

**WASHINGTON STATE INVESTMENT BOARD
Private Markets Committee Meeting Minutes
November 4, 2010**

The Private Markets Committee met in open public session at 9:04 a.m. in the boardroom at the Washington State Investment Board in Olympia, Washington.

Members Present: George Masten, Chair
Steve Hill
Patrick McElligott
Treasurer Jim McIntire
David Nierenberg
Representative Sharon Tomiko Santos
Jeff Seely

Members Absent: Richard Muhlebach

Other Board Members
Present: Judi Owens

Others Present: Theresa Whitmarsh, Executive Director
Gary Bruebaker, Chief Investment Officer
Tom Ruggels, Senior Investment Officer – Private Equity
Janet Kruzel, Assistant Senior Investment Officer – Private Equity
Steve Draper, Senior Investment Officer – Real Estate
Paul Silver, Investment Officer – Tangible Assets
Reggie Ross, Investment Officer – Real Estate
Matt Meredith, Investment Officer – Real Estate
Linda Buchanan, Administrative Assistant

Steve Dietrich, Assistant Attorney General
Andrew Bernstein, Capital Dynamics
Michael Humphrey, Courtland Partners
Dan Krivinskas, RV Kuhns
James Kelley, Vestar Capital Partners
John Woodard, Vestar Capital Partners
Eric Resnick, KSL Capital Partners
Mike Shannon, KSL Capital Partners
Garret House, Evergreen Investment Advisors
Don Suter, Evergreen Investment Advisors
Lisa Stewart, Sheridan Production Partners
Len Allen, Lone Star Funds
John Grayken, Lone Star Funds
Louis Paletta, Lone Star Funds

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

The meeting convened at 9:04 a.m. with Chair Masten identifying members present.

ADOPTION OF THE SEPTEMBER 2, 2010, MINUTES

Mr. McElligott moved to adopt the minutes of September 2, 2010. Mr. Hill seconded, and the motion carried unanimously.

PRIVATE EQUITY INVESTMENT RECOMMENDATION – VESTAR CAPITAL PARTNERS VI, L.P.

Mr. Ruggels introduced himself and Mr. Bernstein, Capital Dynamics, and said that staff recommends an investment of up to \$200 million in Vestar Capital Partners VI, L.P., a middle-market buyout fund with a target size of \$3.7 billion. VCP VI will invest in management buyout, growth equity, and recapitalization transactions in the U.S. and Europe. The WSIB has invested in three prior Vestar funds. The proposed investment is consistent with the updated annual plan for private equity discussed at the July Board meeting and the model portfolio approved by the Board in January.

[Representative Santos was in attendance at 9:07 a.m.]

Mr. Ruggels described Vestar's excellent performance, especially in a difficult market time, and compared those returns to public markets, the private equity benchmark, and other private equity funds during the same time period. Fund V is still being invested and, while largely unrealized, is first quartile. He discussed recent profitable exits, conservative valuations, international investments, organizational changes, integration of multiple offices, and investment discipline. Mr. Ruggels explained that the investment provides diversification in the U.S. portion of the private equity portfolio, which is over-weighted in large-cap markets. Although Vestar overpaid for some deals in Fund V, most deals are doing well and growing rapidly. Vestar has shown restraint in its investment pace with 6 years between funds, providing better vintage diversification within the funds. Mr. Ruggels said that Vestar was an aggressive seller in the market peak year 2007, with realizations of nearly \$2 billion. Mr. Ruggels also described Vestar Resources, a group of ten managing directors with responsibility for monitoring and advising portfolio companies and explained that the team has increased value creation activity over the last several years.

[Treasurer McIntire was in attendance at 9:21 a.m.]

Mr. Nierenberg stated that he was satisfied with Mr. Ruggels' explanations and was prepared to remove his prior objections.

The Committee discussed the portfolio company that was recently taken public on the London stock exchange, prospects for other portfolio companies, returns compared to other funds in the WSIB portfolio, and Vestar's international investment strategy.

