

**State of Rhode Island and Providence Plantations  
STATE INVESTMENT COMMISSION**

**Regular Meeting January 26, 2005**

A State Investment Commission meeting was held in Room 135, State House, Providence, Rhode Island on Wednesday, January 26, 2005. The Treasurer called the meeting to order at 9:15 a.m. Because only three Commission members were present, and the minimum number of members required for a quorum were not present, the Treasurer rearranged the order of the Agenda to first address issues that did not require a vote.

Investment Manager Review – Shott Capital Management (“Shott”). Ms. Caine reminded Commission members that Shott was hired in 1998 for distribution management. Shott manages the liquidation and sale of the private equity portfolio companies that go public. They determine timing and try to achieve the best available price for the pension fund. Shott reports both IRR figures and time-weighted returns on a monthly basis.

Ms. Stacey Brenner, Managing Director and Mr. Whitley Porter, Vice President represented Shott. Ms. Brenner stated that Shott was formed in 1987 to enhance private equity returns to limited partners through a process integrating specialist expertise in research, trading and operations. She noted that the longer a stock is held, the more opportunity to add value. Every client is different as they have different investment objectives and a different private equity portfolio. Some clients are more venture oriented. She noted that 13% of Shott’s clients are in liquidation, 30% in enhanced liquidation and approximately 57% are active management clients. Shott has a self-imposed time limit of one year for holding a stock. The average holding period for RIIERS is approximately 125 days.

Ms. Brenner explained that Shott is compensated on an incentive basis. They have a modest base fee, plus a 10% incentive fee for everything they earn over and above the distribution price. She stated that the pension fund’s average monthly net asset value is \$2 million since inception, and the fund has received over \$60 million in distributions. Both Mr. Porter and Ms. Brenner spend time attending annual meetings of venture capital firms, attending industry conferences, and visiting the companies.

Note: Jayne Donegan, Esq. joined the meeting at 9:35 a.m.

Mr. Porter noted that since inception of the account (September 30, 1998), Shott has received distributions of \$55.9 million and given back \$61.2 million. The realized gain is \$5.3 million. The market value of the account through 12/31/04 was \$160,769.73. Shott’s time-weighted return for RIIERS is 9.58% since inception. In 2004 Shott received \$5.7 million and returned \$7.3 million. The IRR was 11.69% for fiscal year 2004. He then reviewed the top ten stocks distributed and the top ten undistributed holdings.

Wilshire Associates Incorporated – General Consultant Report. Mr. Bensusar stated that for the calendar year 2004, the fund outpaced the policy benchmark by 75 basis points. He noted that the TIPS allocation did well due to its opportunistic nature. Both NorthPointe and Wellington are approximately 4% behind their respective benchmarks for the year; however, the small cap structure and exposure is working well on an absolute basis.

Mr. Bensur noted that international stocks are a bit behind for 2004, but given all the changes made to the fund in the last year, non-US equity returned 20% and US equity returned 12%. He stated that this is the third year in a row that non-US stocks have outperformed US stocks. Regarding the high-yield managers, Sherkman performed well through the third quarter of 2004, but performed poorly in the fourth quarter. MacKay Shields has performed well in most periods since inception.

Note: Mr. John Treat joined the meeting at 9:45 a.m.

Wilshire Associates Incorporated – Capital Market Update. Mr. Lindberg stated that last year the equity markets were up 12% in the US and up 20% internationally. Earnings have been very strong and interest rates have been rising slowly. The equity market is down 3.5% year to date and Nasdaq is down 7%. Last year small stocks outperformed large stocks. The MSCI ACWI index was up 21% last year, but is down 3.3% this year. The bond market was up 4.3% last year but is only up .6% this year.

Mr. Bensur noted that Wilshire's 2005 US equity return expectation is up from 7.75% in 2004 to 8%. Mr. Thorsen noted that achieving the actuarial assumed rate of return of 8.25% will be challenging on a going forward basis and requested that the minutes reflect that the Commission needs to address that situation. Ms. Caine noted that as of December 31, 2004, the fund returned 8.8% and 10.8% for the 15 and 20 year periods, respectively. Treasurer Tavares noted that the Retirement Board decided earlier this year to maintain the assumed rate of return at 8.25% based on the fact that the funds long-term rates of return were above this assumed rate of return.

