State of Rhode Island and Providence Plantations
STATE INVESTMENT COMMISSION

Regular Meeting April 27, 2005

A State Investment Commission ("SIC") meeting was held in Room 135, State House, Providence, Rhode Island on Wednesday, April 27, 2005. The Treasurer called the meeting to order at 9:15 a.m.

Membership Roll Call. Present were: Mr. Michael J. Costello, Dr. Robert J. McKenna, Ms. Marcia Reback, Mr. John R. Treat, and General Treasurer Paul J. Tavares. Ms. Rosemary Booth Gallogly joined the meeting at 9:22. Also present were: Mr. George Carvalho, Chief of Staff, Ms. Joan M. Caine, Deputy Treasurer for Finance, Jayne Donegan, Esq. and William Baldiga, Esq. of Brown Rudnick Berlack Israels, Legal Counsel to the Commission, Mr. David Lindberg of Wilshire Associates Incorporated, Consultant to the Commission, Mr. Peter Martenson of Pacific Corporate Group, Alternative Investments Consultant to the Commission, Mr. Frank Blaschka of The Townsend Group, Real Estate Consultant to the Commission, and other members of the Treasurer's Staff.

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

VOTED: To approve the Minutes of the March 23, 2005 Regular Meeting.

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

VOTED: To approve and seal the Minutes of the March 23, 2005 Executive Session.

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

VOTED: Pursuant to R.I.G.L. § 42-46-5(2) and R.I.G.L. § 42-46-5(7) the Commission votes to close the meeting to the public to discuss the 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 9:20 a.m.

Open Session. Ms. Gallogly 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.

VOTED: To reconvene the meeting into Open Session.

The Commission reconvened into Open Session at 9:40 a.m. Treasurer Tavares noted that no votes were taken while the Commission was in Executive Session.

Ms. Reback moved, Dr. McKenna 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.

VOTED: To seal the Minutes of the Executive Session held today, April 27, 2005.

Proposed Alternative Investment – CVC European Equity Partners IV, L.P. ("CVC IV"). Mr. Martenson of Pacific Corporate Group ("PCG") gave a brief overview of CVC IV, which is being formed to make investments in buy-outs, buy-ins, acquisitions, recapitalizations, and related transactions on a pan-European basis. Some transactions may extend beyond Europe as the fund does not set predetermined geographic or sector targets, but rather invests opportunistically across Europe. CVC Capital Partners has raised $7 billion through three previous funds and made investments in 95 portfolio companies. The Employees' Retirement System of Rhode Island ("ERSRI") is a limited partner in both CVC II and CVC III.

Mr. James Joy, Managing Director represented CVC IV. He noted that CVC IV will invest in companies possessing talented and experienced management teams, strong market positions, and opportunities for profit growth. CVC IV intends to broadly diversify its European investments in a variety of industries and geographical locations in order to mitigate portfolio risk. Historic investments are in the manufacturing, leisure, food and beverage, distribution, chemicals, automotive, utilities, services, and retail industries among others.

Target size of CVC IV is € 5 billion with a cap of € 6 billion. CVC funds have achieved top quartile returns. Fund I has a net IRR of 24.7%, Fund II has a net IRR of 21.0% and Fund III has a net IRR of 44.6%. Mr. Joy noted that CVC is very well positioned, having operated in Europe for 24 years.

Ms. Reback moved, Ms. Gallogly 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.

VOTED: To invest up to $20 million (USD) in CVC European Equity Partners IV, L.P. contingent upon satisfactory review and negotiation of investment and other legal documents.

The Townsend Group ("Townsend") – Real Estate Overview. Mr. Frank Blaschka noted that The RREEF America REIT II Fund ("RREEF II") and the Morgan Stanley Prime Property Fund ("Prime") are both open end commingled funds. They are rated as Tier II open-end core funds in Townsend's four-tiered rating system. Tier II funds are essentially good tactical investments that complement other broader, more diversified funds. They tend to be strong performers and rank among the top of the open end core fund universe.

Proposed Real Estate Investment – RREEF America REIT II Fund ("RREEF II"). Mr. Jon Thompson, Director, Client Relations and Mr. Frank Garcia, Director, Portfolio Management represented RREEF II. Mr. Thompson noted that RREEF is an acronym for Rosenberg Real Estate and Equity Funds ("RREEF"), which was founded in 1975. RREEF II will invest in the four major property groups: office, industrial, retail, and apartment; and will not invest in hotels.

RREEF has $27.1 billion of assets under management, which includes $14.8 billion in core real estate, which is income producing real estate. Since 1975 RREEF has sponsored twenty different commingled funds.

Mr. Garcia noted that RREEF II is structured as a private real estate investment trust. The three main goals for the fund are: the preservation of capital; a high dividend payment; and property appreciation. RREEF II has a strict leverage maximum of 30% and is presently at approximately 19%. Total returns are as follows: 14.5% for one year; 11.3% for three years; and 11.0% for five years. The existing RREEF II portfolio is invested 33% in industrial, 32% in office, 18% in retail and 17% in apartments. The geographic composition consists of 56% in the west; 25% in the east; 15% in the south; and 4% in the mid-west.

Mr. Garcia noted that the portfolio currently has 90% occupancy, projecting 92% average occupancy through 2005. The average lease term is 3.2 years, excluding apartments and he expects a stable dividend pay-out going forward. He also stated that there is not as much market volatility in private REITs as there is in public REITs.

Mr. Treat 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.

VOTED: To invest up to $35 million in RREEF America REIT II fund contingent upon satisfactory review and negotiation of investment and other legal documents.

<u>Proposed Real Estate Investment – Morgan Stanley Prime Property Fund (“Prime”)</u>. Mr. Michael Wright, Executive Director, Mr. Scott Brown, Executive Director and Mr. Robert Weaver, Managing Director represented Prime. Mr. Wright noted that Morgan Stanley Real Estate (“MSRE”) is a global business located in eleven countries. MSRE has approximately $32 billion of assets under management with a very stable management team.

Mr. Brown noted he is one of three investment officers that are 100% dedicated to this fund as a portfolio manager. Prime is a core return, open-end commingled equity real estate fund diversified by property type and geographic location and designed to provide a stable, income-driven rate of return over the long term. Prime is a franchise product of MSRE with a thirty-two year operating history. Prime is currently focused on high-quality office buildings, top tier super regional malls, high-demand multifamily projects and distribution warehouses in targeted markets.

Mr. Brown stated that Prime favors investing in major gateway markets, particularly coastal cities such as New York, Boston, Washington, Miami, San Francisco, Los Angeles, and San Diego. He noted time-weighted returns (before fees) were 18.5% for one year; 11.5% for three years; and 10.2% for five years, consistently outperforming the benchmark. Prime has 34.8% in office space; 31.9% in retail; 15.7% in industrial; 13.4% in residential; and 4.2% in hotels/other. The geographic composition is 42.7% in the west; 34.3% in the east; 14.6% in the mid-west; and 8.4% in the south. Mr. Brown stressed that Prime has access to all Morgan Stanley’s relationships, resources and capabilities.

Mr. Weaver reported on the national press that Morgan Stanley has been experiencing lately. He noted that Morgan Stanley and Dean Witter merged in 1997. There has been tension between the leadership teams since the beginning. When Mr. Philip Purcell, Chief Executive Officer recently promoted two individuals, other aspirants to those positions left the firm. A group of eight top executives wrote a letter to the Board of Directors expressing their dissatisfaction with Mr. Purcell. Mr. Weaver stated that the core issue is not about fraud or accounting practices, but rather about a CEO, who does have the full support of the Board, being engaged in a dispute with former leaders of the firm.

The Board maintains its confidence in the leadership of the firm and is not planning on making any changes. The press is making the case that those leaving the firm have left as a result of their dissatisfaction with Mr. Purcell. This has caused a disruption in the executive offices. There are several scenarios that could happen going forward: 1) the disruption could die down and business could return to normal; 2) the Board could decide to take a further look at Mr. Purcell and his leadership, wherein Mr. Purcell could split his responsibilities by giving up either the chairmanship or the CEO position; or 3) a small chance that Morgan Stanley could be acquired by another financial services firm.

Mr. Weaver stated that as it relates to the real estate business, all twenty-four partners are still in place and not planning to leave. There has been zero impact at the operating level. It has not affected Prime's ability to buy properties or manage its assets.

Mr. Costello moved, Ms. Gallogly 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.

VOTED: To invest up to $35 million in Morgan Stanley Prime Property Fund contingent upon satisfactory review and negotiation of investment and other legal documents.

Wilshire Associates Incorporated – Capital Market Review. Mr. Lindberg noted that 2005 has had a rough first quarter with large stocks down 2.2%, small stocks down 5% and bonds down as well. April has shown a positive fixed income return and earnings announcements will be out this week. Small stocks continue to lag large stocks. As of 4/22/05, the S&P 500 is down 4.5%, the Russell 2000 is down 9.2% and the DJ Wilshire 5000 is down 4.6%.

Deputy Treasurer for Finance Report. Ms. Caine noted that the pension fund is down 70 basis points for the first quarter, which is 50 basis points ahead of the benchmark. For the fiscal year, the fund is up 8.6%, 80 basis points ahead of the benchmark. Ms. Caine distributed a copy of an article from Pensions & Investments which gives more information on portable alpha strategies, the program that Mr. Bensur of Wilshire talked about at the last meeting. She noted that several other plans are actively engaged in similar programs, which have added value over the long-term. Ms. Caine and Mr. Bensur will continue to research this strategy.

Ms. Caine also noted that two of the three providers to the Deferred Compensation Program (457 Program) will be coming before the Commission to recommend some changes in their investment options to better diversify the program. The two providers are ING Aetna and VALIC. The third provider, Fidelity, does not require any changes to their investment options at this time.

Dr. McKenna moved, Mr. Treat 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.

VOTED: To adjourn the meeting.

There being no further business, the meeting was adjourned at 11:10 a.m.

Respectfully submitted,

Paul J. Tavares
General Treasurer