APPROVED

STATE OF WASHINGTON
STATE INVESTMENT BOARD

Private Markets Committee Meeting Minutes

June 3, 2004

The Private Markets Committee met in open public session at 9:00 A.M. in the boardroom at the Washington State Investment Board in Olympia, Washington.

Members Present:	Debbie Brookman, Chair Jeff Hanna John Magnuson Patrick McElligott Mike Murphy
Members Absent:	John Charles Jeff Seely Senator Zarelli
Other Board Members Present:	Charles Kaminski George Masten
Others Present:	Joe Dear, Executive Director Gary Bruebaker, Chief Investment Officer Theresa Whitmarsh, Deputy Director for Operations Steve Draper, Senior Investment Officer – Real Estate Tom Ruggels, Senior Investment Officer – Private Equity Isabelle Fowler, Investment Officer – Private Equity Linda Buchanan, Administrative Secretary Paul Silver, Senior Assistant Attorney General Eric Becker, Pacific Corporate Group Tara Blackburn, Pacific Corporate Group Paul Westhead, Oaktree Capital Management Richard Masson, Oaktree Capital Management Fred Harman, Oak Investment Partners Bandel Carano, Oak Investment Partners Michael Humphrey, Courtland Partners William Song, Song Mondress Dan Schulte, Principal Enterprise Capital Bruce Bruene, Principal Enterprise Capital Mark Poggioli, Principal Enterprise Capital

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

The meeting convened at 9:05 A.M. with Chair Brookman identifying members present.

REVIEW AND APPROVAL OF MINUTES – APRIL 1, 2004

Mr. Murphy moved to adopt the minutes of April 1, 2004. Mr. McElligott seconded, and the motion carried unanimously.

DEVELOPMENTS IN VENTURE CAPITAL MARKETS DISCUSSION

Mr. Ruggels introduced himself and Ms. Blackburn and Mr. Becker who made a presentation on the dynamics of venture capital investing. The presentation looked at previous cycles in venture capital investment, including capital commitments and rates of return, the difficulty of obtaining access to top tier funds as fund sizes contract, the problems venture capital general partners experienced with vintage 1998 and 1999 funds, criteria for selecting general partners, the importance of a portfolio diversified by time, sector and manager style, and the probability that the WSIB will have to consider smaller funds and smaller corresponding commitments in order to meet its venture capital allocation target. The Committee discussed whether current staffing levels are adequate considering the size of the portfolio.

[Paul Silver was in attendance at 9:11 A.M.]

[The Committee recessed at 9:47 A.M. and reconvened at 10:00 A.M.]

PRIVATE EQUITY – OCM OPPORTUNITIES FUND V, L.P. – INVESTMENT RECOMMENDATION

Ms. Fowler presented the staff's recommendation to invest up to $50 million in OCM Opportunities Fund V (OCM V), to be allocated up to $30 million in OCM V and up to an additional $20 million in OCM Vb if raised within one year of the final close of OCM V. She explained that OCM V is a non-control distressed debt fund being raised by Oaktree Capital Management (OCM) with a target capitalization of $1.0 billion.

Ms. Fowler explained that the OCM V documents allow for a "b" fund should Oaktree determine that the environment has become more compelling for distressed debt investing. She stated that the WSIB has been a long time investor with Oaktree, and committed $38.6 million to OCM Opportunities Fund I, $75 million to Fund II, $125 million to Fund III, and $100 million to Fund IV.

Ms. Fowler explained that, in response to the lower amount of opportunities, Oaktree reduced fund size of OCM V and that staff's recommendation is in direct proportion to the lower fund size. She explained that this investment is consistent with the Private Equity Annual Plan that was submitted to the Committee in February.

Ms. Blackburn discussed OCM's strong team, discipline, market terms, strategy, and long-term relationship with the WSIB. She stated that PCG recommends an investment of up to $50 million in OCM Opportunities Fund V, L.P.

Mr. Westhead and Mr. Masson, Oaktree Capital Management, introduced themselves. Mr. Westhead discussed OCM's investment arenas, client profile, size, and locations. He stated that OCM is owned by 78 employees and that a group of long-term client endowments recently bought a financial interest but have no say in the operation of the company.

Mr. Masson discussed OCM's history, market cycles, current market environment, and OCM's international opportunities.

Discussion ensued regarding regulatory changes in Japan and the differences between investing in the U.S. and Japan.

After Mr. Masson and Mr. Westhead were no longer in attendance, discussion ensued regarding a discrepancy in PCG's report in that one portfolio company's number should have been negative rather than positive. Ms. Blackburn confirmed the typographical error.

> **Mr. Murphy moved that the Private Markets Committee recommend to the Board an investment of up to $50 million, plus fees and expenses, in OCM Opportunities Fund V, L.P., to be allocated as follows: up to $30 million in OCM V and up to an additional $20 million in OCM Vb if raised within one year of the final close of OCM V, subject to final negotiation of terms and conditions. Mr. McElligott seconded, and the motion carried unanimously**.

