

APPROVED

STATE OF WASHINGTON
STATE INVESTMENT BOARD

Private Markets Committee Meeting
Minutes

November 4, 2004

The Private Markets Committee met in open public session at 9:06 A.M. in the boardroom at the Washington State Investment Board in Olympia, Washington.

Members Present: Debbie Brookman, Chair
 John Charles
 Jeff Hanna
 John Magnuson
 Jeff Seely
 Senator Zarelli

Members Absent: Patrick McElligott
 Treasurer Murphy

Other Board Members
Present: Charles Kaminski

Others Present: Joe Dear, Executive Director
 Gary Bruebaker, Chief Investment Officer
 Tom Ruggels, Senior Investment Officer – Private Equity
 Isabelle Fowler, Investment Officer – Private Equity
 Steve Draper, Senior Investment Officer – Real Estate
 Linda Buchanan, Administrative Secretary

 Paul Silver, Senior Assistant Attorney General
 Eric Becker, Pacific Corporate Group
 Tara Blackburn, Pacific Corporate Group
 Brian Simmons, Code, Hennessey & Simmons
 Steve Brown, Code, Hennessey & Simmons
 Michael Humphrey, Courtland Partners
 Garret House, Macquarie Capital Partners
 Don Suter, Macquarie Capital Partners

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

The meeting convened at 9:06 A.M. with Chair Brookman identifying members present.

REVIEW AND APPROVAL OF MINUTES – JUNE 3 AND SEPTEMBER 9, 2004

The adoption of the minutes was postponed due to a lack of quorum.

PRIVATE EQUITY – CHS PRIVATE EQUITY V, L.P. – INVESTMENT RECOMMENDATION

Ms. Fowler introduced herself and Mr. Becker, Pacific Corporate Group (PCG). Ms. Fowler stated that staff is recommending an investment of up to \$125 million in CHS Private Equity V, L.P. (CHS V). She explained that the firm is an existing relationship in the WSIB portfolio and that the Board committed \$12.3 million to CHS II in 1994, \$30 million to CHS III in 1997, and \$125 million to CHS IV in 1999. CHS V will follow the same strategy as previous CHS funds, investing primarily in manufacturing, distribution, and service companies with enterprise values under \$500 million. Ms. Fowler described the firm's team, expertise, investment performance, and fit in the private equity portfolio. She explained staff's concerns regarding performance of CHS III and time dedication of one partner. Ms. Fowler stated that the concerns were mitigated by actions taken to improve decision-making processes as well as the stability and expertise of the team.

[Mr. Kaminski was in attendance at 9:13 A.M.]

Mr. Becker, PCG, introduced himself. He discussed the firm's history, analysis methods, fund performance, process improvements, organization, network, and deal sourcing. Mr. Becker discussed the fund's terms and conditions and changes that have been agreed to since publication of the Private Placement Memorandum. He stated that PCG recommends an investment of up to \$125 million in CHS V.

Discussion ensued regarding a recent sale of a portfolio company in CHS III and an initial public offering (IPO) of another portfolio company.

Mr. Simmons of Code, Hennessey and Simmons (CHS) introduced himself and Mr. Brown. They described the firm's history, investment team, experience, organization, investment strategy, origination method, defined strategies, approval process, investment focus, diversification, and performance history. Despite challenges in CHS III, performance is improving and improvements have been made in response to the earlier problems. Mr. Brown and Mr. Simmons described the expected returns for CHS III and IV. CHS V is expected to have a first close of November 19, 2004, and the fund will have a cap of \$1.3 billion. Mr. Simmons and Mr. Brown discussed changes in terms and conditions, including a change in the transaction fee sharing from 50/50 to 80/20 and improvements in the key man provision.

Discussion ensued regarding progression of investment size in different funds, market conditions, deal sourcing methods, competition, proprietary opportunities, leverage, key man provision, dedicated team, and comparison of middle-market to large buyout funds.

The Committee discussed CHS III performance, improved processes, CHS IV performance, reasoning process for recommended investment size, fit in the WSIB portfolio, success of prior funds, key man issues, stability of the partnership, the amount of capital the partners will be investing in CHS V, improved transaction fee split, and the "no fault divorce" clause.

It was the consensus of the members present that this item be forwarded to the Board for consideration of an investment of up to \$125 million, plus fees and expenses, in CHS Private Equity V, L.P., subject to continued due diligence and final negotiation of terms and conditions with special attention to the key man provision.

[The Committee recessed at 10:11 A.M. and reconvened at 10:20 A.M.]

REAL ESTATE – EVERGREEN REAL ESTATE PARTNERS, LLC – INVESTMENT RECOMMENDATION

Mr. Draper introduced himself and described Evergreen Real Estate Partners, LLC's, investment strategy, exclusivity, market expertise, alignment of interest, fit in the WSIB real estate portfolio, performance, team, organization, professionals, governance, terms and conditions, and potential for follow-on growth in the relationship. Risks of this investment include operating risk, departure from Macquarie Capital Partner's (MCP) existing model, competition, market pricing, and incentive compensation on unrealized events. Mr. Draper stated that staff recommends a \$500 million commitment to Evergreen Real Estate Partners, LLC, based on the experience and skill set of MCP and the excellent fit in the WSIB real estate portfolio.

Mr. Magnuson said that the rates are reasonable and stated that: (1) The investment is efficient. It is important that the WSIB decentralize the management oversight and investment responsibility. The real estate operating company (REOC) strategy is almost by necessity the WSIB's preferred strategy and gives the best returns. (2) Real estate is still a very local business, especially in the non-core, non-traditional type of investments. (3) WSIB control of the investment is attractive and is set up in this investment. The WSIB controls the deal and has all the power in the transactions. WSIB staff has demonstrated the ability to exercise that control. (4) The co-investment and alignment of interest of the principals is very important, and the amount equates to a significant portion of the net worth of the principals. The principals are motivated to make excellent returns. (5) This allows the WSIB the flexibility to invest in non-core, non-traditional property types. Although riskier than traditional investments, the return is higher. (6) This investment reduces the WSIB reliance on PEC, Hometown, Washington Holdings, and PacTrust, which is a good, defensive posture to take. Evergreen will invest in different types of properties and markets, so it is a complimentary rather than competitive arena. Mr. Magnuson concluded that Evergreen is an excellent fit in the WSIB real estate investment strategy, and he recommends the investment.

Mr. Humphrey introduced himself and discussed the fund's investment terms, alignment of interest, preferred return, consistency with investment strategy, management team, structure, history, deal flow, expected returns, organization, and terms. Lack of prior operating history or asset management experience and potential conflicts of interest are areas of concern with this investment. However, risks are mitigated by the firm's extensive experience sourcing and structuring investments on an agency basis, dedicated team co-investment, and carried interest. Mr. Humphrey stated that Courtland recommends an investment of \$500 million in Evergreen Real Estate Partners, LLC, subject to negotiation of final terms and conditions

Discussion ensued regarding terms and conditions, market conditions, investment strategy, advantages of REOCs, and fit in the WSIB real estate investment strategy.

Mr. Suter and Mr. House, MCP, introduced themselves, and described the firm's investment strategy, competitive environment, experience, background, core competencies, structure, alignment of interest, professionals, history, team, organization, and geographic and sector focus. They discussed market environment, real estate fundamentals, capital availability, opportunities, valuations, cap rates, and investment horizon.

Discussion ensued regarding leverage, investment opportunities, role of technology in investments, exclusivity issues, investment structure, and the history of the MCP investment professionals.

It was the consensus of the members present that this item be forwarded to the Board for consideration of an investment of up to \$500 million, plus fees and expenses, in Evergreen Real Estate Partners, LLC, subject to continued due diligence and final negotiation of terms and conditions.

PRIVATE EQUITY – FORTRESS FUND III, L.P., ALLOCATION

Mr. Bruebaker stated that staff has elected to withdraw this transaction based on the terms of the co-investment. He explained that this is a good partner and staff remains satisfied with the current investment.

PRIVATE MARKETS COMMITTEE 2005 MEETING SCHEDULE

The adoption of the schedule was postponed due to a lack of quorum.

PRIVATE MARKETS CLOSING LOG

The Private Markets Closing Log was presented for informational purposes.

OTHER ITEMS

There being no further business to come before the Committee, the meeting adjourned at 11:38 A.M.