Deputy Treasurer for Finance Report. Ms. Caine noted that on an absolute basis, the fund is overweighted in international equities, approximately \$124 million over target. She explained that staff has been dollar cost averaging out of the international portfolio to fund pension benefits and that staff will continue to utilize the non-us equity portfolio as a funding source in the near-term. She also reported that she and Mr. Bensur have been discussing some enhancements that could be made to the domestic equity portfolio. Mr. Bensur stated that the overwhelming investment theme in the institutional marketplace in the last three years has been hedge funds. Hedge funds use the raw material from the capital markets and there is only so much return available in the capital markets. While Wilshire does not recommend hedge funds as an asset class, certain investment techniques that are designed to transfer alpha opportunities on top of the market exposure can be utilized to maintain the systematic exposure to the equity market. Wilshire's plan it to bring some of these ideas on an educational basis to the Commission at its March meeting.

The Townsend Group ("Townsend") – Real Estate Consultant Report. Mr. Frank Blaschka, Principal of Townsend explained that both groups coming before the Commission today are Tier I Open End Core Funds ("OECF") that will serve as a stable return foundation for the retirement system ("RIERS"). Tier I funds are large, diversified funds that have good policies and procedures and strong teams. They are considered the anchor funds for the portfolio. Tier II funds are good performers, but either because of size or composition tend not to be as well diversified. They are a good addition on top of Tier I funds. Both groups before the Commission today will provide a solid base for the portfolio.

Mr. Blaschka explained that the reason for the recommendations of a \$50 million commitment to each fund is due to market conditions. The current capital market for core oriented real estate is very competitive and both funds are subject to substantial investment queues until committed capital is requested for investment. A larger commitment has more capital drawn down, thus leading to invested status sooner.

Proposed Real Estate Investment – JP Morgan Fleming Asset Management Strategic Property Fund (“SPF”). Ms. Anne S. Pfeifer, Managing Director and Portfolio Manager and Mr. John O’Shea, Vice President (Client Service and Marketing) represented the SPF. Mr. O’Shea stated that SPF has gross assets of \$10.8 billion with 148 clients. Ms. Pfeifer noted that JP Morgan Fleming has 30 years of real estate experience. She stressed that SPF focuses on high quality assets that are stabilized investments, with a high quality income stream.

Note: Dr. Robert McKenna joined the meeting at 10:25 a.m.

Ms. Pfeifer noted that open-end funds have an element of liquidity. SPF has \$7.2 billion of net assets, and a 7% income yield, which can be distributed to investors if they wish. The four property types are industrial, residential, retail and office. SPF’s total return target is NCREIF plus 100 basis points with a 5-10 year holding period, a 30% leverage guideline, and 1-3% operating cash target. SPF’s average client size is \$48 million and all investors are defined benefits plans.

Ms. Pfeifer stated that SPF’s investments include: 78 office buildings, 221 industrial buildings, 13,023 apartment units in 23 complexes, 23 super regional malls, and 220 neighborhood and community retail centers. SPF focuses on the following property types: retail (29%), residential (18%), office space (36%), industrial (11%), cash and other investments (6%). SPF uses a 15% market concentration risk guideline. The largest metropolitan statistical areas that SPF is exposed to are Los Angeles, CA at 9.9%, Chicago, IL at 8.6%, Dallas, TX at 7.6%, Atlanta, GA at 6.1% and New York, NY at 6.0%.

Ms. Pfeifer noted that SPF’s annualized returns as of 12/31/04 were 12.3% for one year, 9.3% for three years, 9.9% for five years, and 11.5% since inception in 1998. She stated that co-mingled open-ended funds allow you to rebalance, as clients are able to take income for benefit payments.

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

**VOTED: To invest up to \$50 million in JP Morgan Fleming Asset Management Strategic Property Fund contingent upon satisfactory review and negotiation of investment and other legal documents.**

Membership Roll Call. Present were: Mr. J. Michael Costello, Dr. Robert J. McKenna, Mr. James E. Thorsen, Mr. John R. Treat and General Treasurer Paul J. Tavares. Also present were: Mr. George Carvalho, Chief of Staff, Joan M. Caine, Deputy Treasurer for Finance, Mr. William Bensus and Mr. David Lindberg, of Wilshire Associates Incorporated, Consultant to the Commission, Jayne Donegan, Esq., of Brown Rudnick Berlack Israels, Legal Counsel to the Commission, Mr. Frank Blaschka, of The Townsend Group, Real Estate Consultant to the Commission, and other members of the Treasurer’s Staff. Ms. Rosemary Booth Gallogly and Ms. Marcia Reback were absent.

State Investment Commission Minutes. Mr. Thorsen moved, Dr. McKenna seconded and the following motion was passed unanimously. The following members voted in favor: Mr. Costello, Dr. McKenna, Mr. Thorsen, Mr. Treat, and Treasurer Tavares.

**VOTED: To approve the Minutes of the December 1, 2004 Regular Meeting.**

State Investment Commission Executive Session Minutes. Dr. McKenna moved, Mr. Treat seconded and the following motion was passed unanimously. The following members voted in favor: Mr. Costello, Dr. McKenna, Mr. Thorsen, Mr. Treat, and Treasurer Tavares.

**VOTED: To approve the Minutes of the December 1, 2004 Executive Session.**

Proposed Real Estate Investment – Prudential Real Estate Investors (“PRISA”). Mr. J. Allen Smith, Managing Director and Senior Portfolio Manager and Mr. Kevin R. Smith, Vice President and Senior Asset Manager represented PRISA. Mr. K. Smith gave an organizational overview of PRISA noting it has \$7.6 billion in gross assets under management as of 9/30/04. PRISA had a total of 154 clients as of 12/31/04, 39 of which are public pension fund clients. Corporate pension fund clients total 62, Taft Hartley pension fund clients total 44 and there are 9 endowment and foundation clients.

Mr. Allen Smith noted that PRISA is a core real estate equity portfolio that generates a high proportion of its total return from income. PRISA focuses on five major commercial property types: office (36.3%), retail (20.5%), industrial (17.7%), apartment (21.2%), and hotel (4.3%). Assets are primarily completed, well-leased, income-producing properties. For one year, the total return before management fees was 15.3%; for three years, the return was 10.2%; and for five years, the return was 10.5%.

Mr. A. Smith noted that PRISA has a bias towards newer construction because of lower capital expenditure requirements. This has resulted in a high level of cash flow returns available for distribution or re-investment. The occupancy level of the properties are as follows: Office 89.3%, Industrial 90%, Retail 94.7%, and Residential 90.7%. High occupancy with a low level of lease expirations over the next few years has helped insulate PRISA from the tenant-oriented leasing market and contributed to the stability of the cash flow. He noted that it would take approximately 4-6 quarters to draw down the capital.

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

**VOTED: To invest up to \$50 million in Prudential Real Estate Investors (PRISA) contingent upon satisfactory review and negotiation of investment and other legal documents.**

Mr. Blaschka reported that he expected to bring an additional fund or two to the February SIC meeting which would be a good compliment to these two funds.

Brown Rudnick Berlack Israels, LLP (“Brown Rudnick”) – Renewal of Contract. Treasurer Tavares stated that the contract with Brown Rudnick for general representation has expired. He and staff recommend renewal for one year under the current terms and conditions.

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

**VOTED: To approve the engagement of Brown Rudnick Berlack Israels to serve as General Counsel to the State Investment Commission for a period of one year ending October 31, 2005 under the current terms and conditions of the existing contract.**

Brown Rudnick Berlack Israels, LLP (“Brown Rudnick”) – Engagement for Gateway Eight Litigation. Treasurer Tavares stated that Brown Rudnick has been representing the SIC’s interests in the Gateway Eight litigation, and that it is his and Staff’s recommendation to formally confirm the engagement.

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

**VOTED: To approve the engagement of Brown Rudnick Berlack Israels to serve as Legal Counsel to the State Investment Commission in connection with the Gateway Eight Bankruptcy.**

Executive Session. Treasurer Tavares requested a motion to convene in Executive Session, pursuant to R.I.G.L. § 42-46-5(2) to discuss potential litigation regarding the Gateway Eight lease; and pursuant to R.I.G.L. § 42-46-5(7) to discuss the investment of public funds regarding the Gateway Eight lease. Mr. Thorsen moved, Mr. Costello seconded and the following motion was passed unanimously. The following members voted in favor: Mr. Costello, Dr. McKenna, Mr. Thorsen, Mr. Treat, and Treasurer Tavares.

**VOTED: Pursuant to R.I.G.L. § 42-46-5(2) and R.I.G.L. § 42-46-5(7), the Commission voted to close the meeting to the public to discuss potential litigation regarding the Gateway Eight mortgage; and to discuss the investment of public funds regarding the Gateway Eight mortgage.**

The Commission went into Executive Session at 11:40 a.m.

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

**VOTED: To reconvene the meeting into Open Session.**

The Commission reconvened into Open Session at 11:55 a.m.

Treasurer’s Report. The Treasurer reported that the article in The Providence Journal today stated that the Governor’s proposal on pension reform contains some of the Treasurer’s ideas and proposals. He noted that he is optimistic that something can be worked out and he will keep the Commission informed.

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

**VOTED: To adjourn the meeting.**

There being no further business, the meeting was adjourned at 12:00 p.m.

Respectfully submitted,

Paul J. Tavares  
General Treasurer