



Final Minutes
Endowment Fund Investment Regular Board Meeting
May 8, 2007

A regular meeting of the Endowment Fund Investment Board (Board) was held in the Board Conference Room at 816 W. Bannock Street, Ste. 301, Boise Idaho on May 8, 2007. Chairman M. Dean Buffington called the meeting to order at 8:01 a.m. and recognized that a quorum was present.

Member's Present:

Chairman Dean Buffington
Senator Brad Little
Vaughn Heinrich (*departed 12:58 p.m.*)
John Taylor
Richelle Sugiyama
Tom Kealey
Sue Simmons (*departed 11:58 a.m.*)
Gavin Gee (*arrived 8:03 a.m.*)

Staff Present:

Larry Johnson
Chris Halvorson
Andy Potter
Judy Shock

Legal Counsel:

Julie Weaver (*9:29 a.m.-12:59 p.m.*)

Member's Absent:

Representative Max Black

Guests:

John Pickett, RBC Dain (*departed 10:33 a.m.*)
Jack Pratt, RBC Dain (*departed 10:02 a.m.*)
Dwight Johnson (*9:29 - 10:15 a.m.*)
Bill Reese (*9:52-10:33 a.m. / 12:57 - 4:26 p.m.*)
Jae Hallett, Eide Bailly (*9:59 - 10:15 a.m.*)
Justice Roger Burdick (*10:22 -10:33 a.m. / 1:08 - 4:26 p.m.*)
Bob Maynard (*10:22 a.m. - 1:04 p.m. / 3:48 - 4:26 p.m.*)
Doug Bates, Adam Benton, David Richardson - Clearwater
(*12:57 - 3:45 p.m.*)
Kathy Opp, Dept. of Lands (*1:02 - 3:05 p.m.*)
Jim Alcorn, State Insurance Fund (*1:11 - 4:26 p.m.*)

Investment Consultants:

NEPC: Carolyn Smith - 1:00 p.m.
Mike Manning
Callan: Janet Becker-Wold - 1:45 p.m.
Jay Kloepfer
Bill Howard
Angeles: Howard Perlow - 2:49 p.m.
Shana Mulkerin

Hard copies of board materials were mailed and delivered six days prior to the scheduled board meeting and a meeting notice was posted on the door of the EFIB office beginning May 1, 2007.

Board Meeting Minutes: - Approved

Senator Little made a motion that the minutes of the April 5, 2007 special meeting be approved as submitted. The motion was seconded by Mr. Taylor and approved unanimously.

Mr. Johnson recognized Mr. Halvorson's one year anniversary with the Endowment Fund.

A letter from Mr. Gee was given to each member, regarding his wife's employment with Eide Bailly. Her primary position is tax manager and she does not participate in any audits. She is not a partner and holds no equity position with Eide Bailly. Mr. Gee will reclude himself from any consideration of the auditor contract. This letter is similar to letters provided by Mr. Gee in past years in regards to the Independence Statement each staff and board member signs each year.

Fund Performance & Evaluation - RBC Dain

Mr. Pickett introduced Mr. Jack Pratt, a new senior analyst with RBC Dain. He indicated that the Endowment Fund is satisfactorily meeting its goals and objectives. The overall portfolio is performing well with all active managers above their benchmark and/or peer group for the 3-year trailing period, except for Marvin and Palmer. Mr. Pickett recommended Marvin & Palmer remain on the watch list.

Mr. Pickett reported that Mastrapasqua was placed on the watch list the second quarter of 2006 because of personnel turnover. He, Mr. Johnson and Mr. Halvorson visited Mastrapasqua's offices in Nashville in March 2007. He did not believe there was a negative impact on the investment process from the personnel termination. Mastrapasqua's continued asset shrinkage, as reported in 12/31/06 - \$521 million to \$450 million on 3/31/07 has become a concern. There are also management succession issues. Because of these concerns, Mr. Pickett recommended termination of Mastrapasqua.

Discussion followed regarding viable index options and fees. A transition manager might be considered to assist in the portfolio transition.

Senator Little made a motion to terminate Mastrapasqua as an investment manager and transition the funds to a mid cap index and search for another manager in the mid cap growth arena. The motion was seconded by Ms. Simmons and approved unanimously.

Mr. Pickett reviewed the portfolio and compliance checklist, as shown on page 14 of the board packet. He stated there is no need to rebalance the portfolio based on our objectives. He reviewed the Net Performance as shown on pages 19-20, each individual manager's review and insight, as shown on pages 22-23, and additional information regarding Domestic Active Manager Attribution (pages 24-28).

Marvin & Palmer: Mr. Pickett discussed concerns with Marvin & Palmer, because of their underperformance and the market dynamics that are running counter to their style. Mr. Johnson mentioned some concerns with NWQ. They have changed their legal structure and added several new employees, and in some ways look more core than value. His recommendation is to look at the entire international sector again and determine if using growth and value managers is appropriate. Mr. Johnson indicated that Marvin & Palmer will be visiting next month. Ms. Sugiyama suggested staff look at a global manager who could make the U.S./international call. The consensus of the board was to accept Mr. Johnson's recommendation, to include examining global options, and present this information to the board in August.

EFIB Staff Reports

Committee Assignments – Chairman Buffington noted on page 116 of the board packet, the three committees: Executive Committee, Audit Committee, and Compensation Committee. He stated that because of Mr. Kealey's involvement in the RFP process, he chose to remove him temporarily from the Compensation Committee, which left Mr. Heinrich and Ms. Simmons to meet with Mr. Johnson and gather information for the board regarding employee compensation.

Chairman Buffington temporarily adjourned the Endowment Fund Investment Board at 8:47 a.m. to attend Joint Land Board Meeting at the Borah Post Office building.

Chairman Buffington reconvened the meeting at 9:29 a.m. and recognized that a quorum was present.

Fund Performance and Evaluation (cont.)

Mr. Pratt reviewed the information on EFIB Domestic Portfolio Performance, found on pages 30-42 in the board packet.

Mr. Johnson noted that the portfolio's slight bias toward mid-cap growth could be partly due to not strictly rebalancing ourselves toward the targets for each individual asset class; staff will review.

Based on the analysis in the board book, Mr. Pickett stated that the recent slip in performance is no cause for alarm and that no significant changes are warranted.

Bill Reese, JRF – arrived 9:52 a.m.

State Insurance Fund – Mr. Pickett met with Jim Alcorn on Monday, May 7th and stated that the current status of SIF is satisfactory based upon the investment goals in its policy. The current allocation of the portfolio is within acceptable parameters in the investment policy. He pointed out that the new international equity allocation through Tradewinds NWQ has reached a weight of 1.5% vs. a target of 2.6%. Mr. Johnson noted that the SIF was briefed on the pros and cons of active vs. passive investments in the international sector before Tradewinds was selected as the investment manager. However, the SIF will be included in the international review discussed earlier for the EFIB.

Mr. Hallett arrived 9:59 a.m.

Mr. Pratt departed 10:02 a.m.

Financial Statement Disclosure – Jae Hallett, Eide Bailly

Mr. Hallett spoke on the financial statement footnote disclosure required for issues related to the Agricultural College endowment. He said we have, in essence, a contingent liability owed to the Ag College endowment and a contingent receivable from the State of Idaho. From an accounting standpoint, no entries need to be made for these contingencies, but they should be described in the footnotes that EFIB staff prepares.

Mr. Hallett indicated that an issue regarding a conflict in the investment mix allowed per state law and the mix allowed by the Morrill Act will also need to be mentioned in the disclosure.

Chairman Buffington called for a five minute recess at 10:16 a.m.

Bob Maynard and Justice Burdick arrived at 10:22 a.m.

The board reconvened at 10:23 a.m.

Fund Performance and Evaluation (cont.)

Judges Retirement System – Mr. Pickett reviewed the status of the Judges' Retirement Fund, stating the fund is satisfactory based upon the investment goals and policies outlined in its various mandates. The current allocation of the portfolio is within acceptable parameters. All of the managers are performing above their benchmark and/or peer group for the 3-year trailing period.

Mr. Johnson noted that although the Fund is 3.7% overweighted toward equities, the Investment Policy indicates that a rebalancing occurs when the Fund is 5% out of balance. Mr. Johnson stated that review of the overall international sector for the Judges' Fund will be included in the upcoming review for the endowment and SIF portfolios.

Mr. Pickett concluded his presentation by stating that should the EFIB decide to retain a new consultant, that RBC Dain would assist the EFIB in any way to make the transition as smooth as possible.

Justice Burdick, Bill Reese, and John Pickett departed 10:33 a.m.

MOI Performance Review, Salary Reviews for all EFIB Employees; Ag College Endowment Discussion Personnel Committee – Ms. Simmons indicated that she and Mr. Heinrich spoke with Mr. Johnson regarding staff performance, salary reviews, state performance and salary guidelines, and available agency budget. Mr. Johnson provided his recommended merit increases, retention bonuses, and performance bonuses.

Senator Little made a motion that the board enter Executive Session pursuant to *Idaho Code §67-2345* for the purpose of personnel/agent matters §67-2345 (1) (b) and consideration of records exempt from public disclosure §67-2345 (1) (d). The motion was seconded by Ms. Simmons and approved unanimously. The board went into Executive Session at 10:37 a.m.

The roll call vote was as follows:
Chairman Dean Buffington – Aye
Gavin Gee – Aye
Vaughn Heinrich – Aye
Tom Kealey – Aye
Senator Little – Aye
Susan Simmons - Aye
Richelle Sugiyama – Aye
John Taylor - Aye

Guests present during Executive Session: Julie Weaver

EFIB staff and Mr. Maynard departed at 10:38 a.m.

Mr. Johnson was invited to return to executive session at 11:06 a.m.

At 11:50 a.m., a motion to return to regular session was made by Mr. Gee. The motion was seconded by Ms. Sugiyama and approved unanimously.

Mr. Heinrich made a motion to approve staff salary increases and bonuses, per Mr. Johnson's recommendations. The motion was seconded by Mr. Taylor and approved unanimously.

Mr. Heinrich made a motion to approve a salary increase for Mr. Johnson of 5%. The motion was seconded by Senator Little and approved unanimously.

Mr. Heinrich made a motion to direct staff to change the assets of the Agricultural College Endowment Fund to a portfolio of bonds 100% guaranteed by the federal government. This move would be as soon as practical, but completed before July 1, 2007. The Executive Committee may approve the hiring of a manager for this portfolio and may delay implementation of this move should, prior to implementation, federal legislation authorize investment into a broader portfolio. The motion was seconded by Ms. Sugiyama and approved by the board, with Mr. Little voting in opposition.

Mr. Taylor moved that the EFIB request that the Board of Examiners provide funding for EFIB and Department of Lands Agricultural College Endowment management fees for fiscal year 2008. If the Board of Examiners chooses to decline the request, EFIB staff should prepare a request for a supplemental appropriation from the legislature. Also, the EFIB's 2009 budget should include a request for funding these fees from the General Fund. The motion was seconded by Senator Little and approved unanimously.

The Board recessed at 11:55 a.m. for lunch.

Ms. Simmons departed at 11:58 a.m.

Chairman Buffington reconvened the meeting at 12:14 p.m.

Commission Recapture Manager – Chris Halvorson

Mr. Halvorson presented information on commission recapture. Mr. Halvorson recommended that the EFIB switch from the three current vendors of Russell, CAPIS and Lynch, Jones & Ryan to using one: Lynch, Jones and Ryan (LJR). LJR has the highest share of the EFIB's current recapture business, the largest recapture broker network, and their own trading desk. Their reporting is good and they received the strongest recommendation from our investment managers.

Mr. Gee moved to hire Lynch, Jones, and Ryan as the exclusive recapture broker. Mr. Heinrich seconded the motion. During discussion, Mr. Halvorson stated that the time/cost of monitoring the recapture agreement is very little compared to the commissions recovered. The motion was restated to say that action would be taken pending the support of the new consultant. The amended motion was approved unanimously.

Capitol Permanent Fund Distribution

Mr. Johnson asked the Board to give final approval to a Capitol Permanent Fund distribution of \$467,109 and to approve minor revisions to the Spending Policy for that fund, as stated on page 107 in the board packet. Mr. Johnson indicated that this distribution was tentatively approved at the August 2006 meeting, "subject to EFIB staff obtaining information from the Capitol Commission, regarding budget needs; and from the Department of Lands, regarding future revenues from the Capitol Permanent Fund's endowment lands."

Mr. Johnson reported that the Capitol Commission has reviewed their budget needs and has not budgeted to spend these funds in FY2008. However, they would like to hold the funds as a contingency to provide a degree of comfort they can obtain a supplemental appropriation should an emergency arise. Any funds that remain unspent will be factored into the Commission's FY2009 budget. If they do not receive this distribution, their current cash balance of approximately \$1 million will fall by about half, since their FY2008 budget is \$508,700. With regard to land revenues, Mr. Johnson said the Department of Lands has confirmed that, due to heavy sale activity in the last few years, revenues from timber harvests on Capitol Commission endowment lands are expected to drop to almost zero beginning in 2011 and remain low for approximately 10 years.

Mr. Heinrich moved to authorize distribution of 5% of the three-year average balance of the Capital Permanent Fund (i.e., \$467,109 effective July 1, 2007). The motion was seconded by Mr. Gee and approved unanimously.

Mr. Taylor made a motion to approve the Capitol Permanent Fund spending policy on page 108 in the board packet. The motion was seconded by Mr. Gee and approved unanimously.

EFIB Staff Reports

Mr. Potter presented the Market Value, New Money Received, and Coverage Ratio reports to the board, as shown on pages 110-112. Mr. Johnson noted there is a correction to the year shown in the box on page 112, "Earnings Reserves relative to 2008 distributions"... and not 2007 distributions.

Timber Prices – Mr. Johnson explained that the graph on page 113 shows that recent auction prices continue to be at or above the levels used by the Department of Lands in developing the revenue forecasts provided to the EFIB.

Estimated 2009 Distributions – Mr. Johnson reviewed pages 114-115, showing what is expected at the August meeting regarding beneficiary distributions. He stated that staff will not be recommending a change in the Spending Policy and has developed an estimate of the 2009 distributions by assuming that the Permanent Fund balance remains at March 31, 2007 levels until the fiscal year end. He indicated that the reasons for not changing the Spending Policy are: 1) Earnings Reserves remain below the levels required to support the long-term spending objective of 4% of endowment funds plus net revenues from lands; 2) Distributions will grow in excess of inflation; and 3) No state budget shortfall is anticipated. The 2009 distributions are growing at 8.4% over 2008, with the highest endowment growing to 9.0% and the slowest at 7.6%. However, given the action of the board earlier today regarding the Agricultural College endowment asset mix, staff may recommend a change in policy for that endowment.

Expenses vs. Budget – Mr. Johnson stated that we are under budget in personnel and operating expenses; and on budget for capital expenses.

Gift Log – Mr. Johnson pointed out the Employee Gift Log on page 118. Chairman Buffington stated that Mr. Johnson has also submitted his time sheets and agency travel expense for his review.

Chairman Buffington asked the board for a volunteer to serve on the EFIB Task Force, replacing Representative Bill Deal. A replacement was not determined.

Bill Reese arrived 12:57 p.m.

Clearwater Advisors: arrived at 12:58 p.m.

Mr. Heinrich departed at 12:58 p.m.

Ms. Weaver departed 12:59 p.m.

Kathy Opp, Dept. of Lands arrived 1:02 p.m.

Mr. Maynard departed 1:04 p.m.

Justice Burdick arrived 1:08 p.m.

Jim Alcorn, State Insurance Fund arrived 1:11 p.m.

Investment Consultant Interviews

Mr. Kealey explained the RFP review process, noting that the RFP was sent to over 30 companies and 17 companies responded. After a detailed review by EFIB staff and the board's RFP Committee (Ms. Sugiyama and Mr. Kealey) it was narrowed to 3 finalists. The 3 finalists presented their observations on asset mix and investment managers the day before this board meeting to staff, Ms. Sugiyama, Mr. Kealey, Mr. Alcorn and Mr. Reese.

The finalists then made presentations to the Board:

- New England Pension Consultants – Carolyn Smith and Mike Manning
- Callan Associates – Janet Becker-Wold, William Howard and Jay Kloepfer
- Angeles Investment Advisors – Shana Mulkerin and Howard Perlow

Kathy Opp departed 3:05 p.m.

Clearwater Advisors staff departed 3:45 p.m.

Mr. Maynard returned 3:48 p.m.

The board and staff discussed each finalist. Justice Burdick and Jim Alcorn each said they could accept any of the three.

Mr. Kealey indicated that Ms. Weaver has worked with the three finalists to resolve all contract issues.

Senator Little moved to hire Callan Associates as the EFIB consultant – Mr. Taylor seconded. The motion was approved unanimously.

Adjournment

There being no further business to come before the Board, Mr. Kealey moved for adjournment. The motion was seconded by Mr. Gee and approved unanimously. The meeting adjourned at 4:26 p.m.