

**MONTANA BOARD OF INVESTMENTS
DEPARTMENT OF COMMERCE**

**2401 Colonial Drive, 3rd Floor
Helena, Montana
June 14, 2004**

MINUTES

BOARD MEMBERS PRESENT:

Dick Anderson, Chairman
Dennis Beams
Karen Fagg
Maureen Fleming
Jay Klawon
Joel Long
Terry Moore
Tim Ryan
Calvin Wilson

BOARD MEMBERS ABSENT: None

STAFF PRESENT:

Robert T. Bugni, CFA, Senior Investment Officer
Geri Burton, Deputy Director
Richard Cooley, CFA, Senior Investment Officer
Kimberly Dallas, Program Assistant
David Ewer, Senior Portfolio Manager
Edward Kelly, Assistant Investment Officer
Herbert Kulow, Senior Portfolio Manager
Rande Muffick, CFA, Assistant Investment Officer
James R. Penner, CFA, Chief Investment Officer
Delrene Rasmussen, Assistant Investment Officer
Carroll V. South, Executive Director
Louise Welsh, Bond Program Officer

GUESTS:

Gordon Hoven, Piper Jaffray
Mr. Trey Haskell, Barclay's Global Investors
Mr. Bruce Posey, Streeter Brothers Mortgage, Billings

CALL TO ORDER

Chairman Anderson called the regular meeting of the Board of Investments (Board) to order at 9:30 a.m.. in the

conference room at 2401 Colonial Drive, 3rd Floor, Helena, Montana. As noted above, the meeting convened with 9 members of the Board present.

Member Fleming motioned for approval of the April 23, 2004 minutes; Member Klawon seconded the motion and the motion was passed 9-0.

PUBLIC COMMENT - Public Comment on Board-Related Items

Chairman Anderson called for Public Comment of Board-Related Items. No Public Comment was made.

SPECIAL REPORTS/RECOMMENDATIONS

RFP Sub Committee Report/Recommendation(s)

Mr. Terry Moore presented to the Board a proposed "Scope of Services" which would be the basis for the Request for Proposals (RFP) process. This report was prepared by the subcommittee appointed by Chairman Anderson at the April meeting.

In addition, Mr. Carroll South composed a memorandum explaining the roles of the Board and the boundaries and authorities which the Board has in dealing with the various funds managed by staff. The memorandum also explains the legislative direction that is given to the Board.

The Scope of Services addresses 16 topics which will assist in determining the course of action and how to proceed. The 16 topics are as follows:

1. Investment Management Structure and Costs
2. Efficiency and Effectiveness of the BOI's Organizational Structure and Resources
3. Portfolio Risk
4. Investment Policy Statement
5. Investment Performance
6. Investment Process
7. Asset Allocation
8. Monitoring of Investments and Reporting
9. Investment Benchmarks
10. New Investment Strategies and Instruments
11. Brokerage Practices
12. Due Diligence Procedures/Selection of Investment Service Providers
13. Code of Ethics
14. Internal Controls and Risk Management
15. BOI's ability to attract and retain personnel
16. Disaster Preparedness

Mr. South addressed the RFP Process and encouraged the need for this process to be a Board driven project. Mr. South asked for permission to work with the subcommittee to structure the RFP once the Scope of Services has been approved. At that time, the subcommittee will be able to go to the next step of issuing the RFP. The Board or the subcommittee appointed by Chairman Anderson will need to answer the questions and score the respondents and decide on the top two or three that would be asked to come before the Board to present.

Additionally, Mr. South suggested that within the structure of the RFP, they ask the respondents to consider an immediate report as outlined with in the RFP, and respond as well to their availability of staying on on a retainer basis. The retainer basis would allow the Board to continue consulting with the chosen respondent in the future. The retainer fee would be based on an hourly charge/fee, outlined in the RFP responses.

Member Ryan asked Mr. South to describe the timeline that this Request for Proposal process would follow. Mr. South explained that staff should be able to issue the RFP by July 1. The Question period would be approximately 2-weeks and responses would be due by August 1. The subcommittee would have approximately 2-weeks to score and

determine the top two or three candidates. The candidates would appear before the board at a meeting soon following, or at a special meeting of the Board. Mr. South recommended that the Board request that the chosen respondent be given no more than 60 days to have a finished product ready for the Board.

Member Ryan motioned to allow the subcommittee to proceed with the RFP Process; Member Wilson seconded the motion. Further discussion took place and the Board concurred that the subcommittee will determine the rankings of importance of the topics and issues in question. Attention will also be focused on the pension funds and the two bond fund pools.

Member Ryan called for the question. The motion was unanimously approved.

Investment Process Report/Recommendation(s)

Mr. Rande Muffick and Mr. David Ewer presented to the Board a thorough review of the current investment process utilized for the Board's actively-managed domestic equity pool and suggested recommendations for improvements. Chairman Anderson requested that this review take place in a memo dated April 29, 2004 to Mr. Muffick and Mr. Ewer.

Chain of Command - Recommendation #1: The Montcomp PM should direct research activities by supervising the Research Director, who in turn supervises the equity research staff. The analysts' work assignments should be based on the PM's priorities. There should be a clear line of communication between the analysts and the Montcomp PM. This recommendation should be effective immediately.

Discussion took place regarding this recommendation. Member Fleming motioned to adopt this recommendation; Member Klawon seconded the motion and the motion was passed 9-0.

ADJOURNMENT - EXECUTIVE SESSION

Chairman Anderson, as presiding officer, determined that the demands of individual privacy clearly exceed the merits of public disclosure, as such; the regular meeting was adjourned and went into a Closed Executive session at 10:50 a.m.

RECONVENE

The Regular Meeting of the Board was reconvened and open to the public at 11:45 a.m.

Investment Process Report/Recommendation(s) - continued

Upon reconvening of the Regular Meeting of the Board, Chairman Anderson advised Mr. Muffick and Mr. Ewer that it is the Board's decision to accept Recommendation No. 1. The remaining recommendations will be implemented by staff. The Board does not feel that each individual item requires to be addressed by the Board.

The Company Report - Recommendation #2: Company Reports, as with Industry Reports, should be used primarily for training or a remedial tool and as otherwise directed and prioritized by the Montcomp PM. This recommendation should be effective immediately.

Research Staff Resources - Recommendation #3: Provide two additional FTE's to serve as investment analysts. This recommendation may require substantial lead-time.

Equity Analysts: Compensation and Performance Appraisal - Recommendation #4: Direct accomplishments, knowledge and expertise benefiting Montcomp should be the main drivers for salary advancement as well as showing mentoring and leadership skills. The Research Analyst position descriptions should be rewritten so that direct accomplishments, ability to look forward, applied knowledge and other key ingredients are the main drivers for career and salary advancement. This recommendation will require about a 90-day lead-time for implementation.

Professional Development: the Chartered Financial Analyst Program - Recommendation #5: The CFA program should be voluntary with the Board paying for course materials and providing compensatory time for taking the test but providing no on-the-job study time. Salary incentives for achieving each CFA level would be additive as a competency, regardless of position level. This recommendation should become effective July 1, 2004. CFA financial incentive amounts would need to be brought to the Board for approval, probably in September or October 2004.

Trading - Recommendation #6: Provide one FTE for a position of Trader/Portfolio analyst. Procure and implement an electronic trading system with order management capabilities. This recommendation may require substantial lead-time.

Portfolio Management - Recommendation #7: At a future meeting, the Board should revisit and thoroughly discuss with the Montcomp PM the limits currently imposed on his discretion in managing the portfolio. We suggest that this matter be scheduled for the Board's August 2004 meeting.

Summary of Recommendations:

- " The chain of command should directly connect the Montcomp PM to the research staff and likewise directly connect the research staff to the Montcomp PM
- " Company Reports should be replaced by more dynamic, value adding projects and reports
- " Evaluations and career advancement for analysts should depend on adding value to the portfolio rather than obtaining steps in the CFA program (CFA achievement would still be encouraged)
- " Additional 2 FTE for analyst positions at estimated cost of \$120,000
- " Additional 1 FTE for a trader/portfolio analyst supervised by the Montcomp PM, est. cost \$60,000
- " Procure and implement an electronic trading system with order management capabilities, estimated cost \$100,000
- " Schedule portfolio discussion as an agenda item for a future board meeting

Managing an active equity fund of pension assets requires a minimum level of support in many areas: trading, research, accounting and equipment. Adopting the recommendations we present should bring the Board to the minimum level of infrastructure necessary to operate the Board's \$2 billion internally managed equity fund. The additional costs, given the current size of Montcomp, should amount to less than \$400,000 or 2 basis points.

EXECUTIVE DIRECTOR REPORTS

Budget Status Report

Executive Director Carroll South presented this report for the period ending May 31, 2004.

BOND PROGRAM

Activity Summary

The Board reviewed this report for the period ending May 31, 2004

Staff Approved Loans Report

Ms. Louise Welsh reported that:

Borrower: Missoula County

Purpose: Finance two separate projects:

1. To finance Western Montana Fair equipment - \$158,623 for 10 Years.
2. To finance the purchase of motor pool vehicles, and photocopiers - \$78,597 for 3 Years.

Staff Approval Date April 7, 2004

Board Loan Amount: \$237,220

Borrower: Victor School District #7

Purpose: To finance costs associated with installing a new bio-mass heating system.

Staff Approval Date April 16, 2004
Board Loan Amount: \$120,000
Term: 10 Years

Borrower: Lakeside Volunteer Fire Service Area, Inc.
Purpose: To purchase a 1999 International fire truck.
Staff Approval Date April 16, 2004
Board Loan Amount: \$30,000
Term: April 16, 2004

Borrower: Culbertson Elementary School District #17
Purpose: To finance costs associated with a re-roofing project.
Staff Approval Date April 19, 2004
Board Loan Amount: \$200,000
Term: 5 Years

Borrower: Lake County
Purpose: To purchase land for Road Department gravel and a new election ballot counter.
Staff Approval Date April 20, 2004
Board Loan Amount: \$197,500
Term: 3 Years

Borrower: City of Lewistown
Purpose: To finance the purchase of a new loader.
Staff Approval Date April 20, 2004
Board Loan Amount: \$48,640
Term: 1 Year

Borrower: Town of West Yellowstone
Purpose: To finance the purchase of a used loader mount snow blower.
Staff Approval Date April 29, 2004
Board Loan Amount: \$30,000
Term: 3 Years

Borrower: Albertson Public Schools
Purpose: To refinance two loans and purchase a new copier, books and computer equipment.
Staff Approval Date May 10, 2004
Board Loan Amount: \$59,678.42
Term: 5 Years

Borrower: Hill County
Purpose: To finance costs associated with replacing the Wanke Bridge.
Staff Approval Date May 18, 2004
Board Loan Amount: \$140,759
Term: 10 Years

Borrower: West Valley School District #1 (Kalispell)
Purpose: To finance various maintenance/repair projects and equipment.
Staff Approval Date May 24, 2004
Board Loan Amount: \$174,000
Term: May 24, 2004

Borrower: Ravalli County
Purpose: To purchase a new mobile command and communications van for the Search & Rescue Department.
Staff Approval Date May 24, 2004

Board Loan Amount: \$85,000
Term: 5 Years

Borrower: City of Laurel
Purpose: To finance the purchase of fire bunker gear.
Staff Approval Date May 26, 2004
Board Loan Amount: \$36,150
Term: 2 Years

Borrower: Somers School District #29
Purpose: To finance costs associated with renovation of the middle and elementary schools.
Staff Approval Date May 28, 2004
Board Loan Amount: \$200,000
Term: 10 Years

Borrower: Dawson Community College
Purpose: To finance costs associated with a water booster station.
Staff Approval Date May 28, 2004
Board Loan Amount: \$180,000
Term: 10 Years

has been approved by staff.

INTERCAP

Ms. Louise Welsh 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:

Borrower: Lewis & Clark County
Board Loan Amount: \$500,000
Term: 10 Years
Purpose: To finance costs associated with the Gable Estates Rural Improvements District road improvements.

Borrower: City of Conrad
Board Loan Amount: \$1,000,000
Term: In anticipation of US Army Corps of Engineers WRDA Grant.
Purpose: For the Lake Frances Intake and Pump Station Project.

Borrower: Missoula
Board Loan Amount: \$686,698 (two loans)
Purpose/Term:
1. \$386,698 to finance vehicles and equipment for capital improvement projects. Loan term - 2 Years;
2. 300,000 to finance costs associated with the Art Museum Building remodel. Loan term - 10 years

Borrower: Dawson Community College
Board Loan Amount: \$500,000
Term: 10 Years
Purpose: To finance contingency costs associated with Physical Education, performing Arts Center, and Library expansion.

Borrower: Powell County
Board Loan Amount: \$359,287
Term: 10 Years
Purpose: To finance the Powell County Memorial Hospital renovation.

Member Moore moved for approval of these recommendations; Member Wilson seconded the motion. Motion to approve loan requests for Lewis & Clark County, City of Conrad, and Missoula was passed 9-0. Motion to approve requests for Dawson Community College and Powell County was passed 8-0. Member Ryan abstained.

CHIEF INVESTMENT OFFICER REPORTS

Asset Allocation Report

Mr. Jim Penner, Chief Investment Officer, presented the Asset Allocation report for June 30, 2004 transactions.

Asset Allocation - Plan 2005 Revisions

Mr. Penner presented to the Board the Asset Allocation Plan, 2005. The purpose of an asset allocation plan is to provide the investment staff direction in carrying out a board approved investment program.

The following table shows the current asset allocation as of April 30th and the recommended asset allocation targets for June 30, 2005:

Asset Category	April 2004	Old 2005	New 2005
Domestic Equity - Active	34%	32%	25%
Domestic Equity - Enhanced	0	0	10
Domestic Equity - Passive	11	16	5
Domestic Equity - Small Cap	5	0	5
Subtotal	50%	48%	45%

International Equity	14	12	15
Private Equity	4	7	7
Equity Total	68%	67%	67%

Bond Pool	28	26	29
Mortgages	2	5	2
STIP	2	2	2
Fixed Income Total	32%	33%	33%

Board discussion took place and the Board requested that the allocation for Domestic Equity categories be changed as follows:

1. Domestic Equity - Active increase from 25% to 27%
2. Domestic Equity - Enhanced decrease from 10% to 6%
3. Domestic Equity - Passive increase from 5% to 7%

There is no change to Domestic Equity - Small Cap.

Member Fleming motioned to accept the Asset Allocation report with changes; Member Klawon seconded the motion and the motion was passed 9-0.

Residential Loan Program Recommendation

Mr. Penner presented staff recommendation to discontinue the residential mortgage loan program. Staff rationale for this recommendation is as follows:

1. The pension portfolio has experienced redemptions of over \$200 million of mortgage loans in the last year and one half due to refinancing. The reinvestment of these dollars in a lower rate environment disadvantages portfolio management for the fixed income portion of pension fund assets.
2. When the Program began there was no active secondary market for Montana financial institution generated

residential mortgage loans. Today, there is a vibrant and competitive landscape of secondary buyers bidding aggressively for Montana's residential mortgage loans.

3. Processing and accounting for mortgage loans is a highly inefficient way to include mortgages in the pension portfolios. BOI made three purchases of mortgage loans in recent days totaling \$100 million; three transactions versus approximately 1,000 individual transactions to be analyzed staff and accounted for individually.

4. Individually purchased mortgages in the Program are illiquid adding another element of risk to the pension portfolio.

Mr. Bruce Posey spoke to the Board asking them not to discontinue the Program. Board and staff also received correspondence from two banks voicing their support of the Program.

Member Klawon motioned to discontinue the Residential Mortgage Loan Program; Member Moore seconded the motion. Those Members voting "Yea" are voting in favor of the motion; those Members voting "Nay" are against the motion.

Dennis Beams - "Yea" Karen Fagg - "Nay"
Maureen Fleming - "Nay" Jay Klawon - "Yea"
Joel Long - "Yea" Terry Moore - "Yea"
Tim Ryan - "Nay" Calvin Wilson - "Nay"
Dick Anderson - "Yea"

Motion passes, 5 "Yea" to 4 "Nay".

MONTANA LOAN PROGRAM

Consideration of Commercial Loan Participation - Permanent Coal Trust Fund

Mr. Herb Kulow presented staff's recommendation to participate in the following loan request:

Borrower: CTA Building, LLP.

Lender: First Interstate Bank, Billings

Purpose of Loan: To remodel the existing industrial complex building into professional office space.

Amount of Loan: \$2,742,000

Board Loan Amount: \$2,193,600

Board Participation: 80%

Term of Loan: 20 Years

Interest Rate: 7.25%* + .20 LSF (7.45%) fixed

Recommendation: Approval, subject to the terms and conditions in Schedule A.

Loan Committee Recommendation: Approved as presented.

* Job creation interest rate reduction will be applied for.

Member Wilson moved for ratification of loan committee recommendation; Member Long seconded the motion and the motion was passed 8-0. Member Moore abstained.

Borrower: Big Sky Economic Development Authority Infrastructure Loan

Lender: Montana Board of Investments

Purpose of Loan: To purchase land and building to be converted into a parking lot for the new CTA Building, LLP facility.

Amount of Loan: \$458,400

Board Loan Amount: \$458,400

Board Participation: 100%

Term of Loan: 20 Years

Interest Rate: 7.25*%

Recommendation: Approval, subject to the terms and conditions in Schedule A.

