

**REGULAR MEETING OF THE
MONTANA BOARD OF INVESTMENTS
DEPARTMENT OF COMMERCE
2401 Colonial Drive, 3rd Floor
Helena, Montana**

February 16 & 17, 2006

AGENDA – February 16, 2006

- I. BOARD EDUCATION: RV Kuhns, Retainer Consultant** **10:30 a.m.**

AGENDA – February 17, 2006

- I. CALL TO ORDER** **8:30 a.m.**
- A. Roll Call
 - B. Approval of the November 10, 2005 Regular Meeting Minutes
 - C. Administrative Business
 - 1. Human Resource Committee Report
 - 2. Audit Committee Report
 - 3. Loan Committee Report:
 - a. Loan Committee activity requiring Board Action:
 - Value-Added Loan Policy Revision Recommendation/Decision
 - Missoula County Infrastructure Loan Program Recommendation/Decision
 - Western Hospitality Group Commercial Loan Program Recommendation/Decision
 - b. Loan Requests receiving Loan Committee Action:
 - Wheat Montana Farms, Inc. (2)
 - SFH II, LLC.
- II. PUBLIC COMMENT** **9:00 a.m.**
- A. Public Comment on Board-Related Items
- III. EXECUTIVE DIRECTOR REPORTS – Carroll South** **9:05 a.m.**
- A. Exempt Positions Vacancies/Recommendations/Decision
 - B. Delegation of Investment Manager Selection/Decision
 - C. Bond Program Credit Enhancement Policy/Decision
 - D. RFP for Securities Litigation Monitoring Services/Decision
 - E. Resolution 199 Update/Information
- IV. BOND PROGRAM – Louise Welsh** **10:15 a.m.**
- A. INTERCAP
 - 1. Activity Report
 - 2. Staff Approved Loans Report
- V. MONTANA LOAN PROGRAM – Delrene Rasmussen** **10:30 a.m.**
- A. Coal Tax Loan Program Activity Report
 - B. Commercial Loans Delinquency Report
 - C. Pension Mortgage Program Activity Report
 - D. Mortgage Program Delinquency Report
 - E. Value-Added Loan Program Policy Revision/Decision

- VI. INVESTMENT REPORTS – R.V. Kuhns & Cliff Sheets, CFA, CIO** **10:45 a.m.**
- A. Capital Markets Overview (*to be provided by RVK*)
 - B. Performance Report (*to be provided by RVK*)
 - C. Asset Allocation Report
 - D. Real Estate Recommendation/Decision

- VII. INVESTMENT STRATEGY** **11:30 a.m.**
- A. Montana Private Equity Pool – Ed Kelly & Cliff Sheets, CFA
 - 1. Recent Activity
 - 2. Pacing Study – Preliminary Results
 - B. Montana Domestic Equity Pool (MDEP) – Rande Muffick, CFA & Cliff Sheets, CFA
 - 1. Pool Structure Overview
 - 2. Montana Common Stock Portfolio
 - C. Montana International Equity Pool (MTIP) – Cliff Sheets, CFA
 - D. Fixed Income – Bob Bugni, CFA

VIII. ADJOURNMENT **12:00 p.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**

**2401 Colonial Drive, 3rd Floor
Helena, Montana
Friday, February 17, 2006**

MINUTES

BOARD MEMBERS PRESENT:

Terry Moore, Chairman
Teresa Cohea
Maureen Fleming
John Paull
Jack Prothero
Jim Turcotte

BOARD MEMBERS ABSENT:

Elouise Cobell
Karen Fagg
Calvin Wilson

STAFF PRESENT:

Jason Brent, Investment Analyst
Robert T. Bugni, CFA, Senior Investment Officer
Geri Burton, Deputy Director
Richard Cooley, CFA, Senior Investment Officer
Kimberly Dallas, Program Assistant
Bobbie Ecklund, Research Manager – Interim
Mary Edwards, Bond Program Assistant
Tim House, Investment Analyst
Edward Kelly, Assistant Investment Officer
Teri Kolnik, Investment Analyst
Herbert Kulow, Senior Portfolio Manager
Gayle Moon, Accounting Fiscal Manager
Rande Muffick, CFA, Assistant Investment Officer
Jon Putnam, Investment Analyst
Delrene Rasmussen, Assistant Investment Officer
Clifford A. Sheets, CFA, Chief Investment Officer
Carroll V. South, Executive Director
Steve Strong, Investment Analyst
Louise Welsh, Bond Program Officer
Charlie Williamson, Investment Analyst

GUESTS:

Gordon Hoven, Piper Jaffray
Dave Senn, Executive Director, Teachers' Retirement System
Peter Madsen, Senior Consultant, RV Kuhns & Associates
Jim Voytko, RV Kuhns & Associates

CALL TO ORDER

Chairman Moore called the regular meeting of the Board of Investments (Board) to order at 8:34 a.m. in the conference room at 2401 Colonial Drive, 3rd Floor, Helena, Montana. As noted above, the meeting convened with six members of the Board present. Member Cobell, Member Fagg and Member Wilson were absent.

Member Prothero motioned for approval of the November 10, 2005 minutes; Member Paull seconded the motion and the motion was passed 6-0.

ADMINISTRATIVE BUSINESS

Human Resource Committee Report:

Committee Chair Maureen Fleming reported the following:

1. The Exempt Staff Salary Survey and Performance Appraisal System – A new Performance Appraisal System will be piloted for year 2006. Changes and improvements to the plan will be made in 2007 and 2008. Pleased with the plan that is being laid out, however there are some changes that are being made to refine it. Implement date will be March 1.
2. Research Manager – Requesting Board approval of the job description for this position, and will be moving forward in the search to fill this position. Also asking the Board's indulgence to allow the HR Committee to negotiate the salary for this position.
3. Assistant Investment Officer – Requesting Board approval of the job description for this position, and recommending approval to offer the position to Herb Kulow. It is the recommendation of the HR Committee that Mr. Kulow's salary will be the same as the salary of the incumbent in place.

Review – Ms. Fleming asked Board approval of the job description for the Research Manager position and the Assistant Investment Officer position, and is requesting Board approval to delegate the authority to negotiate the salary of the Research Manager to the HR Committee.

Member Turcotte motioned for approval of the Human Resource Committee recommendations as presented; Member Cohea seconded the motion and the motion was passed 6-0.

Member Fleming further explained to the Board that the new Performance Appraisal System will be phased in and there will be plans to implement an incentive system during the next fiscal year.

Audit Committee Report

Member Turcotte Chaired the Audit Committee Meeting in the absence of Committee Chair Karen Fagg.

Member Turcotte reported that the Committee met with Jim Gillett and the LAD Audit Team. The LAD will begin the Financial Audit at the end of February and will return in September to complete the Audit. The schedule to complete Financial Statements will be the same as fiscal year 2005.

Member Turcotte reported that the Audit Committee had not had a fiscal year 2005 exit conference with the LAD. There were no recommendations made by the LAD to address in an exit interview. The LAD will schedule a time to meet with the Audit Committee to complete the exit interview.

Member Turcotte reported that the Legislative Audit Committee is pleased to be working with the BOI Audit Committee.

In closing, the Audit Committee is still addressing and continuing to work on the Governance Policy.

Loan Committee Report:

Committee Chair Jack Prothero reported the following items will require Board action:

1. Value-Added Loan Program Policy:

Staff recommended the following be added to Section 6 of the Value-Added Loan Policy:

- (i) Lender will have an initial 365 days from the date the application is received by BOI to close, fund and participate the value-added loan with BOI.
- (j) If the project for which the loan proceeds will be utilized is not completed within the initial 365-day period, up to two additional 365-day increments may be granted upon written request from the lender for each requested extension.
- (k) Funding documents required in the commitment letter must be received within ninety (90) days after the first principal and interest payment date of the project term note or the commitment date expiration, whichever comes first.

Member Prothero motioned for approval of this staff recommendation as approved by the Loan Committee; Member Fleming seconded the motion and the motion was passed 6-0.

2. Coal Tax Loan Program Requests requiring Board Action:

Borrower:	Missoula County Infrastructure Loan
Lender:	Montana Board of Investments
Purpose of Loan:	To provide financing for Missoula County to purchase the completed building constructed by DIRECTV Group, Inc.
Total Amount of Loan:	\$9,600,000
Board Loan Amount:	\$9,600,000
Staff recommendation:	
Loan Committee Recommendation:	Approval with modifications: 1. Guarantor: DIRECTV Holdings, LLC. 2. Tenant: DIRECTV Customer Services, Inc. And subject to the terms and conditions in Schedule A.
Board Action:	Member Prothero motioned for approval of this staff recommendation as approved by the Loan Committee; Member Fleming seconded the motion and the motion was passed 6-0.

Borrower:	Western Hospitality Group
Lender:	First National Bank of Montana
Request to increase loan amount:	Lender is requesting an increase in the loan amount of \$1,605,170 for a total loan amount of \$7,824,888.
Staff recommendation:	That the Board maintains the original commitment to First National Bank of Montana for \$6,219,718, which was approved at the March 2004 Board Meeting.
Loan Committee Recommendation:	Approve staff recommendation as presented.

Board Action:	Member Prothero motioned for approval of this staff recommendation as approved by the Loan Committee; Member Turcotte seconded the motion and the motion was passed 6-0.
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3. Coal Tax Loan Program Requests:

Member Prothero presented the following loan requests receiving Loan Committee approval. The Loan Committee authorized staff to proceed with processing and closing these loans using the Board's standard Commercial Loan Program procedures.

Borrower:	Wheat Montana Farms, LLC.
Lender:	Northwest Farm Credit Services
Purpose of Loan:	To provide partial financing for the purchase of 100% of the outstanding stock of Wheat Montana Farms, Inc.
Total Amount of Loan:	\$3,000,000
Board Loan Amount:	\$2,250,000
Recommendation:	Approval, subject to the terms and conditions in Schedule A.
Loan Committee Recommendation:	

Borrower:	Wheat Montana Farms, LLC.
Lender:	Northwest Farm Credit Services
Purpose of Loan:	To provide partial financing for the purchase of 100% of the outstanding stock of Wheat Montana Farms, Inc.
Total Amount of Loan:	\$1,660,000
Board Loan Amount:	\$1,245,000
Recommendation:	Approval, subject to the terms and conditions in Schedule A.
Loan Committee Recommendation:	

Borrower:	SFH II, LLC.
Lender:	First Interstate Bank, Billings
Purpose of Loan:	To provide long term financing for the purchase of a 14-story office building.
Amount of Loan:	\$4,781,250
Board Loan Amount:	\$3,825,000
Board Participation:	80%
Term of Loan:	20 Years
Interest Rate:	7.21% + .14% LSF = 7.35%
Recommendation:	Approval, subject to the terms and conditions in Schedule A.
Loan Committee Recommendation:	

INTERCAP Loan Requests:

Member Prothero presented the following loan requests receiving Loan Committee approval. The Loan Committee authorized staff to proceed with processing and closing this loan using the Board's standard Bond Program Office procedures.

Borrower: Department of Transportation
Board Loan Amount: 2,347,763.40

Term: 5 – 7 Years
Purpose: To finance vehicle purchases for the state Motor Pool.

Human Resource Committee Report continued:

Member Fleming recommended approval of a new organization chart. The new organizational chart will have the Research Director reporting to the Chief Investment Officer. Member Turcotte seconded the motion and the motion was passed 6-0.

Member Fleming also recommended approval of the Assistant Investment Officer salary for Mr. Kulow; Member Cohea seconded the motion and the motion was passed 6-0.

Future Meeting Dates:

The next regularly scheduled meeting of the Board will be May 18, 2006. Chairman Moore asked staff to coordinate this date with Teachers' Retirement System for the Asset/Liability Study presentation by RV Kuhns & Associates.

The following dates have been set for future board meetings, August 17 & 18, 2006 and December 1, 2006. Additional meetings may be scheduled if needed.

