State of Rhode Island and Providence Plantations
STATE INVESTMENT COMMISSION

Regular Meeting August 25, 2004

A State Investment Commission ("SIC") meeting was held in Room 135, State House, Providence, Rhode Island on Wednesday, August 25, 2004. There being a quorum present, the Treasurer called the meeting to order at 9:05 a.m.

Membership Roll Call. Present were: Mr. Michael Costello, Ms. Marcia Reback, Mr. James E. Thorsen, Mr. John R. Treat and General Treasurer Paul J. Tavares. Dr. Robert McKenna joined the meeting at 9:07 a.m and Ms. Rosemary Booth Gallogly joined the meeting at 9:10 a.m. Also present were: Mr. George Carvalho, Chief of Staff, Ms. Joan M. Caine, Deputy Treasurer for Finance, Mr. William G. Bensur of Wilshire Associates Incorporated, Consultant to the Commission, Mr. Peter Martenson of Pacific Corporate Group, Alternative Investments Consultant to the Commission and Mr. Frank Blaschka of The Townsend Group, Real Estate Consultant to the Commission, and other members of the Treasurer's Staff. Senator Daniel DaPonte was absent.

State Investment Commission Minutes. Ms. Reback moved, Mr. Thorsen seconded and the following motion was passed unanimously. The following members voted in favor: Mr. Costello, Dr. McKenna, Ms. Reback, Mr. Thorsen, Mr. Treat and Treasurer Tavares. (Note: Ms. Gallogly was not present for this vote.)

VOTED: To approve the Minutes of the July 20, 2004 Special Meeting.

Proposed Alternative Investment – Providence Equity Partners V, L.P. ("PEP V"). Mr. Martenson of Pacific Corporate Group ("PCG") gave a brief overview of PEP V, which is being formed to continue the investment strategy employed through four prior funds. The Fund seeks to acquire communications and media companies targeting individual investments of $100-$400 million in approximately 15 to 20 companies. The proposed Fund has a targeted size of $4.0 billion.

Mr. Paul J. Salem, Senior Managing Director and Mr. Julie Fisher, Principal represented PEP V. Mr. Salem stated that PEP is the world's largest private equity firm specializing in communications and media in the US and Europe. PEP has over $4.5 billion of equity capital under management. He noted that the realized IRR's of the first four funds are as follows: PEP I is at 47%; PEP II is at 117%; PEP III is at 23% and PEP IV is at 42%.

PEP's current and previous areas of investment include wireless telephone systems (cellular, personal communications systems and enhanced specialized mobile radio systems), competitive local and long distance telephone networks, Internet service providers, cable television systems and networks, paging/advanced messaging systems, wireless data networks, newspaper and magazine publishing, radio and television broadcasting, in-store advertising, directories, and other media and communications sectors. Mr. Salem reported that deal flow is strong in both the US and Europe. He noted that large distressed media and communications companies continue to sell assets to reduce debt or rationalize business lines and that values continue to be attractive.

Dr. McKenna moved, Mr. Thorsen seconded and the following motion was passed unanimously. The following members voted in favor: Mr. Costello, Ms. Gallogly, Dr. McKenna, Ms. Reback, Mr. Thorsen, Mr. Treat and Treasurer Tavares.

VOTED: To invest up to $25 million in Providence Equity Partners V, L.P., contingent upon satisfactory review and negotiation of investment and other legal documents.

Mr. Martenson noted that the pension fund is targeting $90 million of alternative investments in 2004. He expects to bring three more funds in the fall – one venture capital fund; one special situations fund (probably in energy); and one corporate finance fund (probably another Aurora Capital fund).

Proposed Real Estate Investment – Fremont Strategic Property Partners II, L.P. ("Fremont"). Mr. Frank Blaschka of the Townsend Group gave a brief overview of the first proposed investment in the real estate program. He noted that Fremont is categorized as a high return or "opportunistic" fund with a specialized investment strategy. Fremont will invest in non-traditional real estate sectors and selected traditional subsectors in real estate that capitalizes on research-based trends or opportunities. The fund has a targeted size of $400 million.

Mr. Steven Karpf, Managing Director, Mr. Raphael Sidelsky, Principal and Mr. Matthew Reidy, Managing Director and Head of Asset Management represented Fremont. Ms. Karpf noted that Fremont Group is a privately held investment firm, managing approximately $11 billion in assets for institutions and individuals. Fremont's first fund raised $221 million in 2000 and as of 3/31/04, investments representing $84 million of equity commitments have been realized and have produced an IRR of approximately 41%.

Mr. Karpf stated that Fremont intends to capitalize on market imbalances present in non-traditional subsectors within traditional real estate sectors. Traditional sectors and subsectors include office, industrial, multifamily and retail. Non-traditional subsectors include self storage, cold storage, seniors housing and for-sale housing. Fremont's investment criteria include: focusing on US investments (with a maximum of 30% of commitments in foreign markets); targeted 20% gross IRR; capital commitments of $20-40 million; operating partner co-investment; and a control path to liquidity. Mr. Reidy noted that the actual leveraged IRR of the first fund is 51.8%.

Mr. Thorsen moved, Mr. Costello seconded and the following motion was passed unanimously. The following members voted in favor: Mr. Costello, Ms. Gallogly, Dr. McKenna, Ms. Reback, Mr. Thorsen, Mr. Treat and Treasurer Tavares.

VOTED: To invest up to $15 million in Fremont Strategic Property Partners II, L.P., contingent upon satisfactory review and negotiation of investment and other legal documents.

Note: Mr. Thorsen left the meeting at 10:15 a.m., thereby recusing himself from the following portion of the meeting.

State Street Bank & Trust Company ("State Street") – Custody Contract Renewal. Ms. Caine explained that State Street's contract was signed in 2000 after the RFP process in 1999. The contract was extended in 2002 for one year and extended again in 2003 for an additional year. The terms of the contract allow only one more extension for a year. Prior to the RFP process in 1999, the state was paying approximately $1.2 million in custody fees per year. Since the contract was signed in 2000, the state has paid between $200,000 to $250,000 in custody fees per year.

Ms. Caine noted that the substantial rate reduction is the result of the competitive RFP process and the bundled relationship the State has with State Street. State Street manages $1.5 billion of our assets in an Index fund and a core domestic equity portfolio, and we also re-established the securities lending program with State Street, which provides annual income of $1.7 million - $2.0 million. The State also saves money with transition management services which State Street provides. Additionally, Treasury negotiated for some premium products and services such as Performance Analytics and Investment Policy Reporting which we receive at no charge. Ms. Caine also noted that the team at State Street is extremely responsive to staff and the State's auditors and the client service team regularly attend SIC meetings. Mr. Bensur noted that he agreed that State Street is a valuable partner for the state. Ms. Caine recommended that the contract be extended for one year under the same terms and conditions currently in place.

Dr. McKenna moved, Mr. Costello seconded and the following motion was passed unanimously. The following members voted in favor: Mr. Costello, Ms. Gallogly, Dr. McKenna, Ms. Reback, Mr. Treat and Treasurer Tavares. Note: Mr. Thorsen was not present for this vote.

VOTED: To extend the custody contract with State Street Bank & Trust Co. for the period of one year under the same terms and conditions.

<u>Wilshire Associates Incorporated – Capital Market Review</u>. Mr. Bensur noted that the economy has recovered a bit and heading in the right direction. Inflation remained pretty stable and growth has picked up. Year-to-date the equity market is down 50 basis points. Interest rates and fixed income returns have been volatile over the last four months. However, the allocation to TIPS has performed well since being established in July. He noted that international markets are up 50 basis points. The bond market is up 2.4% as of 8/24/04.

<u>Wilshire Associates Incorporated – Executive Summary of Investment Performance</u>. Mr. Bensur noted that asset allocations are on target. As of 6/30/04 total assets were $6.2 billion. Calendar year-to-date the fund is up approximately $215 million. For the fiscal year ending June 30, 2004, the fund investment gains were up $1 billion. For one year the total fund was up 19.2% which was 1% over the policy. Ms. Caine noted that for July, 2004 the fund and the policy were both down 2.4%. Mr. Bensur noted that on a year-to-date basis the fund is about 50 basis points ahead of policy. The Treasurer noted that we tied the policy on the down side and beat it on the up side.

The Treasurer stated that the Retirement Board establishes the assumed rate of return which is the SIC's return objective. He noted that the actuary recently recommended that we lower the assumed rate of return from 8.25% to 8.0%, but because there was sufficient long-term historical data showing the fund has earned average annual returns greater than 8.25%, the Retirement Board voted to maintain an 8.25% assumed rate. The Treasurer reminded the Commission members that past performance is no indication of future performance. Mr. Bensur reminded Commission members that the focus is on building a long-term investment program.

<u>Deputy Treasurer for Finance Report</u>. Ms. Caine stated that there has been an announcement of a management buyout of one of our international managers – Delaware International Advisers, Ltd. The new name of the firm will be Mondrian Investment Partners.

The principals and the team will remain the same and the buyout is expected to be effective at the end of September.

Ms. Caine updated the Commission on the state-held mortgage on the old American Express building. In 1999 a refinance plan was signed for a five-year loan with a balloon payment due December 1, 2004. The developer (Congress Group Ventures “CGV”) has requested that we refinance the deal again because the tenant (Boston Financial Data Services) has exercised their option to pull out of their lease. Ms. Caine and Mr. Carvalho have had several meetings with CGV’s attorneys in an attempt to re-negotiate the mortgage which has a balance of approximately $22 million. The Townsend Group and Brown Rudnick will be attending another meeting with CGV today along with staff. The building has been appraised at approximately $20.6 million. The deal is further complicated by the fact that the building is on leased land. Ms. Caine indicated that she would update the Commission with future developments.

Dr. McKenna moved, Ms. Reback seconded and the following motion was passed unanimously. The following members voted in favor: Mr. Costello, Ms. Gallogly, Dr. McKenna, Ms. Reback, Mr. Treat and Treasurer Tavares. Note: Mr. Thorsen was not present for this vote.

VOTED: To adjourn the meeting.

There being no further business, the meeting was adjourned at 10:50 a.m.

Respectfully submitted,

Paul J. Tavares
General Treasurer