

**REGULAR MEETING OF THE
MONTANA BOARD OF INVESTMENTS
DEPARTMENT OF COMMERCE**

May 17 & 18, 2001

**2401 Colonial Drive, 3rd Floor
Helena, Montana**

Thursday, May 17, 2001

AGENDA

- I. CALL TO ORDER** **1:00 p.m.**
- A. Roll Call
 - B. Approval of the April 12 & 13, 2001 Regular Meeting Minutes
 - C. Administrative Business
- II. EXECUTIVE DIRECTOR REPORTS Carroll South** **1:15 p.m.**
- A. Value-added/Commercial Loan Policies/Applications Approval
 - B. School Trust Loan Approval
 - C. Electrical Generation Facility Loans
 - D. Out-of-State Travel Requests
- III. BOND PROGRAM Geri Burton** **1:45 p.m.**
- A. INTERCAP
 - 1. Activity Report
 - 2. Staff Approved Loans Report
 - 3. Loan Requests
- IV. CHIEF INVESTMENT OFFICER REPORTS Jim Penner, CFA** **2:00 p.m.**
- A. Economic Overview Newsletter
 - B. Asset Allocation
 - C. Commercial/Loan Portfolio Recommendation
 - D. Lead Plaintiff Requests Recommendation
 - E. CFA Exam Policy
 - F. REIT Liquidation
 - 1. Transactions March and April
 - G. Quarterly Investment Performance
- V. MONTANA LOAN PROGRAM Delrene Rasmussen** **2:45 p.m.**
- A. Consider Commercial/Multi-Family Loans
 - 1. Hooper's Nursery, Inc.
 - 2. Rovero's LLC.
 - 3. Pattee Street LLC.
 - 4. Bryan Kurth
 - 5. Montana Orthopedic Center LLC.
 - 6. C & C Land LLC.
 - B. Staff Approved Value Added Loans
 - 1. Great Harvest Franchising, Inc.
 - 2. Pyramid Mountain Lumber, Inc.
 - a. Construction Loan
 - b. Term Loan
 - C. Coal Tax Loan Activity Report March
 - D. Mortgage Program Activity Report March
- VI. PRESENTATION SCHRODERS ASSET MANAGEMENT** **4:00 p.m.**
Mr. Donald Farquharson and Mr. Richard Sennitt

REGULAR MEETING OF THE

**MONTANA BOARD OF INVESTMENTS
DEPARTMENT OF COMMERCE**

Friday, May 18, 2001

AGENDA

VII. PRESENTATION LEXINGTON PARTNERS, INC. 8:30 a.m.
Mr. Nick Harris, General Partner

VIII. INVESTMENT ACTIVITY 9:00 a.m.

- A. Private Equities Ed Kelly
 - 1. Lexington Partners Recommendation
 - 2. Transactions March and April
 - 3. Venture Capital Update
- B. Domestic Equities (Montcomp) Rande Muffick, CFA
 - 1. Transactions March and April
 - 2. Holdings Report
 - 3. Strategy
 - 4. Portfolio Additions
 - a. Franklin Resources
 - b. Waters Corporation
- C. International Equities (MTIP) David Ewer
 - 1. Europe and Americas
 - a. Internal Transactions March and April
 - b. Internal International Holdings Report
 - c. Strategy
- D. Fixed Income Bob Bugni, CFA
 - 1. Transactions March and April
 - 2. Strategy
 - 3. Investment Policy Statements
 - a. Teachers' Retirement System
 - b. Public Employees' Retirement System
 - c. Sheriffs' Retirement System
 - d. Municipal Police Officers' Retirement System
 - e. Firefighters' Unified Retirement System
 - f. Highway Patrol Officers' Retirement System
 - g. Judges' Retirement System
 - h. Game Wardens' Retirement System
 - i. Volunteer Firefighters' Compensation Act
- E. Security Lending Rich Cooley, CFA
- F. STIP and Treasurer's Funds Rich Cooley, CFA
 - 1. STIP Transactions March and April
 - 2. STIP Holdings Report
 - 3. Treasurer's Fund Transactions March and April
 - 4. Treasurer's Fund Holdings Report
 - 5. Strategy

IX. ADJOURNMENT 11:30 a.m.

The Board of Investments makes reasonable accommodations for any known disability that may interfere with a person's ability to participate in public meetings. Persons needing an accommodations must notify the Board (call 444-0001) or write to P.O. Box 200126, Helena, Montana 59620) no later than three days prior to the meeting to allow adequate time to make needed arrangements.