Public Comment:

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

EXECUTIVE DIRECTOR REPORTS

Exempt Positions Vacancies/Recommendations/Decisions

Mr. Carroll South presented to the Board a review of the eight "exempt" positions allocated to the Board. "Exempt" means that these eight positions are not subject to the state's personnel classification system. This gives the Board more flexibility in managing the positions. The exempt position of Research Manager has been vacant since November 2004 and an exempt position, Assistant Investment Officer – In-State Loan, will become vacant at month end of February 2006.

Mr. South emphasized the importance of the position of the Research Manager. The future of this position will require an individual with supervision experience, good analytical skills, and more importantly the knowledge and experience in managing external managers. As the Board begins the process of diversification, all of the diversification will be external.

Mr. South also expressed his thanks to Delrene Rasmussen for her years of service to the Board.

Delegation of Investment Manager Selection/Decision

Mr. Carroll South presented to the Board staff recommendation that all Investment Manager selections be delegated to staff and that staff provide to the Board a due diligence report on the selected manager.

As outlined in the February 17, 2006 memo addressed to the Board, implementation would be as follows:

The first step is for the Board to select those additional asset classes it wishes to enter and at what initial allocation. By phasing in the funding, the allocations can be adjusted up or down at a later date based on future market conditions. The Board's investment consultant and Chief Investment Officer (CIO) can provide much assistance in this regard and will be making recommendations at the

next Board meeting. Board members should be comfortable with any new asset classes they approve. The second step would be for the Board to determine whether to further diversify within asset classes in which it currently invests – perhaps allocating the portfolios to additional investment styles. Once these decisions are made, staff would be authorized to search for and hire the appropriate managers under the following guidelines.

- *The state’s Request for Proposals (RFP) process would be utilized to search for managers in the various asset classes and styles approved by the Board. This process ensures that the process would be fair, comply with state procurement policies, and be observed by a third disinterested party.*
- *The Board’s investment consultant would be involved in drafting the “role and scope” section of the RFP, searching its data base for information on the universe of managers investing in the asset class, establishing scoring parameters, advising Board staff on the selection of finalists and documenting the search process.*
- *The CIO, and at his discretion, other staff and the consultant would interview the finalists and the CIO would make the final selection.*
- *At the first Board meeting after the selection of a manager, staff would report to the Board on the search process, the number of responses received to each RFP, and the due diligence performed by staff and the consultant in the selection process.*
- *If feasible, recently hired managers would appear at the next regularly scheduled Board meeting to meet Board members and respond to any questions members may have.*

In conclusion, while the investment manager selection process recommended here is a departure from past Board practices, staff believes that the Board cannot diversify the pension portfolios in a timely and prudent manner if the hiring of investment managers required to enter these classes must occur at quarterly Board meetings. Staff asks that the Board approve this recommendation so that diversification can be achieved in a timely manner.

Member Turcotte moved for approval and implementation of staff recommendation as presented; Member Prothero seconded the motion and the motion was passed 6-0.

Credit Enhancement Policy/Decision

Mr. Carroll South presented to the Board the Credit Enhancement Policy. The INTERCAP Program and the Montana Facility Finance Authority (MFFA) issues the bonds under the Municipal Finance Consolidation Act. The bonds are tax-exempt bonds used to fund low interest loans to eligible government entities for various projects (INTERCAP), and health care organizations, continuing care residential programs and community service providers (MFFA). The bonds are enhanced by:

- Guaranteeing to replenish the reserve fund so sufficient funds are available to pay bond principal and interest; and
- Guaranteeing to purchase bonds that have been tendered but not remarketed.

The Board has never been called upon to purchase un-tendered bonds or replenish debt service reserves in either program.

These activities are authorized by law, and this policy will further establish procedures and protocol. In addition, the Loan Committee Charter will be revised to include the following under “Delegated Authority”:

- ◆ *Board staff may authorize enhancement of up to \$1.0 million in Montana Facility Finance Authority Act (MFFA) bonds, without concurrence of the Loan Committee.*
- ◆ *Board staff may authorize enhancement of MFFA bonds greater than \$1.0 million and up to \$5.0 million, only with concurrence of the Loan Committee. Enhancement of MFFA bonds greater than*

\$5.0 million shall be reviewed by the Loan Committee and recommended to the full Board for final approval.

