

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

**Regular Meeting June 28, 2006**

A State Investment Commission ("SIC") meeting was held in Room 135, State House, Providence, Rhode Island on Wednesday, June 28, 2006. The Treasurer called the meeting to order at 9:05 a.m.

Membership Roll Call. Present were: Mr. Jeffrey Britt, Mr. Michael Costello, Ms. Rosemary Booth Gallogly, Dr. Robert McKenna, Ms. Marcia Reback, Mr. John Treat, and General Treasurer Paul J. Tavares. Also present were: Mr. George Carvalho, Chief of Staff, Ms. Joan M. Caine, Deputy Treasurer for Finance, Jayne Donegan, Esq., of Brown Rudnick Berlack Israels, Legal Counsel to the Commission, Ms. Michelle Davidson 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. Mr. Treat moved, Dr. McKenna seconded and the following motion was passed unanimously. The following members voted in favor: Mr. Britt, Mr. Costello, Ms. Gallogly, Dr. McKenna, Ms. Reback, Mr. Treat, and Treasurer Tavares.

**VOTED: To approve the Minutes of the May 24, 2006 regular meeting.**

Proposed Investment in Thomas, McNerney & Partners II, L.P. ("TMP II"). Ms. Michelle Davidson of Pacific Corporate Group ("PCG") gave a brief overview of TMP II. She noted that TMP II is being formed to make venture capital investments at all stages of development and across all sectors of the life sciences and medical technology industry. The Employees' Retirement System of RI ("ERSRI") previously invested \$15 million in TMP's first fund. Fund I has achieved top quartile returns, however it is largely unrealized.

Mr. Peter McNerney, Co-Founder and Partner represented TMP II. He stated that TMP II will focus on specific areas of sector emphasis which will include biotechnology, medical devices, pharmaceuticals, and other forms of medical product innovation. Fund I is invested in eleven companies, soon to be thirteen companies and is approximately 80% allocated. TMP II will build a portfolio of approximately 20 companies investing in four to five companies per year with an average investment size of \$15 million.

Mr. McNerney noted that Fund I has a gross IRR of 25 %. In prior funds during the time period of 1998 - 2000, returns were 73.9%; during 1994 - 1998 returns were 32.7% and pre-1994 returns were 29.9%. TPM II's current sector diversification is approximately 45% medical devices and approximately 55% biotech/pharmaceuticals. The three sectors are concentrated fairly heavily in three parts of the country: the northeast, the upper midwest and the west coast.

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

**VOTED: To invest up to \$15 million in Thomas, McNerney & Partners II, L.P. contingent upon satisfactory review and negotiation of investment and other legal documents.**

Proposed Investment in First Reserve Fund XI, L.P. ("FR XI"). Ms. Davidson gave a brief overview of FR XI. She noted that ERSRI is invested in three prior First Reserve Funds - VIII, IX and X. FR XI is being formed to employ a top down, bottom up strategy, similar to prior funds focusing on energy infrastructure services. First Reserve has been employing the same strategy for approximately 14 years through five prior funds generating a net return of 27%.

Ms. Cathleen Ellsworth, Managing Director represented FR XI. She noted that Fund X is 95% committed and Fund XI will close in July. First Reserve has focused solely on energy for the last 25 years in all kinds of markets. She stated that First Reserve has a strong deal flow through strategic relationships, noting that 80% of current holdings are from proprietary sources. She stated that First Reserve is the largest and most well-known participant in the industry. Gross performance figures through 3/31/06 reveal that Funds VI, VII, VIII and IX have realized IRRs of 32%, 17%, 25%, and 89% respectively.

Ms. Ellsworth noted that energy is a global industry with more than 75% of the market outside the United States. She noted that natural gas and coal is becoming increasingly important and that 52% of the energy in the United States is produced by coal. There is an increasing demand for oilfield service and equipment and for manufacturing and service companies. There is also an increasing demand for ancillary businesses such as LNG, shipping and pipelines.

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

**VOTED: To invest up to \$20 million in First Reserve Fund XI, L.P. contingent upon satisfactory review and negotiation of investment and other legal documents.**

Proposed Investment in TA Associates Realty Fund VIII ("TA VIII"). Mr. Frank Blaschka of The Townsend Group gave a brief overview of TA VIII noting that it is a valued added fund in the enhanced return sector of the portfolio. TA Realty was formed in 1982 by Mike Ruane and Arthur Segal and currently manages \$8.6 billion in real estate assets, including \$4.9 billion in value added funds. TA VIII will continue the same strategy as in their six previous funds.

Mr. Michael Ruane, Managing Partner, Mr. Scott Van Houten, Partner/Acquisitions, and Mr. Reid Parker, Partner represented TA VIII. Mr. Ruane noted that TA VIII will have a strong emphasis on finding properties in major markets, particularly along the coastal regions and will not invest in specialized property types. He noted that TA Associates has been able to maintain targeted returns in a lower return environment not by taking on more leasing risk or life cycle risk, but by employing more leverage. It will likely have a floor of 50% loan to value over the life of the fund, with initial periods being 100% leveraged as they finance the first half of the portfolio before calling equity, and using shorter holding periods of underlying investments. He also noted that TA Associates always completes investments in one fund before starting another.

Mr. Parker reviewed statistics regarding the prior four funds stressing that the average size of an investment is approximately \$20 million. He noted that the investments are well diversified in the four major property types throughout the US. The last four funds are invested

as follows: approximately 46% in industrial space, 44% in office space, 8% in the multi-family space, and 2% in retail space. The four property types are concentrated fairly heavily in the west coast, the east coast and southwest. Mr. Van Houten reviewed some representative transactions.