**MONTANA BOARD OF INVESTMENTS
DEPARTMENT OF COMMERCE**

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**2401 Colonial Drive, 3 Floor
Helena, Montana
May 17 & 18, 2001**

MINUTES

BOARD MEMBERS PRESENT:

Dick Anderson, Chairman
Douglas Bardwell
Dennis Beams
Maureen Fleming
Jay Klawon
Joel T. Long
F. Lee Robinson
Calvin Wilson

BOARD MEMBERS ABSENT:

Tim Ryan

STAFF PRESENT:

Robert T. Bugni, CFA, Assistant Investment Officer
Geri Burton, Bond Program Officer
Dana Chapman, Administrative Assistant
Richard Cooley, CFA, Assistant Investment Officer
Kimberly Dallas, Program Assistant
David Ewer, Senior Portfolio Manager
Mona Freshour, Bond Program Assistant
Coralie Hunter, Accountant
Edward Kelly, Assistant Investment Officer
Herbert Kulow, Senior Portfolio Manager
Gayle Moon, Accounting Fiscal Manager
Rande Muffick, CFA, Assistant Investment Officer
Kaci Munson, Accounting Intern
James R. Penner, CFA, Chief Investment Officer
Delrene Rasmussen, Assistant Investment Officer
Paul Runnalls, Investment Analyst
Dan Stevens, Investment Analyst
Steve Strong, Investment Analyst
Carroll V. South, Executive Director
Lon Whitaker, Investment Analyst

GUESTS:

Mr. Gordon Hoven
Mr. Donald Farquharson, Schroders Asset Management
Mr. Richard Sennitt, Schroders Asset Management
Mr. Nick Harris, General Partner, Lexington Partners, Inc.
Mr. Perry Backus, Montana Standard
Mr. Rod Leese, AVP, Bitterroot Valley Bank
Mr. Loren Rose, Pyramid Mountain Lumber
Mr. J. Michael Ferritti, President, Great Harvest Franchising, Inc.
Mr. John K. Phelan, AVP, Farm Credit Services, Dillon
Mr. James D. Eisenzimer, VP, State Bank & Trust Co., Dillon

CALL TO ORDER

Chairman Anderson called the regular meeting of the Board of Investments (Board) to order at 1:00 p.m. in the conference room at 2401 Colonial Drive, 3rd Floor, Helena, Montana. As noted above, the meeting convened with eight members of the Board present. Member Ryan was absent.

Member Anderson motioned for approval of the April 12 & 13, 2001 minutes; Member Wilson seconded the motion and the motion was passed 8-0.

ADMINISTRATIVE BUSINESS

- Chairman Anderson presented the following Administrative Business:

1. Ms. Gayle Moon introduced Ms. Kaci Munson. Ms. Munson was hired to be an intern with the accounting staff this summer.

EXECUTIVE DIRECTOR REPORTS

Value-Added/Commercial Loan Policies & Applications

Mr. Carroll South, Executive Director, presented proposed commercial/multi-tenant and value-added loan policies/applications changes based on changes made in House Bill 47 and Senate Bill 279.

The Commercial/Multi-Tenant loan policy/application has been revised to reflect house Bill 47 amendments. Substantive revisions made as a result of legislative amendments are:

- Maximum loan size increases from 1.0 percent to 10.0 percent of the Coal Tax Trust.
- Loans in excess of 6.0 percent of the Trust require 30.0 percent lender participation.
- The 10.0 percent loan size restriction is cumulative and includes any value-added or infrastructure loan the borrower may have received from the Trust.
- The "1.0 percent of the Trust restriction" on loan size eligible for job credit interest rate reduction is eliminated.
- The time frame by which qualifying jobs must be created to be eligible for job credit interest rate reductions is eliminated to provide the Board more flexibility.

The Value-Added loan policy/application is based on substantive amendments contained in Senate Bill 279 as follows:

- Reduction in the number of jobs required for loan eligibility from 15 to 10.
- Ten jobs provide a 4.0 percent initial interest rate; 15 jobs provide a 2.0 percent rate.
- Job retention, as well as job creation, becomes an eligibility factor.
- Jobs are quantified in mathematical terms to provide numerical thresholds.
- The last five years of the loan term are at the Board's posted rate, rather than prime.
- Codifies the Board's current policy of increasing interest rates if jobs are eliminated.
- Authorizes the reduced interest rate only after the required jobs are created.

Member Beams moved for approval of staff recommendation; Member Bardwell seconded the motion and the motion was passed 8-0.

School Trust Loan Approval

Additionally, Mr. Carroll South, Executive Director, presented an overview of the Board's involvement with Senate Bill 495, enacted by the 2001 Legislature. This bill requires that up to \$75.0 million be loaned from the Coal Tax Trust to the School Trust effective July 1, 2001. Staff understands the bill to read that the Legislature is making the

loan and simply requesting that the Board facilitate the process and track the loan during its 30-year term. Prior to making the loan, the Board is required to enter into a contract with the administrator of state school land, Department of Natural Resources. The contract will:

- Transfer the loan proceeds from the Coal Tax Trust to the School Trust.
- Pledge a percentage of School Trust mineral royalties to loan principal repayment.
- Pledge School Trust mineral royalties for interest payments.
- Specify how the loan will be made and how the interest rate will be calculated.

Mr. South recommends that the Board approve the loan in concept so staff can begin the contract drafting process and establish the necessary state accounts required to track the loan. The contract will be available for review at the Board's July meeting and should be signed by the Chairman at that time.

Member Bardwell moved for approval of staff recommendation; Member Long seconded the motion and the motion was passed 8-0.

Electrical Generation Facility Loans

House Bill 474, enacted by the 2001 Legislature and effective July 1, 2001, requires the Board to review loan applications for funding new and existing electrical generating plants. Loan applications would be processed pursuant to the In-State Investment law that requires the Board to operate under the "prudent expert" principle.

A very narrow window for submitting and processing applications is required. A new generating facility must be operating or have completed construction by July 1, 2003. Given the short time frames established by law, staff believes that the existing commercial loan policy and application should be used to facilitate the application process. Any loan for an electrical generating facility would be limited to 10.0 percent of the Trust. A loan in excess of 6.0 percent of the Trust requires 30.0 percent lender participation.

Apart from the typical loan underwriting and approval process for these loans, the Board must make several findings that a loan is in the "public interest" as follows:

- The project must promote economic development and create/maintain employment.
- The project must provide stable electrical rates for "default supplier" customers.
- The project must meet state and federal environment quality standards.
- The project must sell its power via long-term fixed-rate contracts.

Loan documents must contain the following statutory requirements that will necessitate ongoing monitoring through the term of the loan:

- Initial rates may not exceed \$0.05 per kilowatt-hour.
- Annual rate increases must not exceed the rate of inflation.
- Borrowers must contract with default provider or a Montana industry for 15-20 years.
- Revenue from sale of electricity is pledged to loan repayments.

The Board directed Executive Director South to proceed. No action was needed.

Out-of-State Travel

Executive Director Carroll South, presented travel recommendations for David Ewer to attend the International Investing Conference, hosted by State Street Bank, May 4 9, 2001, in Boston, MA., and Paul Runnalls to attend the Northwest Taxable Bond Conference, June 7 10, 2001, in Portland, OR. Member Fleming moved for approval of this

recommendation; Member Wilson seconded the motion and the motion was passed 8-0.

BOND PROGRAM

Activity Report

The Board reviewed this report for the period ending May 4, 2001.

Staff Approved Loans Report

Ms. Geri Burton reported that:

Borrower:	City of Helena
Purpose:	To finance the purchase of an addressable fire alarm system for the City-County Building.
Staff Approval Date	April 25, 2001
Board Loan Amount:	\$98,280
Term:	7 years

Borrower:	City of Choteau
Purpose:	To finance the purchase of a street sweeper.
Staff Approval Date	April 27, 2001
Board Loan Amount:	\$39,000
Term:	10 years

Borrower:	Beaverhead County
Purpose:	To finance costs associated with road improvements from a DOT bridge project.
Staff Approval Date	April 27, 2001
Board Loan Amount:	\$152,000
Term:	5 years

Borrower:	Saco School District 12A & B
Purpose:	To finance a roofing project.
Staff Approval Date	May 4, 2001
Board Loan Amount:	\$130,000
Term:	5 years

has been approved by staff.

INTERCAP

Ms. Geri Burton presented staff's recommendation that the Board authorize staff to proceed with processing and closing the following loans using the Board's standard Bond Program Office procedures:

<u>Lewis and Clark County</u>	<u>Missoula County</u>
\$750,000	\$500,000
7 Years	5 Years
To finance the purchase of a computer aided	To finance the cost of purchasing

dispatch and records management computer equipment for the Public Works Dept. system.

City of Sidney

\$215,100

10 Years

To finance a water meter replacement project.

Member Klawon moved for approval of this recommendation; Member Wilson seconded the motion and the motion was passed 8-0.

CHIEF INVESTMENT OFFICER REPORTS

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Chief Investment Officer, James Penner, recapped the preceding reports and presentations.

Commercial Loan Portfolio Recommendation

Mr. Jim Penner, Chief Investment Officer, presented a staff memo recommending capping the Link deposit program at 15% of the portfolio. Upon presentation of this recommendation, it was revised that instead of the cap at 15% of the portfolio, staff would increase the interest rate by 50 to 75 basis points. Board concurred with staff and directed staff to proceed.

Lead Plaintiff Request Recommendation

Mr. Penner presented staff recommendation that the Montana Board of Investments not sign on as lead plaintiff for class action complaints being prepared based on the Private Securities Litigation Reform Act. The Board of Investments, through its accounting department, participates in all class action settlements involving holdings held or formerly held. There is no difference in monetary recovery, if there is any recovery, whether Montana is a lead plaintiff or a participant in a class action effort. Board concurred with staff.

Quarterly Investment Performance Report

Mr. Penner presented the following Quarterly Investment Performance Reports: Total Funds under Management, Breakdown of Funds under Management, Residential and Commercial Loan Programs, MTCP, International-Asia, International-Europe, Total International Equities, Private Equity, RFBP, PERS, State Fund Performance and Returns by Asset Type ending March 31, 2001.

Asset Allocation Report

Mr. Jim Penner, Chief Investment Officer, presented staff recommendation for the following Asset Allocation for July 1, 2001:

- \$2.5 million to each of the two external Asian Pacific managers, SG PAM and Schrodgers
- \$5 million to the external European manager, Pyrford International

The Board concurred with staff recommendation.

LOAN PROGRAMS

Consideration of Commercial/Multi-Family Loan Participation Permanent Coal Trust Fund

Ms. Delrene Rasmussen and Mr. Herb Kulow presented staff's recommendation to participate in the following loan requests:

Borrower: Hooper's Nursery, Inc.
Lender: Glacier Bank, Kalispell
Purpose of Loan: To build a 4,000 sq. ft. work building and purchase additional greenhouses.
Amount of Loan: \$250,000
Board Loan Amount: \$200,000
Board Participation: 80%
Term of Loan: 10 Years
Interest Rate: 7.10% + .80 Lenders Service Fee
Staff Recommendation: Approval, subject to the terms and conditions in Schedule A.
Loan Committee Recommendation Approve

Borrower: Rovero's LLC.
Lender: Two Rivers Bank, Milltown, MT.
Purpose of Loan: To provide long term financing for the borrowers by paying off an escrow with a current interest rate of 10%.
Amount of Loan: \$1,050,000
Board Loan Amount: \$787,500
Board Participation: 75%
Term of Loan: 15 Years
Interest Rate: Prime + 1% Lenders Service Fee
Staff Recommendation: Approval, subject to the terms and conditions in Schedule A.
Loan Committee Recommendation: Approve

Borrower: Pattee Street, LLC.
Lender: First Interstate Bank, Missoula
Purpose of Loan: To provide long term financing for the purchase of the 4th and 5th condominium floors of the Millennium Building.
Amount of Loan: \$1,476,492
Board Loan Amount: \$1,033,545
Board Participation: 70%
Term of Loan: 25 Years
Interest Rate: 7.65% + 1.0% Lenders Service Fee
Staff Recommendation: Approval, subject to the terms and conditions in Schedule A and approval of the exception to the 1.25, 20-year debt coverage ratio.
Loan Committee Recommendation: Approve

Borrower: Brian and Teri Kurth
Lender: U.S. Bank Montana, Billings
Purpose of Loan: To refinance existing debt and for improvements to property located in Bozeman.
Amount of Loan: \$1,850,000

Board Loan Amount: \$1,110,000
Board Participation: 60%
Term of Loan: 15 Years
Interest Rate: 7.20% + .70% Lenders Service Fee
Staff Recommendation: Approval, subject to the terms and conditions in Schedule A and approval of the exception of a Summary Appraisal.
Loan Committee Recommendation: Approve

Borrower: Montana Regional Orthopedics, LLC.
Lender: Mountain West Bank, Missoula
Purpose of Loan: To provide permanent financing for a new 4,800 sq. ft. surgery center, a 20,800 sq. ft. office building and equipment to be purchased.
Amount of Loan: \$4,500,000
Board Loan Amount: \$3,600,000
Board Participation: 80%
Term of Loan: 20 Years
Interest Rate: 7.30% + .70% Lenders Service Fee
Staff Recommendation: Approval, subject to the terms and conditions in Schedule A.
Loan Committee Recommendation: Approve

The staff recommendation for C & C Land was not presented due to loan being withdrawn by Lender.

Consideration of Value Added Loan Program Coal Tax Trust Fund

Mr. Herb Kulow presented a loan request to participate in the following loan:

Borrower: Great Harvest Franchising, Inc.
Lender: Northwest Farm Credit Services, Dillon
Purpose of Loan: To finance the purchase of Great Harvest in Montana and not close the business in Dillon and relocate the office to North Carolina.
Amount of Loan: \$3,400,000
Board Loan Amount: \$2,550,000
Board Participation: 75%
Staff Recommendation: Approval, subject to the terms and conditions in Schedule A.
Loan Committee Recommendation: Approve

Borrower: Pyramid Mountain Lumber, Inc.,
Lender: Two Rivers Bank, Milltown, MT.
Purpose of Loan: To restructure existing debt and extend additional funds to purchase new equipment to modernize the mill.
Total Amount of Loan: \$4,600,000
Board Loan Amount: \$3,450,000
Board Participation: 75%
Staff Recommendation: With the USDA guaranty, staff recommends approval, subject to the terms and conditions in Schedule A.
Loan Committee Recommendation: Approve

Borrower: Pyramid Mountain Lumber, Inc., Construction Loan
Lender: Two Rivers Bank, Milltown, MT.

Purpose of Loan:	Loan proceeds will be used for the construction phase of the value-added loan application.
Total Amount of Loan:	\$2,500,000
Board Loan Amount:	\$1,550,000
Board Participation:	62%
Recommendation:	Approval, subject to the terms and conditions in Schedule A and if the Board approves the permanent loan request.
Loan Committee Recommendation:	Approve

Member Bardwell moved for approval of this recommendation; Member Beams seconded the motion and the motion was passed 8-0.

Coal Tax Loan Activity

Ms. Delrene Rasmussen presented and the Board reviewed this report for March.

Staff Approved Loans Committed

The Board reviewed this report for March.

Mortgage Program Activity Review

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The Board reviewed this report for March.

INVESTMENT ACTIVITY

Fixed Income

-
Mr. Robert Bugni presented March and April transactions, and the current investment strategy.

In addition, Mr. Bugni presented the Investment Policy Statements for Teachers' Retirement System, Public Employees' Retirement System, Sheriffs' Retirement System, Municipal Police Officers' Retirement System, Firefighters' Unified Retirement System, Highway Patrol Officers' Retirement System, Judges' Retirement System, Game Wardens' Retirement System, and Volunteer Firefighters' Compensation Act. Member Fleming moved for approval of the Fixed Income strategy and the Investment Policy Statements as presented; Member Bardwell seconded the motion and the motion was passed 8-0.

Security Lending

Mr. Richard Cooley presented this report for March.

Treasurer's and STIP Funds

Mr. Cooley also presented March and April STIP transactions the STIP holdings report as of April 30, 2001, the March and April Treasurer's Fund transactions, the Treasurer's Fund holdings report as of April 30, 2001 and the current investment strategy for both of these funds. Member Wilson moved for approval of the STIP Fund and Treasurer's Fund strategy as presented; Member Long seconded the motion and the motion was passed 8-0.

PRESENTATION

Mr. Donald Farquharson and Mr. Richard Sennitt, Schrodgers Asset Management, presented to the Board its annual review. Mr. Farquharson gave the overview of Schrodgers Asset Management and performance. Mr. Sennitt presented the investment strategy for the countries of Hong Kong, Australia, Malaysia and Korea.

International Investment

- Mr. David Ewer presented March and April transactions, the holdings report as of April 30, 2001 and the current investment strategy. Member Wilson moved for approval of the International Investment strategy as presented; Member Beams seconded the motion and the motion was passed 8-0.

ADJOURNED

The meeting adjourned for the day at 5:00 p.m.

CALL TO ORDER

The meeting was reconvened Friday, May 18, 2001 at 8:30 a.m. Six members of the Board were present. Member Ryan, Member Fleming and Member Wilson were absent.

PRESENTATION

Mr. Nick Harris, Lexington Partners, L.P., presented to the Board an overview of the company and its Secondary Market Private Equity Fund V.

INVESTMENT ACTIVITY continued

Private Equities

Mr. Ed Kelly presented staff recommendation to commit to investing \$25 million dollars in the secondary market private equity specialist Lexington Partners L.P. Fund V. Member __Bardwell moved that \$50 million dollars be invested in the Lexington Partners L.P. Fund V; Member Klawon seconded the motion and the motion was passed 6-0.

Mr. Ed Kelly presented March and April transactions. In addition, Mr. Kelly presented the Venture Capital Update and the Leveraged Buyout Update.

Montcomp

- Mr. Rande Muffick presented March and April transactions, the holdings report as of April 30, 2001 and the current investment strategy. Member Beams moved for approval of the Montcomp strategy as presented; Member Robinson seconded the motion and the motion was passed 6-0.

In addition, Mr. Muffick presented Franklin Resources and Waters Corporation as a Portfolio Addition.

Next Meeting

The next regularly scheduled meeting of the Board will be held July 10, 2001.

ADJOURNMENT

There being no further business, the meeting was adjourned at 10:00 a.m.

BOARD OF INVESTMENTS

APPROVE: _____
Dick Anderson, Chairman

ATTEST: _____
Carroll South, Executive Director

DATE: