State of Rhode Island and Providence Plantations
STATE INVESTMENT COMMISSION

Regular Meeting August 30, 2006

A State Investment Commission ("SIC") meeting was held in Room 135, State House, Providence, Rhode Island on Wednesday, August 30, 2006. The Treasurer called the meeting to order at 9:05 a.m.

Membership Roll Call. Present were: 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: Ms. Joan M. Caine, Deputy Treasurer for Finance, Jayne Donegan, Esq., of Brown Rudnick Berlack Israels, Legal Counsel to the Commission, Mr. William Bensur and Mr. Stephen Marshall of Wilshire Associates Incorporated, General 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. Mr. Jeffrey Britt was absent.

State Investment Commission Minutes. Mr. Costello 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 approve the Minutes of the June 28, 2006 regular meeting and to approve and seal the Minutes of the June 28, 2006 Executive Session.

Proposed Investment in Westbrook Real Estate Fund VII, L.P. ("Westbrook VII"). Mr. Frank Blaschka of The Townsend Group gave a brief overview of Westbrook VII, a high return non-core fund. He noted that the Employees' Retirement System of Rhode Island ("ERSRI") invested in Westbrook Real Estate Fund VI. Because of the strength of the deal flow, Westbrook is returning to the market for Fund VII to raise capital to allow them to take advantage of compelling investment opportunities consistent with their historical strategies.

Mr. Paul D. Kazilionis, Founder and Chief Executive Officer represented Westbrook VII. He explained that Westbrook VII will pursue opportunistic real estate investing within the following areas: undervalued assets and portfolios; corporate and government divestitures; urgent recapitalizations; and dysfunctional ownership. The fund intends to focus on major cities in the United States, Europe, and Japan such as Washington, DC, New York, San Francisco, London, Paris and Tokyo. There are no limits on the international exposure, which is a change from the 45% international limit in fund VI.

Mr. Kazilionis noted that Westbrook VII will focus on high quality, well-located properties with an emphasis on privately negotiated transactions. The target IRR for US investments is 18-22%+, for European investments 20-25%+, and in Japan the target IRR is 25-30%+. He reviewed performance for Westbrook V which is projected to achieve an aggregate IRR in excess of 30% and 66% of the total capital commitments have been returned. Westbrook VI is expected to be fully invested within 45-60 days. It is projecting a 20% IRR but expectations are that the returns will be significantly higher. Fund VI has already returned 11%.

Mr. Kazilionis noted that liquidity in the markets is so great that the funds are reaching their exit values sooner than expected. Properties that were expected to be held for 3-5 years, are finding liquidity in 1-2 years. He stressed that Westbrook has a very focused investment strategy, very specific markets, and a real focus on private originations.

Ms. Gallogly 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 invest up to $15 million in Westbrook Real Estate Fund VII, L.P. contingent upon satisfactory review and negotiation of investment and other legal documents.

Gateway Eight Update - Great Point Investors ("Great Point") and The Townsend Group ("Townsend"). Mr. Gary R. Schwandt, Principal, Mr. Joseph Versaggi, Principal and Mr. Andrew LeStage, Vice President represented Great Point and Mr. Frank Blaschka represented Townsend. Mr. LeStage reported that the sale of the Gateway Eight Building to Commonwealth Ventures for $20 million was finalized on August 2, 2006.

Ms. Caine reminded the Commission that in May 2005, the developer of the Gateway Building "tossed the keys" to ERSRI in Bankruptcy Court. Because ERSRI was in no position to take over management of the building, she called Mr. Blaschka at Townsend for a recommendation of a firm able to help ERSRI take over the operation and control of the building. At that point insurance protection was needed along with security services and operational and systems managers. Mr. Blaschka recommended Great Point Investors in Boston. After her call to Great Point, Mr. Versaggi was on the premises within 24 hours and essentially took over management of the building. Ms. Caine thanked everyone involved and stated that it was because of the Great Point team and Mr. Blaschka's connection that the end result is so favorable.

Treasurer Tavares thanked Mr. Blaschka and the Great Point team as well as Commission members for their diligence and support given throughout this ordeal. The Treasurer also thanked Ms. Caine and staff.

Ms. Caine reported that she is preparing a detailed list of costs and expenses incurred in the management of the property so that we can notify the Economic Development Corporation ("EDC") of the deficit as EDC had provided a $3 million guaranty. She expects the deficit to be between $1.5 to $2 million. The EDC will then notify the Governor of the demand under the guaranty. It is then up to the General Assembly to put that appropriation into the Governor's budget. It will probably be about a year before the issue is resolved.

Ms. Caine also noted that the SIC and the City of Providence entered into a Liquidating Trust Agreement to attempt to recapture approximately $2 million in back taxes from BFDS, the former tenant who exited its lease early. The attorneys are in mediation discussions to try to recapture a portion of that $2 million which will be split between the SIC and the City of Providence.

Mr. Schwandt thanked Mr. Blaschka for his recommendation which enabled Great Point the opportunity to work with the SIC. He also thanked Ms. Caine and staff and stated that he could not imagine a better group of people to work with. He also noted that although the SIC had not met Mr. Versaggi previously, that he had been the initial contact and was also involved in all the advice given and the decisions made that Mr. LeStage and he delivered to the SIC.

Mr. Versaggi thanked Ms. Caine for her kind words. He explained that the Gateway experience enabled Great Point to employ a number of the skills they possess in the value added or enhanced investment practice. Those skills will be offered to clients in the form of a fund Great Point is raising and they would welcome the opportunity to discuss it with the SIC at a future time.

The Treasurer asked that the Minutes also reflect his thanks to Attorney William Baldiga of Brown Rudnick Berlack Israels who represented ERSRI in the bankruptcy. He noted that if it were not for his knowledge, professionalism and tenacity ERSRI may not have attained the same outcome. He again thanked all those involved for their teamwork in resolving the Gateway Eight Building matter.

<u>Wilshire Associates Incorporated - Asset /Liability Analysis Report</u>. Mr. Bensur introduced Mr. Stephen Marshall, an actuary from Wilshire's Santa Monica, California office. Mr. Bensur noted that most defined benefit plans exist in an underfunded status. He noted that by mid 2008 to 2009 there will be more inactive participants in the system than active employees. Institutional investors are actively seeking higher returns and/or a lower risk profile by investing in non-traditional asset classes such as private equity, real estate, hedge funds, and commodities.

Mr. Bensur noted that the actuarial discount rate assumption is 8.25% and that the current asset allocation policy is expected to generate a long-term return of 8.08%. The asset allocation policy decision alone will have a limited impact on the unfunded liability status of the ERSRI. Additional total contributions will be required to achieve improved funded status. He stated that the ERSRI portfolio (the "Fund") has had top quartile returns over both three and five years. The Fund beat the policy benchmark by 100 basis points on a net basis for three years and by 50 basis points over a five year period.

Note: Dr. McKenna left the meeting at 10:40 a.m.

Mr. Bensur presented six alternative policy portfolio examples as follows: Lower Risk (Alt. A), introduce Commodities (Alt. B), No Home Country Bias (Alt. C), Higher Return (Alt. D), introduce Commodities and Increase Private Equity (Alt. E), and No Country Bias, introduce Commodities and increase Private Equity (Alt. F). The six Alternative Portfolios project the following median returns: Alternative A (7.81%); Alternative B (7.98%); Alternative C (8.08%); Alternative D (8.24%); Alternative E (8.25%); and Alternative F (8.28%). He noted that Alternatives E and F seem like the most efficient from a statistical standpoint and are reasonable for consideration.

Mr. Bensur noted that over the last five years, the Wilshire 5000 (all US stocks) was up 4%. The All Country World ex-US Index was up 11.85%. Over the last ten years, the Wilshire 5000 was up 8.5% and the All Country World ex-US Index was up 7.2%.

Ms. Caine stated that another consideration would be to invest in international bonds, a sector where many other public funds are invested. She suggested that rather than have a specific allocation to global bonds, it may make sense to allow a domestic fixed income manager to have the capability to invest tactically in the foreign bond market. Mr. Bensur noted that investing in foreign bonds would be a risk reducer rather than a return generator.

Mr. Bensur noted that the asset allocation policy decision alone will have a limited impact on the unfunded liability status of the pension fund. He again stressed that the only way to close the gap between accrued liability and projected market value of assets is to increase contributions. He also recommended maintaining a broadly diversified investment approach, continuing to identify diversified sources of value added investment opportunities, and continuing to rebalance to target allocations.

Ms. Caine encouraged the SIC to continue to think "outside" the public pension fund universe and, similar to the SIC's decision to increase international equities several years ago, consider the investment allocation of endowments.

Mr. Bensur stated that many pension funds have been increasing exposure to "inflation sensitive" assets which would include TIPS and real estate, which ERSRI has exposure to, as well as commodities. He also noted that many pension funds are moving toward the elimination of home-country bias in equities such as a 50-50 balance between US and non-US equities. Wilshire also recommends that ERSRI consider expanding the portable alpha program to include additional strategies such as global macro, currencies, and long-short.

He noted that Wasatch Advisors has trailed its benchmark by 4.50% since inception in March of 2002. MacKay Shields has experienced organization turnover and Shenkman has trailed its benchmark by 5.13% since inception in September of 2002.

Mr. Marshall explained that the core business of a pension plan is to pay benefits promised to its participants. The primary risk to the core business is to have insufficient assets to pay promised benefits. Therefore it is in the best interest of the plan participants to make promised benefits as secure as possible. He noted that Alternatives A and B are too conservative. Alternatives E and F provide savings as they are more diversified with higher returns and a lower standard deviation.

Treasurer Tavares noted that Wilshire's report was given on an informational basis for Commission members. There will be more information forthcoming on bonds and commodities eventually, but that no votes are to be taken at this point with regard to managers or allocations. He noted that Ms. Caine and Mr. Bensur will be looking at measures to be taken and will come back to the Commission with recommendations.

<u>Wilshire Associates Incorporated - Capital Market Review</u>. Mr. Bensur distributed his Capital Market Review noting that equities are up 5.5%, international equities are up 13%, and bonds are up about 2%.

<u>Deputy Treasurer for Finance Report</u>. Ms. Caine distributed a graph that State Street Bank & Trust Co. ("State Street") provided which illustrates that for the one, three, five and seven year time periods, the ERSRI portfolio has outperformed its benchmark and consistently ranks between the 9^{th} and 28^{th} percentile among public funds (>$1 billion). This is a dramatic improvement over the ten year time period when the portfolio underperformed its benchmark and ranked near the bottom of the public fund universe (85^{th} percentile).

Ms. Caine noted that she is a member of the National Association of State Investment Officers ("NASIO") and attends an annual forum where ideas and information is shared regarding various pension portfolios and investment strategies. She noted that the endowment universe consistently outperforms the public fund universe year in and year out. Endowment funds have a larger exposure to private equity and other alternative assets relative to public funds.

Ms. Caine noted that in 1999 ERSRI was invested in 32 private equity partnerships and as of 8/30/06 there are 75 partnerships in the ERSRI portfolio. Private equity provides a good diversification, superior returns and our consultant helps to ensure that we implement that strategy thoughtfully with particular focus on vintage year, sector and partnership exposures. She also recommended that the SIC consider increasing its allocation to private equity from 7.5% to 10%.

Ms. Caine has restructured the Investments Department as part of a succession plan as staff retires. She has broadened job descriptions of staff to allow for more dedicated resources for the pension plan and introduced Cheryl Melise who recently joined the department.

Ms. Caine stated that at September's meeting she would like to bring in State Street Global Markets to explain their cash liquidity management program. It would be a way to streamline the rebalancing process that staff performs every month and enable ERSRI to equitize the portfolio's cash. The program monitors target allocations and enhances rebalancing thereby reducing transaction costs.

Ms. Reback requested that the actuary be brought before the Commission at some point. Ms. Gallogly requested that Commission members be provided with a packet of information which would be useful with a new Treasurer coming in.

General Treasurer's Report. Treasurer Tavares noted that a nationally known website - SavingForCollege.com has conducted a study regarding the performance of the 529 Plans and it has ranked Rhode Island as #1 as of June 30, 2006. Rhode Island is still number one for direct sales, broker sales and performance over a three year period.

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

VOTED: To adjourn the meeting.

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

Respectfully submitted,

Paul J. Tavares
General Treasurer