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

**VOTED: To invest up to \$15 million in TA Realty Fund VIII contingent upon satisfactory review and negotiation of investment and other legal documents.**

Real Estate Consultant - The Townsend Group - 1<sup>st</sup> Quarter Performance Report. Mr. Blaschka stated that ERSRI has committed \$305 million to 13 commingled fund investments. This is broken down as follows: 71% of the capital targeted for stable return investments has been committed; 65 % of the capital targeted to enhanced return investments has been committed; and all of the capital targeted for high return has been committed. Approximately \$94 million remains to be committed to future commingled fund investments in the stable return and likely enhanced return sectors.

Mr. Blaschka noted that the real estate portfolio is benchmarked to the NCREIF Property Index (“NPI”). The stable return investments outperformed the NPI for the first quarter by 130 basis points on a gross basis. The enhanced and high return investments are lagging due to the effects of the “J-curve” whereby fees on committed capital exceed distributions due to minimal invested capital and the early stages of the value-added process in the underlying investments.

Mr. Blaschka stated that gross return for the one year period ending 3/31/06 was 23.5% versus the benchmark’s 20.2%. The portfolio outperformed the NPI over the past year by 330 basis points on a gross basis; it was 170 basis points below the NPI on a net of fee basis, with the high fee load attributed to the J-curve effect. Townsend anticipates the spread between the gross and net return will narrow as the portfolio matures.

Investment Manager Review - Fidelity Management Trust Co. (“Fidelity”). Ms. Caine gave a brief overview of Fidelity noting that they were retained in 1989 to provide a long-term, strategic allocation to the mortgage-oriented sector of the fixed income market. The market value of the portfolio at March 31, 2006 was \$415.8 million. The portfolio comprises 24.8% of the fixed income composite and 5.8% of the total fund composite. She noted that the portfolio has met their objective of returning 20 basis points over the Lehman Mortgage Index on the one-year, three-year, five-year, and since inception time periods.

Mr. Arthur Greenwood, Senior Vice President and Relationship Manager and Mr. William Irving, Portfolio Manager represented Fidelity. Mr. Greenwood noted that Fidelity has recently separated its institutional business from the retail mutual fund business, but that will not affect the ERSRI portfolio in any way. Mr. Irving noted that the portfolio is comprised of 57% in 30-year fixed rate mortgages, 14% in 15-20 year mortgages, 7% in commercial mortgage-backed securities, 18% in collateralized mortgage obligations, and 3% in asset-backed securities. He noted that the Fed has steadily raised short-term rates while long-term rates are more stable. Mortgage rate volatility was low and prepayments were stable.

Mr. Irving reported that California, Florida and the Northeast have had very strong home-price appreciation, and that Texas and Ohio have had much more subdued growth. High home prices together with higher interest rates have put strains on affordability. The housing market

is slowing in those regions and the number of months the housing supply is on the market is the highest it has been in several years. He also noted that the subprime market has grown considerably and has performed well.

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

**VOTED: Pursuant to R.I.G.L. § 42-46-5(5) and R.I.G.L. § 42-46-5(7), the Commission votes to close the meeting to the public to discuss the disposition of publicly held property wherein advanced public information would be detrimental to the interest of the public and to discuss the question of the investment of public funds where premature disclosure would adversely affect the public interest regarding the Gateway Eight building.**

The Commission went into Executive Session at 10:47 a.m.

Open Session. Mr. Britt moved, Mr. Costello seconded and the following motion was passed unanimously. The following members voted in favor: Mr. Britt, 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 11:15 a.m. There were no votes taken while the Commission was in Executive Session.

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

**VOTED: To seal the Minutes of the Executive Session held today, June 28, 2006.**

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

**VOTED: To authorize the General Treasurer to negotiate the offers to acquire the Gateway Eight building received from the top bidders after the national marketing campaign, as discussed by the Commission in its June 28, 2006 Executive Session, and to authorize the General Treasurer, in his sole discretion, to accept an offer from any such bidder to purchase the Gateway Eight building, provided that the Treasurer determines such offer to be the highest and best offer available.**

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

**VOTED: To authorize the General Treasurer to execute, acknowledge and deliver any agreements, certificates, deeds and other documents which he deems appropriate to effect the purposes of the foregoing resolution and consummate the sale of the Gateway Eight building.**

Deputy Treasurer for Finance Report. Ms. Caine distributed Wilshire's Capital Market Review. She noted that the pension fund was up 14% at the end of April and 11.3% at the end of May. She stated that the pension fund's hurdle rate is 8.25%. The capital markets so far in June don't appear to be as volatile as in May and she expects the plan to meet the hurdle rate by the end of June. She noted that the international markets have outperformed all other markets again for the fourth year in a row. The international portfolio was up 26%, the domestic equity portfolio was up 10.4 % and the fixed income portfolio was essentially flat.

Ms. Caine informed the Commission that there was a change in the policy index to better reflect the asset allocations. Historically the private equity portfolio and the real estate portfolio were folded into the Wilshire 5000 Index, a measure of the broad equity market. Since ERSRI now has significant investments in these assets, the real estate portfolio is now benchmarked to the NCREIF property benchmark and the private equity portfolio has been benchmarked to the S&P 500 plus 300 basis points.

Ms. Reback requested that the actuary be invited to a State Investment Commission meeting for a presentation regarding the hurdle rates.

Ms. Caine asked Commission members if they wished to have a July meeting or as has been past practice to cancel the July meeting.

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

**VOTED: To cancel the July 26, 2006 meeting of the State Investment Commission.**

Mr. Britt moved, Dr. Mc McKenna seconded and the following motion was passed unanimously. The following members voted in favor: Mr. Britt, 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 11:23 a.m.

Respectfully submitted,

Paul J. Tavares  
General Treasurer