reported that Pathway's contract will expire June 30, 2008. Pathway was originally hired in 1996 to manage a non-discretionary separate account for the WSIB investing in venture capital partnerships. Following an RFP process in 2001, Pathway was retained and given discretion under a 5-year contract with up to five 1-year extensions at the sole discretion of the Board. Under the contract, the Board has the right to end the relationship without cause at any time after providing five days written notice. This recommendation is based, in part, on the firm's experienced management team, ability to access quality partnerships, performance, proprietary system, and fit in the WSIB private equity portfolio.

Mr. McElligott said he hoped that Pathway would have success in adding new venture capital funds to the portfolio.

The above motion carried unanimously.

Private Equity Contract Extension – INVESCO Private Capital

Mr. McElligott moved that the Board authorize the Executive Director to execute the remaining three 1-year extensions of the INVESCO Private Capital contract at rates of $58,350, $60,100, and $61,900. Mr. Masten seconded the motion.

Mr. McElligott reported that the contract with INVESCO is scheduled to end on June 30, 2008. 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. 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. A fee of $55,000 annually plus a 3 percent increase with each 1-year extension was negotiated. INVESCO has performed the services of the contract to staff's satisfaction. Under the contract, the Board has the right to end the relationship without cause at any time after providing five days written notice.

The above motion carried unanimously.

Messrs. Kaminski and Magnuson shared their concerns with the heavy agenda at the last Private Markets Committee. Managers scheduled toward the end of the agenda seemed to get the least amount of questions, and some members had left the meeting. Mr. Magnuson said this could potentially create a problem. Mr. McElligott, Private Markets Committee Chair, invited members to contact him with any agenda concerns, and said he would work with staff for a resolution. Mr. Bruebaker said that advance notice would be needed to provide timely notice so presenters could rearrange travel.

[The Board took a recess at 12:03 p.m. and reconvened in open session at 12:28 p.m.]

QUARTERLY DISCUSSION OF MARKETS

Discussion

Mr. Bruebaker said that staff changed the quarterly report two quarters ago due to the global markets shift, extensive benchmark changes, asset class restructure, new custodian bank, and a need to streamline and reduce redundancy. He reviewed the CTF report changes: what was removed and why, information that has been updated, and the new color-coating of fund/manager performance compared to the benchmark.

Mr. Bruebaker reported that performance of the CTF was down for the quarter, but the portfolio outperformed in the one-, three-, and five-year periods. The allocation decision hurt the fund by 33 basis points (bps) and manager decision helped by 8 bps. Within the allocation decision, underweighting in fixed income and overweighting in equities and private equities hurt performance, while overweighting in real estate and frictional cash helped. The enhanced U.S. equity managers hurt performance, but fixed income performance helped to off-set that.

Mr. Bruebaker said the Dow Jones Wilshire 5000 benchmark, which is the overall benchmark for the U.S. equity, was down 9.52 percent for the quarter. The WSIB's three U.S. equity enhanced managers' performance was down: Barclays Global Investors lost 9.3 percent, State Street Global Advisors lost 9.24 percent, and Western Asset Management lost 19.24 percent.

In response to Mr. Masten's question, Mr. Bruebaker explained that, on page 1 of the quarterly report, the bar chart displayed percentages of the total fund, not just the CTF. He said an additional chart would be added to show the CTF percentages.

Mr. Bruebaker invited members to provide comment on the new report format, stating that staff would incorporate any small changes, and the Board would be informed of any substantial changes before they are made.

Private Equity
Mr. Ruggels introduced the private equity performance report for the period ended December 31, 2007. Mr. Woolford said that one addition was made to the quarterly report format as requested by Mr. Kaminski. A further breakout by strategy sub-sector of funds in investment, funds in distribution, and in liquidation/exited is now.

Mr. Woolford reported that fundraising for U.S. buyout and mezzanine capital had increased 40 percent from 2002 to 2007, and he expects the trend will continue. He said there is strong growth in institutional funds within emerging markets. He described the increased size of fund investment and the multiple effect, stating that investors need to make choices. Returns start to fall off the more attractive investments become.

Mr. Woolford reported on WSIB distributions over past 3 years by quarter. He demonstrated that the WSIB has been more successful with returns than the typical private equity investor, by its long-term view and manager selection. Mr. Bruebaker observed the WSIB has had top quartile returns except for the fourth quarter of 2007.

Mr. Woolford described how the EBITDA rate, amount of money borrowed, and multiple of money affect IRR. He expects good opportunities in 2009 within the secondaries market.

Real Estate
Mr. Draper introduced the fourth quarter 2007 performance report for the real estate portfolio. He said growth is slowing, and returns are moderating. Debt is less available and more expensive, and it is challenging for many partners to capitalize their acquisitions and projects in same way they have previously.

In the U.S., he said the office sector saw some of its highest returns in 2007 since 1980, but they dropped off sharply in the fourth quarter of the year. He indicated the retail sector may also experience a drop-off going forward. In response to Vice Chair Matheson's question, Mr. Draper said that WSIB investments in the retail sector are directed more toward necessity retail and that well-located real estate tends to take care of itself. He reported on the relatively stronger demand in the residential rental sector, clearly in manufactured housing and somewhat in apartments. He noted that manufactured housing communities tend to be counter-cyclical.

Mr. Draper said that shorter-term investments are showing more price change and volatility, as compared to longer-term investments, like REOCs, which are focused on the very long-term and on generating income.

Mr. Magnuson asked about the recent downturns shown by Cherokee and Lone Star Funds II and III. Mr. Draper said these reflect write downs of existing investments and noted that Lone Star III has produced a net IRR of over 30 percent to date. He said that Cherokee is working hard on the investments in question.

Mr. Magnuson asked for future reports to breakdown the return profile by fund, REOC, and other; and also to show year-over-year changes to leverage.

BOARD DISCUSSION

Chair Gorton announced that the Board would go into executive session to discuss financial and commercial information relating to an investment since public knowledge regarding the discussion would result in loss to the funds managed by the WSIB or would result in private loss to the providers of the information. He said the executive session was expected to last five minutes, at which time the Board would reconvene in open session.

[The Board went into executive session at 1:20 p.m. and reconvened in open session at 1:47 p.m.]

OTHER ITEMS

There was no further business to come before the Board. The meeting adjourned at 1:47 p.m.

Glenn Gorton
Chair

ATTEST

Joseph A. Dear
Executive Director