Loan Committee Recommendation: Approved as presented.

* Job creation interest rate reduction will be applied for.

Member Ryan moved for ratification of loan committee recommendation; Member Beams seconded the motion and the motion was passed 8-0. Member Moore abstained.

Recommendation - The Lodge at Whitefish Lake, LLC and NDI, Inc.

Mr. Herb Kulow presented staff recommendation for release of collateral identified as "the pool, Condo units #4, #24 and #44" for The Lodge at Whitefish Lake, LLC and NDI, Inc.

The developer will purchase the three condo units. Deducting the three condo units from the original collateral value will determine a new collateral value of \$7,082,858. This will result in a loan to value of 78.07%. Board policy allows the loan to value to be as high as 85% and still qualify for participation by the Board of Investments.

In addition, originally the pool was also listed as collateral, however the lender has learned that the pool is part of the "homeowner's common area" and it is unlikely that BOI could get a viable lien on the pool area. The pool was not specifically valued in the collateral.

Member Wilson moved for approval of staff recommendation; Member Fagg seconded the motion and the motion was passed 9-0.

Coal Tax Loan Program Activity Report

Mr. Herb Kulow presented and the Board reviewed this report for April.

Pension Mortgage Program Activity Report

Mr. Herb Kulow presented and the Board reviewed this report for April.

Approved Lenders

Sterling Savings Bank of Spokane, WA and West One Bank of Kalispell have been accepted as an Approved Lender to the Board of Investments Commercial Loan Program.

INVESTMENT ACTIVITY - Equity

Domestic Equities (Montcomp)

Mr. Rande Muffick presented April transactions, the holdings report as of April 30, 2004 and the current investment strategy. Member Wilson moved for approval of the Montcomp strategy as presented; Member Klawon seconded the motion and the motion was passed 9-0.

Montana Private Equity Pool (MPEP)

Mr. Ed Kelly presented April transactions and the holdings report as of April 30, 2004.

WCAS Capital Partners Fund IV

In addition, Mr. Kelly presented staff recommendation that the Montana Board of Investments commit to investing \$25 million to the WCAS Capital Partners Fund IV, a captive mezzanine private equity fund for WCAS equity investments.

Member Klawon moved for approval of staff recommendation; Member Long seconded the motion and the motion was passed 9-0.

INVESTMENT ACTIVITY Fixed Income

Intermediate Funds

Mr. Cooley presented the April Treasurer's Fund transactions, the Treasurer's Fund holdings report as of April 30, 2004, the April State Fund Transactions and the current investment strategy for both of these funds. Member Ryan moved for approval of the STIP Fund and Treasurer's Fund strategy as presented; Member Klawon seconded the motion and the motion was passed 7-0. Member Fleming and Member Beams were not present.

Long Term Funds

Mr. Robert Bugni presented April transactions, and the current investment strategy. Member Ryan moved for approval of the Fixed Income strategy as presented; Member Klawon seconded the motion and the motion was passed 9-0.

Mr. Bugni also presented the Periodic Reports for Non-Investment Grade Holdings and U.S. Government Agency Holdings.

In addition, Mr. Bugni presented the Investment Policy Statements for Treasure State Endowment Regional Water Funds; Treasure State Endowment Funds; and Permanent Coal Trust Funds. Member Moore moved for approval of the Investment Policy Statements as presented; Member Wilson seconded the motion and the motion was passed 9-0.

INVESTMENT ACTIVITY - FYI Items

The following Investment Activity reports were presented and available for informational purposes. None of these items requires Board action.

" Montcomp Portfolio Additions:

" Citrix Systems " Flextronics Int'l

" Qualcomm " Tribune

" Vishay Intertech " Motorola

" United Health Group

" STIP Transactions/Holdings Report

" Security Lending Report

" Market Perspectives

" MPEP FYI Items

" BNY securities Group - Soft Dollar Update

" Educational Opportunities / Conferences / Seminars

" External Active Manager Portfolio Holdings

NEXT MEETING

The next regularly scheduled meeting of the Board will be July 8, 2004.

ADJOURNMENT

Chairman Anderson, as presiding officer, determined that the demands of individual privacy clearly exceed the merits of public disclosure, as such; the regular meeting was adjourned and went into a Closed Executive session at 3:10 p.m.

BOARD OF INVESTMENTS

APPROVE:

Dick Anderson, Chairman

ATTEST:

Carroll South, Executive Director

DATE: