Minutes

Called Meeting
Arkansas Teacher Retirement System
Board of Trustees

June 27, 2002

The Arkansas Teacher Retirement System Board of Trustees met in a called meeting on Thursday, June 27, 2002, at 1:00 p.m. The meeting was held in Room 300, Arkansas Teacher Retirement Building, 1400 West Third, Little Rock, Arkansas.

Members of the Board Present:

Linda Parsons, Chair
Charles Vondran, Vice Chair
Betty McGuire
Winfred Clardy
Charles Dyer
Dr. Paul Fair
John Fortenberry
Ann Harbison
Mary Harris
Frank White
Gus Wingfield

Members of the Board Absent:

Hazel Coleman
Jimmie Lou Fisher
Louis Midkiff
Raymond Simon

Members of the Staff Present:

Wayne Greathouse, Interim Executive Director
Tammy Medlock, Administrative Assistant
Michael S. Ray, Interim Deputy Director
Hugh Roberts, Retirement Fund Investment Advisor
Dale Walker, Investment Specialist

Others Present:

Bill Conrad, A.G. Edwards & Sons, Inc.
Rosemary Conrad, Fayetteville
Don Cooper, III, Cooper Realty Investments
Darrell Dover, Dover & Dixon, P.A.
Tom Ferstl, Affiliated Real Estate Appraisers of Arkansas
John Gill, Gill Elrod Ragon Owen & Sherman, P.A.
Jay Gadberry, Morgan Stanley
Richard Gould, Morgan Stanley
Sandy Haas, Morgan Stanley
Ben Johnson, State Street
Richard Lawrence, Gill Elrod Ragon Owen & Sherman, P.A.
Ross McLellan, State Street
Sandy Rattray, Goldman Sachs
Carrie Roddy, Cooper Realty Investments

Others Present (Cont'd):

Dewitt Smith, Cooper Realty Investments
Pat Sullivan, Goldman Sachs
Leonard Venable, Office of the State Treasurer
Mike Wickline, Arkansas Democrat-Gazette

I. Roll Call

The minutes were recorded by Tammy Medlock of the Teacher Retirement staff.

II. Status of Holman Litigation – John Gill, Gill Elrod Ragon Owen & Sherman, P.A.

Mr. Gill reported litigation remains in the discovery stage, and should be completed by summer. The depositions of Mr. Shirron and Michael Johns (Dover Dixon Horne PLLC) have been taken. Mr. Holman's deposition will be taken in July.

III. Transition Manager Search Presentations

A. State Street Global Markets
B. Goldman Sachs
C. Morgan Stanley

Mr. Greathouse recommended the Board delay employing a transition manager until the index fund manager has been selected. Dr. Fair made a motion to accept the recommendation of the Executive Director. The motion carried.

IV. Return on Investments – Dewitt Smith, CRI *(Attachment A)*

V. West Memphis Property Update – Tom Ferstl, ATRS Real Estate Manager

Mr. Ferstl reported he had authorized an additional soil test on the property. He stated the system's recourse includes having the seller buy back the building.

VI. Woodland Heights Update – Tom Ferstl

Mr. Ferstl reported he is working on the sale with Mr. Dover; however, they are waiting on a full report from Thomas & Thomas. The claim of a resident injured on the elevator has been turned over to the insurance company.

VII. Jonesboro & Fayetteville Property Evaluation – Tom Ferstl

Ms. Harbison made a motion to retain the Fayetteville property. The motion carried. Mr. Vondran made a motion to list the Jonesboro property at ATRS' investment plus 8% return. The motion carried. Mr. