State of Rhode Island and Providence Plantations
STATE INVESTMENT COMMISSION

Regular Meeting June 22, 2005

A State Investment Commission ("SIC") meeting was held in Room 135, State House, Providence, Rhode Island on Wednesday, June 22, 2005. Ms. Caine, as the Designee of General Treasurer Paul J. Tavares, called the meeting to order at 9:05 a.m.

Membership Roll Call. Present were: Mr. Michael Costello, Dr. Robert McKenna, Mr. James E. Thorsen, Mr. John Treat, and Ms. Joan M. Caine, Deputy Treasurer for Finance serving as the Designee of General Treasurer Paul J. Tavares. Also present were: Jayne Donegan, Esq, of Brown Rudnick Berlack Israels, Legal Counsel to the Commission, Ms. Tara Blackburn and Mr. Monte Brem, of Pacific Corporate Group, Alternative Investments Consultant to the Commission and Mr. Frank Blaschka and Mr. Anthony Frammartino, of The Townsend Group, Real Estate Consultants to the Commission, and other members of the Treasurer's Staff. Mr. David Lindberg, of Wilshire Associates Incorporated, General Consultant to the Commission joined the meeting at 10:20 a.m. Ms. Rosemary Booth Gallogly and Ms. Marcia Reback were absent.

State Investment Commission Minutes. Mr. Costello 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 Ms. Caine.

VOTED: To approve the Minutes of the May 25, 2005 regular meeting.

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 Ms. Caine.

VOTED: To approve and seal the Minutes of the May 25, 2005 Executive Session.

Ms. Caine asked for the indulgence of the Commission in rearrangement of the Agenda, as the presenters from the private equity investments were delayed, but the presenters from the real estate funds were present.

The Townsend Group ("Townsend") – Real Estate Overview. Mr. Frank Blaschka noted that Starwood Capital Hospitality Fund I ("Starwood") and Fillmore East Fund I ("Fillmore") are closed end fund investments in the High Return and Enhanced Return categories. These two funds represent a targeted hospitality related strategy seeking to take advantage of improving cyclical performance related to improving economic conditions and increased business travel, as well as demographic trends that favor travel and resort oriented leisure activities. These two funds offer both downside protection (Fillmore with its high coupon mezzanine loans or other income oriented structured finance investments) and upside potential (Starwood with its development/redevelopment strategies, repositioning assets, and global opportunities).

Proposed Real Estate Investment – Fillmore East Fund I. Mr. Timothy C. Getz, Executive Vice President and Mr. Ronald Silva, President and CEO represented Fillmore. Mr. Getz noted that Fillmore manages both commingled fund and separate account investments, with a current portfolio of $840 million. He described Fillmore as a disciplined contrarian with a bias towards current cash yields and premium total returns. Its focus is on non-traditional, non-commodity investments and market inefficiencies.

Mr. Silva noted that the fund will be capped at $400 million. The fund will have approximately 62% in mezzanine investments, 17% in entity level finance, 14% in first mortgages and 7% in B-notes/second mortgages. He expects approximately 39% of the properties to be in hospitality full service, 34% in hospitality limited service, 14% in office space, 8% in senior housing and 5% in manufactured housing. Representative Fillmore Partners annualized returns for the 1-year period ended 12/31/04 were 14.49%, 3-year annualized returns were 15.09% and 5-year annualized returns were 14.85%.

Fillmore is a new firm formed in 2003 by investment professionals who departed Lowe Enterprises Investment Management (“LEIM”). Mr. Silva, Mr. Getz and Mr. Michael Reinardy were instrumental in managing the prior successful investment activity of LEIM under the same strategy. Mr. Silva spent 13 years at LEIM and was head of the structured finance group originating both debt and equity investments. Mr. Getz joined LEIM in 1998 and Mr. Reinardy in 2000. The three structured more than $2 billion debt and equity investments, at LEIM and/or Fillmore. Townsend has had ten years of investment experience with Mr. Silva as a manager of separate account investments for two Townsend pension fund clients.

Mr. Thorsen 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 Ms. Caine.

VOTED: To invest up to $10 million in Fillmore East Fund I, contingent upon satisfactory review and negotiation of investment and other legal documents.

<u>Proposed Real Estate Investment – Starwood Capital Hospitality Fund I</u>. Mr. Frammartino gave a brief overview of Starwood. Mr. Jerome C. Silvey, Executive Vice President and Chief Financial Officer represented Starwood. Mr. Silvey noted that Starwood has over $9 billion invested in 260 separate transactions. Approximately 80% of Starwood’s investments since inception have been realized. Starwood co-invests 3% with the limited partners. It has an experienced team that has been together from 12 to 16 years. Principals of Starwood have combined real estate, capital markets, and corporate transaction expertise which allows them to alter their investment focus as markets have changed.

Starwood has unique hotel experience in Mr. Barry Sternlicht, former CEO of Starwood Hotels. Mr. Sternlicht brings a wealth of private and public hotel experience, reputation, network and contacts to bear that should be a strong positive factor to enable the fund to source and execute a wide variety of hotel and hotel related strategies. Some of his accomplishments include the recapitalization of Starwood Hotels, the purchase of the Westin chain, the growth of the Starwood Hotel company including the large ITT portfolio purchase. He created and introduced the W Hotel chain. Starwood has invested over $9 billion in 260 transactions since 1991.

Mr. Silvey noted that Starwood’s historical annual performance from 1991 through 2004 was 37%. Target size of the fund is $800 million. The strategy will focus on hospitality related investments that may include operating companies, resorts, condominiums and may have a significant redevelopment component as well as new format such as condo/hotels. Starwood has an exceptional global capability in this sector, having been involved in $15 billion of hotel transactions.

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 Ms. Caine.

VOTED: To invest up to $10 million in Starwood Capital Hospitality Fund I, contingent upon satisfactory review and negotiation of investment and other legal documents.

Real Estate Portfolio Status. Mr. Blaschka reported that the current focus is on building the portfolio. The portfolio will consist of 27% in office properties, and approximately 18-19% each in the retail, apartment and industrial property types. The remaining 18% will be invested in hotels and other specialized property types. With today's commitments to Fillmore and Starwood as non-core investments, Townsend views these as the most compelling opportunities in the market, taking advantage of specialized property types using proven teams with competitive advantages. All commitments are falling well within the ranges in the Investment Policy.

Pacific Corporate Group ("PCG") - Reorganization Structure. Mr. Monte Brem, President of PCG Asset Management distributed PCG's new organizational chart and explained that a year ago PCG began to explore ways to reorganize their business in order to better serve their clients. It was decided that the fund investment activities should focus completely on fund investments. The direct investment activities should focus solely on direct investments. Mr. Brem was appointed President of PCG Asset Management to oversee the fund investments in April, 2005. Mr. Christopher Bower, CEO heads PCG Capital Partners and oversees the direct investments. Nearly 95% of PCG's employees are focused on the fund investment activities. The direct investment side is more of a project based business and much less people intensive. Mr. Brem noted that the changes were made to coincide with changes seen in the market and to optimize how they operate in that market.

Proposed Alternative Investment - Apollo Investment Fund VI, L.P. ("Apollo"). Ms. Blackburn gave a brief overview noting that the fund will be capped at $6 billion. The general partner has committed $100 million to the fund and/or transactions executed by the fund. Apollo will follow the same investment strategy as in previous funds by investing in distressed debt with (1) control or influential minority equity and equity-like positions and (2) debt or other securities that are expected to generate equity-like returns.

Ms. Stephanie Drescher and Mr. Marc Becker represented Apollo. Mr. Becker noted that the Apollo group was founded in 1990 and since then has invested approximately $12 billion of capital in buyouts generating a gross IRR of approximately 41%. The founding partners have been together for 18 years with deep industry expertise in several core industries. Ms. Drescher noted that Fund V generated a gross IRR of 78% and Fund IV generated a gross IRR of 14%. Apollo focuses on downside protection. Approximately 90% of the investments have generated positive returns.

Ms. Drescher noted Apollo builds significant value though its "hands on" approach. It has taken advantage of the debt markets while creating stable long-term capital structures for portfolio companies. The fund will focus on nine industries: chemicals, communications, consumer/retail, distribution/transportation, financial services, hospitality/leisure, manufacturing/industrial, media/entertainment/cable and printing/publishing.

Mr. Thorsen inquired if the SIC should invest $20 million in Apollo instead of the $15 million commitment recommended by PCG. Ms. Blackburn noted that she believed the amended amount may be available.

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 Ms. Caine.

VOTED: To invest up to $20 million in Apollo Investment Fund VI, L.P., contingent upon satisfactory review and negotiation of investment and other legal documents.

Proposed Alternative Investment - Birch Hill Equity Partners III, L.P. ("Birch Hill"). Ms. Blackburn gave a brief overview of Birch Hill which will make investments in sustainable growth opportunities, under-managed companies and special opportunities. The investments will be in middle-market companies principally located in Canada. Historically the investments have been in the manufacturing, software, outsourced services, healthcare, energy, entertainment and media/communications sectors.

Mr. Stephen J. Dent, Partner and Mr. Joseph P. Wiley, partner represented Birch Hill. Mr. Dent noted that Birch Hill is the leading middle-market buyout firm in Canada with C$805 million invested in 31 portfolio companies. Eighteen fully realized investments have generated a 30% gross IRR. It has produced a 25% gross IRR on all investments since 1994. Birch Hill has been backed by the Toronto Dominion Bank ("TD") which is Canada's second largest financial institution since the 1990s.

Mr. Wiley noted that the Canadian market is unique and makes it difficult for foreign funds to compete. It's a small, tight business community where reputation is paramount and with a limited number of top management teams. Canada has a concentrated customer and competitor base and fewer, more conservative domestic banks. Birch Hill has team longevity and a reputation for fair dealing which draws top companies, managers and business partners. It also has deep relationships with top tax, legal and regulatory advisors which enables effective, value-enhancing structuring. Also, the Canadian public markets are less liquid and less efficient, making private equity a relatively more attractive alternative.

Mr. Costello 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 Ms. Caine.

VOTED: To invest up to $15 million in Birch Hill Equity Partners III, L.P., contingent upon satisfactory review and negotiation of investment and other legal documents.

State Street Bank & Trust Company ("State Street") - Custody Contract. Ms. Caine reminded Commission members that in 2000 a Request for Proposals was issued for a custodial bank. The Employees' Retirement System of Rhode Island ("ERSRI") has had a long-term relationship with State Street and they were again chosen for this mandate for a variety of reasons. State Street has an exceptional team in place and are very responsive to our requests. State Street continues to introduce new and enhanced products to us, particularly tools to help us monitor investment managers with regard to performance and compliance with investment policy statement guidelines.

Ms. Caine noted that in 1999 ERSRI was paying between $1 million to $2 million for their services. The past four years ERSRI has been paying between $100,000 to $200,000. The amount varies depending upon what type of investment activity the fund is involved in. ERSRI has also benefited because we have a bundled relationship with State Street. They manage a good deal of indexed money and as a result ERSRI receives a discount on the custody services. Therefore, because of great services, a responsive, knowledgeable team, and a below market price, staff recommends extending the custody contract for two years.

Mr. Thorsen noted that he needed to recuse himself from the vote to extend the custody contract, which meant that a quorum was no longer present. Therefore, at 11:00 a.m. Ms. Rosemary Booth Gallogly was conferenced in by telephone and brought up to date on the custody contract matter by Ms. Caine. After which Mr. Treat moved, Dr. McKenna seconded and the following motion was passed unanimously. The following members voted in favor: Mr. Costello, Ms. Gallogly, Dr. McKenna, Mr. Treat and Ms. Caine. Mr. Thorsen recused himself from this vote.

VOTED: To approve the extension for a term of two years (to July 31, 2007), upon the existing terms and conditions, of the custodian contract between the Commission and State Street Bank and Trust Company, dated September 13, 2000, as thereafter extended to July 31, 2005.

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, Mr. Treat and Ms. Caine. Mr. Thorsen recused himself from this vote.

VOTED: That the General Treasurer, be, and he hereby is, authorized, empowered and directed to execute, acknowledge, and deliver any and all certificates, agreements and other documents, take any and all steps and do any and all things as he may deem necessary or advisable, in his sole discretion, in order to effect the purposes of the foregoing vote.

Note: The telephone call to Ms. Gallogly was completed at 11:05 a.m.

CollegeBound*fund* - AllianceBernstein ("Alliance"). Mr. Tom Fontaine, Senior Portfolio Manager, Mr. Richard A. Davies, Executive Vice President and Ms. Jennifer DeLong, Senior Vice President represented Alliance. Mr. Davies introduced a proposed enhancement to the CollegeBound*fund* known as a "pooling structure", which is essentially a collection of institutional mutual funds that mirror the exact same retail funds currently used, but that add some additional asset classes such as international growth and inflation protected securities. It also helps to globalize Alliance's REIT position. It will also allow Alliance to tie-in to some other similar asset allocation products that Alliance manages for purposes of continued marketing focus within Alliance.

Mr. Davies noted eleven new style-pure pools created through funding from some other products. Alliance will continue to use exchange reserves which is a cash fund. It is not unlike the fund-of-funds structure Alliance has been using over the last five years. Alliance has built these institutional pools from successful institutional product lines that Alliance offers to institutional investors. They have outperformed versus the benchmark since inception in these categories as a group. Mr. Davies noted that style blend portfolio management teams were created when Bernstein and Alliance came together as companies in 2000, specifically to put together the value style of Bernstein together with the growth style of Alliance. The team has had great success bringing in over $40 billion of new assets with this strategy and are responsible for overseeing over $60 billion of assets within the firm.

Mr. Fontaine noted that Alliance is offering two different equity glide paths of age-based portfolios. The reason to offer two different paths is so that individuals can express their risk tolerance - if they want to seek more return with a slightly more aggressive allocation. He also noted an additional offering to the fixed allocation portfolios. These portfolios maintain the same equity bond mix regardless of the age of the beneficiary. Alliance proposes to consolidate the "Growth" and "Aggressive Growth" portfolios into one single "Appreciation" portfolio. Alliance also proposes to retain the "Balanced" portfolio and to add a new fixed allocation portfolio called "Preservation" which has a constant 35% equity allocation. This portfolio is for individuals who want the safety of a high allocation to bonds but want the opportunity to earn more returns than the stable value portfolio.

Ms. DeLong stated that Alliance requests an amendment to the Management Agreement relating to the manner in which remuneration is paid to Alliance. Mr. Davies noted that the intention for the overall expense ratios of the mutual fund complex goes down, and Alliance wants to pass those similar savings along to CollegeBound*fund* participants so that the CollegeBound*fund* pricing and traditional mutual fund pricing is in alignment. It protects investors should the costs go up. Alliance indicated that it intends to annually review the expense ratios and program management fees in light of the expense ratios of retail mutual funds managed by Alliance that are comparable to the underlying mutual funds that comprise the education strategies portfolios. Ms. DeLong noted that with the Commission's approval, these changes would be implemented in early August.

Mr. Costello 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 Ms. Caine.

VOTED: To approve the recommended modifications to the CollegeBound*fund* investment options and portfolio construction modifications to include a pooling structure as outlined in alliance's proposed portfolio enhancement presentation dated June 22, 2005.

Dr. McKenna 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 Ms. Caine.

VOTED: To approve the seventh amendment to the Investment Management Agreement, dated as of August 1, 2000, as amended, by and among the Rhode Island Higher Education Assistance Authority, the State Investment Commission and Alliance Capital Management, L.P., in substantially the form presented to the Commission, which amendment implements a revised expense structure of the CollegeBound*fund* investment portfolios.

<u>Wilshire Associates Incorporated - Capital Market Update</u>. Mr. Lindberg noted that 1st quarter 2005 was difficult as was April. The equity market and fixed income market have been much improved in May and June. Consumer and business spending have been strong with a significant number of good earnings reports coming out. Retail sales have been stronger and home sales continue to be strong. The Fed is expected to raise rates two more times this year.

We now have a slightly positive year-to-date return. The S&P is up approximately 1% half way through the year and international markets are up a little bit also.

Deputy Treasurer for Finance Report. Ms. Caine noted that there will be no July meeting of the SIC. The next meeting will be held on Wednesday, August 24, 2005 at 9:00 a.m. She also noted that fiscal year-to-date return for the eleven months ended 5/31/05 for the fund is 9.6% which is ahead of the hurdle rate.

General Treasurer's Report. Ms. Caine noted that the Treasurer was disappointed not to be in attendance today to present a Citation to George Crepeau who is retiring at the end of June. Mr. Crepeau has worked for the Treasurer's Office for 23½ years and is presently an investment analyst in the Investments Department. She thanked Mr. Crepeau for his dedication to the State of Rhode Island and wished him well in his retirement plans. Commission members gave Mr. Crepeau a standing ovation.

Mr. Costello 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 Ms. Caine.

VOTED: To adjourn the meeting.

There being no further business, the meeting was adjourned at 11:25 a.m.

Respectfully submitted,

Joan M. Caine
Deputy Treasurer for Finance