Member Cohea moved for approval of the Credit Enhancement Policy and revisions to the Loan Committee Charter as presented; Member Fleming seconded the motion and the motion was passed 6-0.

Securities Litigation Monitoring Services Request for Proposal/Decision

Mr. Carroll South presented to the Board staff recommendation to initiate a Request for Proposal for the service of a Securities Class Action Monitoring Firm. The law firm of Barrack, Rodos & Bacine has been monitoring securities class action litigation for the Board since April 2005. This contract will expire in March 2006.

During the past 12-months, staff has received several expressions of interest from other firms specializing in this field and believes that the issuance of an RFP would permit other interested firms the opportunity to respond.

Member Prothero moved for approval of staff recommendation as presented; Member Cohea seconded the motion and the motion was passed 6-0.

BOND PROGRAM

Activity Report

The Board reviewed this report for the period ending January 31, 2006.

Staff Approved Loans Report

Ms. Louise Welsh reported that:

Borrower:	Upper West Shore School District #33 - Dayton
Purpose:	To finance costs associated with building a classroom unattached to the existing structure.
Staff Approval Date	November 1, 2005
Board Loan Amount:	\$50,000
Term:	5 years

Borrower:	Gallatin County
Purpose:	To finance costs associated with the Law & Justice Center District Court remodel.
Staff Approval Date	November 3, 2005
Board Loan Amount:	\$999,000
Term:	10 years

Borrower:	Choteau County District Hospital (dba Missouri River Medical Center) - Fort Benton
Purpose:	To finance costs associated with upgrading its handicap entrance.
Staff Approval Date	November 8, 2005
Board Loan Amount:	\$55,000
Term:	5 years

Borrower:	Lewis & Clark County
Purpose:	Increase – On December 2, 2004, the Board approved the County’s request to borrow \$700,000 to finance the purchase and installation of an integrated public safety radio system. – County requested 10% increase for project cost overruns. November 9, 2005 staff approved the increase; \$770,000 total commitment. Reduction: January 31, 2006 staff reduced total commitment to \$750,000 in compliance with maximum loan allowed per project without a majority vote of the County electors. (7-7-2402 M.C.A.)
Staff Approval Date	January 31, 2006
Board Loan Amount:	\$50,000 increase; \$750,000 total loan
Term:	7 years

Borrower:	Central Montana Regional Water Authority - Hobson
Purpose:	Interim loan in anticipation of a \$210,000 Department of Natural Resources and Conservation (DNRC) Montana Regional Water System Grant #RW-06-004. The loan proceeds will be for costs associated with water well testing at the Utica test well site.
Staff Approval Date	November 10, 2005
Board Loan Amount:	\$49,000
Term:	Short term – 1 year

Borrower:	Big Sandy
Purpose:	To finance the costs associated with constructing a water chlorination building and test well drilling.
Staff Approval Date	November 14, 2005
Board Loan Amount:	\$142,200 (\$129,273 + 10% reserve)
Term:	10 years

Borrower:	Somer’s School District #29
Purpose:	To finance the purchase of new computers.
Staff Approval Date	November 16, 2005
Board Loan Amount:	\$21,654
Term:	3 years

Borrower:	Town of Alberton
Purpose:	To finance the purchase of a new skid-steer loader with various attachments.
Staff Approval Date	November 22, 2005
Board Loan Amount:	\$50,000
Term:	7 years

Borrower:	City of Great Falls
Purpose:	To finance costs associated with design and installation of Eagles Crossing Phase I street lights.
Staff Approval Date	November 29, 2005
Board Loan Amount:	\$56,000

Term:	10 years
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Borrower:	Pleasant Valley School District #27 - Marion
Purpose:	To finance the purchase of a new manufactured home. This will replace a 35-year-old unit needing major repairs.
Staff Approval Date	December 20, 2005
Board Loan Amount:	\$37,000
Term:	5 years

Borrower:	Lincoln County Rural Fire District #1 - Libby
Purpose:	To finance the purchase of two new water tenders.
Staff Approval Date	January 12, 2006
Board Loan Amount:	\$300,000
Term:	7 years

Borrower:	Woods Bay Homesites Water & Sewer District – Big Fork
Purpose:	To finance costs associated with a wastewater system preliminary engineering report.
Staff Approval Date	January 19, 2006
Board Loan Amount:	\$15,000
Term:	3 years

Borrower:	Missoula County
Purpose:	To finance renovations on its component unit, the Missoula Aging Services (MAS).
Staff Approval Date	January 12, 2006
Board Loan Amount:	\$250,000
Term:	10 years

has been approved by staff.

LOAN PROGRAMS

Coal Tax Loan Program Activity Report

The Board reviewed this report for the period ending December 2005.

Commercial Loans Delinquency Reports

The Board reviewed this report for the period ending December 2005.

Pension Mortgage Program Activity Report

The Board reviewed this report for the period ending December 2005.

Mortgage Program Delinquency Report

The Board reviewed this report for the period ending September 2005.

INVESTMENT REPORTS

Capital Markets Overview

Mr. Cliff Sheets, Mr. Pete Madsen and Mr. Jim Voytko presented to the Board the Capital Markets Overview for the quarter ending December 31, 2005.

Performance Report

Mr. Cliff Sheets, Mr. Pete Madsen and Mr. Jim Voytko presented to the Board the Performance Report for the quarter ending December 31, 2005.

Asset Allocation Report

Mr. Cliff Sheets presented to the Board the Retirement Systems Asset Allocation Report as of January 31, 2006.

Real Estate Recommendation/Decision

Mr. Cliff Sheets presented to the Board staff recommendation to approve a preliminary allocation and manager search for exposure to the Real Estate asset class. Real estate represents a large asset class with many unique characteristics that make it an ideal diversification tool. The most important characteristics are the low correlation to traditional public securities, a general ability to hold value in an inflationary environment, and relatively high income returns for core real estate. Member Turcotte moved for approval of staff continuing to pursue the Real Estate asset class; Member Fleming seconded the motion and the motion was passed 6-0.

INVESTMENT STRATEGY

Montana Private Equity Pool (MPEP)

Mr. Cliff Sheets presented various reports on MPEP. These reports included the Holdings Report as of December 31, 2005 and the Cash Flow Analysis Report. No action is required on these reports.

Mr. Cliff Sheets presented to the Board three investment briefs:

1. ArcLight Energy Partners Fund III – Due diligence review as specified in the MPEP Investment Policy Statement was completed in November 2005; staff subscribed to \$25 million of ArcLight Energy Partners Fund III.
2. JLL Partnership Fund V - Due diligence review as specified in the MPEP Investment Policy Statement was completed in November 2005; staff subscribed to \$25 million of JLL Partners Fund V.
3. Welsh, Carson, Anderson & Stowe Fund X - Due diligence review as specified in the MPEP Investment Policy Statement was completed in November 2005; staff subscribed to \$25 million of WCAS Fund X.

Montana Domestic Equity Pool

Mr. Cliff Sheets presented the Domestic Equity Pool Overview as of January 31, 2006.

Mr. Rande Muffick presented to the Board the Montcomp Portfolio Strategy, and Holdings Report as of December 31, 2005.

Montana International Equity Pool (MTIP)

Mr. Cliff Sheets presented the International Equity Pool Overview as of January 31, 2006.

Fixed Income

Mr. Bob Bugni presented to the Board the Fixed Income Overview and Strategy.

NEXT MEETING

The next regularly scheduled meeting of the Board will be May 18, 2006.

ADJOURNMENT

There being no further business, the meeting was adjourned at 12:00 p.m.

BOARD OF INVESTMENTS

APPROVE: _____
Terry Moore, Chairman

ATTEST: _____
Carroll South, Executive Director

DATE: _____