Mr. Bernstein, Capital Dynamics, introduced himself and discussed Vestar's cohesive investment team, experience, strategy, strong reputation, and value-added approach. He described Vestar Resources as fully integrated members of the Vestar team and discussed Vestar's focus on portfolio companies, strong track record with differentiated plan, focus on generating growth and expanding businesses, and consistent strategy over a long period of time. He further discussed turnover issues and performance.

Mr. Kelley and Mr. Woodard, Vestar Capital Partners, introduced themselves and discussed the firm's history, culture, consistent strategy, operating capability, value creation in portfolio companies, middle-market focus, strong alignment of interests, historical performance with excellent risk-adjusted returns, conservative strategy, organization, deep and experienced investment team, and institutionalized management process.

The Committee discussed the firm's level of operational involvement, shared carry interest, integrated process, terms and conditions, and integration of multiple offices.

Mr. McElligott moved that the Private Markets Committee recommend to the Board an investment of up to \$200 million, plus fees and expenses, in Vestar Capital Partners VI, L.P., subject to continuing due diligence and final negotiation of terms and conditions. Mr. Hill seconded.

Mr. Nierenberg said that his questions were answered and he supported the investment.

The Committee discussed the terms and fees.

The motion carried unanimously.

PRIVATE EQUITY INVESTMENT RECOMMENDATION – KSL CAPITAL PARTNERS III, L.P.

Ms. Kruzel introduced herself and stated that staff recommends an investment of up to \$200 million in KSL Capital Partners III, L.P., a \$1.5 billion private equity fund that will invest in travel and leisure businesses. The fund will continue KSL's proven, specialty niche strategy with an experienced, successful partner whose proven operationally-driven approach is positioned to continue to capitalize on opportunities in a distressed market. The WSIB has previously invested in KSL II and KSL II Supplemental. The proposed investment is consistent with the updated annual plan for private equity discussed at the July Board meeting and the model portfolio approved by the Board in January. Ms. Kruzel discussed the firm's opportunistic and flexible approach, value creation, pricing discipline, strong performance, organizational concerns, and differentiated strategy. She further discussed current market conditions and opportunities and stated that the proposed investment is an excellent fit in the WSIB private equity portfolio.

The Committee discussed demand, the impact of current economic conditions on KSL's investments, valuations, and rebounding sales in the luxury market.

Mr. Bernstein, Capital Dynamics, discussed the firm's market niche, strong returns, due diligence process, ability to increase value, reputation, disciplined investment process and pace, conservative valuations, strong performance, current market opportunities, and deep team. He discussed the benefits of the relationship between KSL Capital and KSL Resorts, a leading travel and leisure hospitality management company, and explained that properties are sold unencumbered with no conflict of interest.

Discussion ensued regarding KSL's cost structure, reconfiguration of opportunity properties, labor costs, impact of unions, value added process by increasing services and attracting the local community, the team's experience, and the impact of the current economic environment. The Committee discussed the role of women in discretionary spending decisions and the focus on investing in the U.S. rather than in international markets.

Mr. Resnick and Mr. Shannon, KSL Capital Partners, introduced themselves and discussed the fund's strategy, historical performance, interesting opportunities to capitalize on distressed real estate, growing luxury market, investment discipline, and value creation. They described some of the portfolio companies; sub-sectors of hospitality, recreation, clubs, real estate, and travel services; diversification of revenue streams; and ability to attract the local community creating a broader consumer base and a more stable revenue base. They discussed relevant investment cycles and market opportunities.

The Committee discussed the firm's investment sectors, value added through operations, exit strategies, KSL's relationship with unions, domestic market focus, international opportunities, opportunistic approach, improvements in properties to appeal to women and families, and increase in foreign consumers. The Committee also discussed the current real estate market, demographic trends, and market volatility.

Mr. Hill moved that the Private Markets Committee recommend to the Board an investment of up to \$200 million in KSL Capital Partners III, L.P., subject to continuing due diligence and final negotiation of terms and conditions. Mr. McElligott seconded.