PRIVATE EQUITY – OAK INVESTMENT PARTNERS XI, L.P. – INVESTMENT RECOMMENDATION

Mr. Ruggels stated that staff is recommending a commitment of up to $100 million in Oak Investment Partners XI, L.P. (Oak XI) and that PCG is also recommending an investment of up to $100 million. He explained that Oak XI is a multi-stage venture capital fund and will invest in many sectors including information technology, communications, financial services technology, healthcare services, and retail. Mr. Ruggels stated that approximately 30 percent of the fund will be targeted to traditional venture capital opportunities and approximately 70 percent to more mature "special situations" including recapitalizations, buyouts, growth equity, and corporate spinouts. He stated that Oak is an existing general partner and that the WSIB has committed $20 million to Oak VIII, $60 million to Oak IX, and $100 million to Oak X. Mr. Ruggels explained that this investment is consistent with the Private Equity Annual Plan that was submitted to the Committee in February. Mr. Ruggels discussed the firm's management team, history, experience, past performance, deal flow, brand name, and strategy. He explained steps taken by the firm to mitigate the low returns of recent funds.

Mr. Ruggels stated that Oak XI is a strong portfolio fit and discussed Oak's investments in the state of Washington. Mr. Ruggels described concerns including poor performance of Oak IX, general partner capacity and workload, and fund size and strategy evolution.

Mr. Harman and Mr. Carano, Oak Investment Partners, introduced themselves. Mr. Harman discussed Oak's history, performance, team, experience, expertise, strategy, and investments in the state of Washington.

Mr. Harman discussed Oak's response to poor returns of Oak IX by reduction of fees, extension of new investment period, support of most promising portfolio companies, and management to liquidity.

Discussion ensued on a discrepancy in numbers reported, Northwest investments, fees, terms and conditions, cross fund investments, preferred returns, and whether Oak should still be considered a venture capital firm.

Mr. Harman and Mr. Carano discussed the importance of globalization.

Mr. Murphy asked if this was exporting jobs.

Mr. Harman and Mr. Carano responded that companies need to be competitive; companies sell in other countries as well as in the United States; that for every job added offshore, one is added in the United States; and that the consumer dictates the necessity of lowering prices. Mr. Harman cited Wal-Mart as an example, stating that consumers shop at Wal-Mart because of the lower prices due to goods manufactured offshore.

Mr. Murphy stated that he has never shopped at Wal-Mart and never will, and that they are one of the worst employers in the country. Mr. Murphy stated that he does not think this is the best model for making money in the long-run for the United States.

Discussion ensued regarding the terms of Oak XI.

Mr. Murphy asked if there would be any crossfund investments in Oak XI.

Mr. Carano replied that they have the flexibility to invest in crossfunds if it is clearly in the best interest of Oak XI to do so. He explained that the valuation committee would ensure that such investment would be an exceptional opportunity for Oak XI. Mr. Carano stated that there would definitely be less crossfund investing than in the last cycle.

Mr. Murphy stated that, in his opinion, Oak has departed from being strictly a venture fund, and asked whether the 25 percent carry is negotiable.

Mr. Carano replied that the carry is not negotiable and he disagreed with Mr. Murphy's opinion.
Mr. Carano explained that the provision of priority return of capital with a 25 percent carry yields the same IRR as a 20 percent carry on a non-priority of return fund.

[Mr. Kaminski was no longer in attendance at 12:00 P.M.]

After Mr. Harman and Mr. Carano were no longer in attendance, discussion ensued regarding slow j-curve, losses in previous funds, fees, market volatility, quality of team, and strategy change.

Ms. Brookman stated that Mr. Kaminski had to leave but left a note stating that he supports the investment.

> **Mr. McElligott moved that the Private Markets Committee recommend to the Board an investment of up to $100 million, plus fees and expenses, in Oak Investment Partners XI, L.P., subject to final negotiation of terms and conditions. Ms. Brookman seconded.**

Discussion ensued regarding the fund's evolution, the firm's total history, Oak's response to the poor performance of Oak IX, and prospects for Oak X.

Mr. Dear reported that Jeff Seely was unable to attend but sent an email stating he supports the investment.

Discussion ensued regarding cross-fund investments and expectations to improve returns of Oak IX.

The motion carried with Mr. Murphy voting no.

[The Committee recessed at 12:35 P.M. and reconvened at 1:01 P.M.]

REAL ESTATE – PRINCIPAL ENTERPRISE CAPITAL I, LLC – DISCUSSION

Chair Brookman announced that the Committee would go into executive session under the provisions of RCW 42.30.110(k) to discuss legal risks with legal counsel of a proposed action or current practice that the agency has identified since public discussion of the legal risks identified is likely to result in an adverse legal or financial consequence to the WSIB.

The Committee expected the executive session to last 60 minutes. At the end of the executive session, the Committee would resume its regular open session.

Discussion ensued regarding the reasons for the executive session with Mr. Murphy stating that he was opposed to going into executive session.

Chair Brookman announced that the Committee would go into executive session.

[The Committee went into executive session at 1:05 P.M. The regular session reconvened at 3:15 P.M.]

The Chair announced a revision to the agenda.

PRIVATE EQUITY – CONTRACT EXTENSION – SHOTT CAPITAL MANAGEMENT

Mr. Bruebaker introduced himself. He explained that Shott Capital Management (Shott) was hired in December 2000 to serve as a fiduciary providing a comprehensive post-venture distribution management service. He explained that Shott takes stocks and sells them for us when general partners distribute stock instead of cash. He explained that the process is complex due to liquidity constraints, trading restrictions, and other factors. Mr. Bruebaker stated that the current contract expires December 31, 2004, and that the final one-year extension is available through December 31, 2005.
Mr. Bruebaker stated that Shott is doing a very good job. He explained that the WSIB will go out for a full RFP during the coming year.

Mr. McElligott moved that the Private Markets Committee recommend to the Board the final one-year extension of the Shott Capital Management contract through December 31, 2005. Mr. Murphy seconded, and the motion carried unanimously.

PRIVATE EQUITY – CONTRACT EXTENSION – PACIFIC CORPORATE GROUP

Mr. Bruebaker stated that the Pacific Corporate Group contract expires December 31, 2004, and that the final one-year extension to December 31, 2005, is available. He explained that staff is already working on an RFP for this service. He stated that PCG performs two functions: backroom accounting and investment recommendations.

Discussion ensued on the number of consultants able to perform the service that PCG performs. Mr. Bruebaker stated that staff is researching whether services should be separated as a means of expanding the number of providers available.

> **Mr. McElligott moved that the Private Markets Committee recommend that the Board authorize the Executive Director to extend Pacific Corporate Group's Contract No. 00-005 through December 31, 2005, as provided in the existing contract terms. Mr. Murphy seconded.**

Mr. Murphy stated that he is delighted with the work PCG has done, and he is thrilled to support the extension.

Discussion ensued regarding fee structure.

> **The motion carried unanimously.**

[Treasurer Murphy was no longer in attendance at 3:19 P.M.]

REAL ESTATE – PRINCIPAL ENTERPRISE CAPITAL I, LLC – FOLLOW-ON INVESTMENT RECOMMENDATION

Mr. Draper introduced himself. He stated that staff recommends that the Committee recommend to the Board a $600 million follow-on investment in Principal Enterprise Capital I (PEC I). He stated that the Board has an existing $800 million commitment to PEC, which has been fully earmarked to six real estate operating companies (REOCs). Mr. Draper stated that PEC is the cornerstone of the real estate program and that he believes that investing at the company level is the best way to invest in real estate. He discussed alignment of interest, the benefits of being the sole investor, and the importance of local market expertise. Mr. Draper discussed PEC's strategy, return expectations, experience dealing with successes and challenges, partnership, and opportunities. He explained PEC's working relationship with other WSIB real estate partners including three transactions undertaken with such partners. Mr. Draper discussed risks, including the risks of investing in operating companies, the size of the investment, and that the carried interest will be paid on unrealized events. He discussed PEC's management team, the investment's attractive terms and conditions, and PEC's returns to date.

Mr. Humphrey discussed PEC's earmarked funds, historical performance, deal flow, strategy, control level, management team, financial focus, model, preferred return, and exclusive relationship. He discussed concerns including strategy, restructuring, and personnel issues at the REOC level. He discussed Principal's corporate structure as it relates to PEC investments.

Discussion ensued regarding the use of other Principal groups by PEC investments, incentive fees, and level of control.

Mr. Schulte, Mr. Poggioli, and Mr. Bruene, PEC, introduced themselves. Mr. Schulte discussed PEC's strategy, capitalization history, organizational structure, business model, alignment of interest, control function, portfolio, and bifurcation of strategic and tactical control.

Mr. Bruene described two of PEC's REOC investments and their strategies and returns, and Mr. Poggioli discussed geographic locations and types of investments.

Mr. Schulte discussed future potential areas of investment focus and key challenges looking forward, including scarcity of assets, scarcity of excellent operating partners, and demand for assets.

Discussion ensued regarding leverage, market locations, and exit strategies.

> **It was the consensus of those Committee members present to forward this item to the Board for consideration of a follow-on investment of up to $600 million, plus fees and expenses, in Principal Enterprise Capital I, LLC, subject to final negotiation of terms and conditions.**

Mr. Magnuson stated the he strongly feels that this is high-quality opportunity at a time in real estate investing where very few exist, with a proven partner with a proven track record. For the benefit of the beneficiaries, this is something the WSIB should not pass up.

Mr. McElligott thanked Mr. Draper and Mr. Humphrey for their hard work.

<u>PRIVATE MARKETS CLOSING LOG</u>

The Private Markets Closing Log was presented for informational purposes.

Mr. Bruebaker stated that Mr. Dear executed the closing documents for Hellman & Friedman on June 1, and that the investment is for $75 million.

<u>OTHER ITEMS</u>

There being no further business to come before the Committee, the meeting adjourned at 4:08 P.M.