Discussion ensued regarding the firm's specialty niche in high-end businesses; market conditions and the rebound in luxury goods; compensation and benefits of employees; property improvements; domain, engineering, and operational expertise; investment discipline; historical returns; and fit in the private equity portfolio.

The motion carried with Representative Santos voting no.

[The Committee recessed at 11:57 a.m. and reconvened at 12:22 p.m.]

REAL ESTATE INVESTMENT RECOMMENDATION – EVERGREEN REAL ESTATE PARTNERS, LLC

Mr. Draper introduced himself and stated that staff recommends a follow-on investment of \$500 million in Evergreen Real Estate Partners, LLC. The WSIB has previously committed \$2 billion to Evergreen in \$500 million increments since 2004. Evergreen invests in or with real estate operating companies, consistent with the WSIB's primary strategy for real estate investment. The recommendation is consistent with the Board-approved 2010 Real Estate Annual Plan as updated at the July 2010 Board meeting. Mr. Draper explained that Evergreen is a cornerstone relationship of the real estate program. He described the firm's strong partners, foundation, and global reach. The WSIB has strong governance rights, and Evergreen invests only for the WSIB. Mr. Draper discussed the firm's performance, long-term investment view, portfolio performance and expectations, conservative valuations, fit in WSIB real estate

portfolio, diversification, operating risk, operationally intense investments, and relationship with and support from the broad M3 organization.

Mr. Humphrey, Courtland Partners, discussed market trends as more investor capital is being put in core real estate, opportunities to build core companies, and the advantages of investing with local expertise whose interest is aligned well. He described the firm's management team, exit flexibility, cost effectiveness on a management fee basis, and the Florida investment.

The Committee discussed the firm's returns, attractive opportunities, and market conditions.

Mr. Suter and Mr. House, Evergreen Investment Advisors, introduced themselves and discussed the M3 organization and Evergreen's recent investments, portfolio companies, investment strategies, diversification by geography and property type, prospective investments, potential investments in Brazil and China, investment discipline, committed and invested equity, historical performance, J-curve element, and conservative valuations. They described the firm's well-positioned platforms and long-term, patient approach to investing.

The Committee discussed market conditions, developments in California and Florida, self-storage investments, improving fundamentals, cap rates, and international opportunities.

Mr. Hill moved that the Private Markets Committee recommend to the Board an additional investment of \$500 million, plus fees and expenses, in Evergreen Real Estate Partners, LLC, subject to continuing due diligence and final negotiation of terms and conditions. Mr. McElligott seconded, and the motion carried unanimously.

TANGIBLE ASSETS INVESTMENT RECOMMENDATION – SHERIDAN PRODUCTION PARTNERS II, L.P.

Mr. Silver introduced himself and said that staff recommends an investment of \$125 million in Sheridan Production Partners II, L.P., a \$1.3 billion (target) fund that will invest in mature and producing oil and gas projects. The WSIB previously invested in Sheridan through the Innovation Portfolio. The fund was transferred from the Innovation Portfolio to the Tangible Assets portfolio upon the creation of the asset class. Mr. Silver said that the fund will not invest in deep water drills and described the firm's successful investment strategy, prudent distribution of investments in gas and oil, low-risk approach, property enhancement and operational improvements, use of hedging, strong management team, and experience. He discussed key-person risk and the potential impact of new financial regulations.

Discussion ensued regarding mature deal development, in-fill drilling, whether other WSIB partners use hedging, market volatility, and offshore drilling.

Mr. Krivinskas, RV Kuhns, introduced himself and recommended an investment of up to \$125 million. He said that the proposed investment was a prudent, low-risk way to gain exposure to the market and a good fit in the innovation portfolio. He discussed the firm's management skills, good returns in a difficult market, investment platform, returns, investment approach, operational efficiencies, competition, hedging component, changes in regulations, and accident risk.

The Committee discussed accident risk as well as the firm's focus on training and relationship with Warburg Pincus.

Ms. Stewart, Sheridan Partners, introduced herself and discussed the firm's low-risk strategy, use of leverage, history, use of hedging to protect returns, management of assets, diversification of asset types and geography, performance and returns, quality of assets, selective process, operations team, and balance between oil and gas investments.

The Committee discussed the methods of hedging, conventional assets, environmental limitations, expected life of investments, exit strategies, competition, barriers to entry in the field, growing interest in the area, the firm's unique structure and funding, and relationship with Warburg Pincus. The firm is not participating in shale activity or drilling in Federal waters.

Treasurer McIntire asked for information on portfolio concentration in the gas and oil market in private equity. The information will be provided at the annual planning session in January.

[Mr. Nierenberg was no longer in attendance at 2:00 p.m.]

Mr. McElligott moved that the Private Markets Committee recommend to the Board an investment of \$125 million, plus fees and expenses, in Sheridan Production Partners II, L.P., subject to continuing due diligence and final negotiation of terms and conditions. Treasurer McIntire seconded, and the motion carried unanimously.

INNOVATION PORTFOLIO INVESTMENT RECOMMENDATION – LONE STAR FUND VII (U.S.) L.P.

Mr. Bruebaker explained that the recommendation was for a higher amount and if approved would not be subject to the 1 percent limit since it was being presented to and approved by the Committee and Board.

Mr. Meredith introduced himself and said that staff recommends an investment of \$300 million in Lone Star Fund VII (U.S.), L.P., and that the investment be placed in the Innovation Portfolio. Over the past 14 years, the WSIB has invested over \$2 billion in six Lone Star funds. The recommendation to move the fund to the Innovation Portfolio is due to Lone Star's strategy shift from real estate or debt directly collateralized with commercial real estate to investments in distressed whole-loans, debt, securities and structured products, financial institutions, and corporate and consumer credit. The recommendation is consistent with the updated Annual Plans for real estate and tangible assets discussed at the July Board meeting. Mr. Meredith discussed the fund's investment strategy in the distressed market with a focus on non-performing loans, competitive advantage, geographic focus, relationship with Hudson Advisors, investment servicing capabilities, value enhancement, core competencies, narrow focus, regulatory risk, global banking regulators, structural risks, and complex debt structures. The WSIB has been on the advisory committee since 1996, and staff is pleased with Lone Star's results.

The Committee discussed the firm's valuation and investment processes, research and due diligence capabilities, value creation through restructuring of loans rather than repossessions, complex structure, market expertise, vertical integration, and analytical expertise and capability.

Mr. Humphrey, Courtland Partners, discussed the firm's leadership, focus on distressed market, opportunistic global approach, top-tier performance, and understanding of underlying real estate.

The Committee discussed the firm's performance as compared to peers, international investments, investment process, and current opportunities.

Mr. Grayken, Mr. Paletta, and Mr. Allen, Lone Star Funds, introduced themselves and discussed the firm's history, investment strategy, market opportunities, and target fund size of \$4 billion with a \$5 billion hard cap. They described attractive opportunities in the current market, competition, pressure on banks to reduce exposure to the asset class, and expected returns over the next several years.

Discussion ensued regarding foreclosure and documentation issues. Lone Star prefers to create value through loan restructuring rather than foreclosures and utilizes its own servicer and, thus, is not dependent on banks. Warranties are obtained when Lone Star does buy from banks. The Committee discussed the level of due diligence in valuations, market expertise, forecast of housing trends by zip code, deal sources including U.S. and European banks, analytical process, market cycles, and prospects for market recovery.

[Mr. Hill was no longer in attendance at 2:47 p.m.]

Treasurer McIntire moved that the Private Markets Committee recommend to the Board an investment of \$300 million, plus fees and expenses, in Lone Star Fund VII and that the investment be placed in the Innovation Portfolio, subject to continuing due diligence and final negotiation of terms and conditions. Further, that the investment not be subject to the 1 percent allocation limit within the Innovation Portfolio Policy 2.10.800 since this is being approved by the Private Markets Committee and the Board. Representative Santos seconded, and the motion carried unanimously.

VENTURE CAPITAL DISCUSSION

The discussion was tabled to the December meeting.

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 2:59 p.m.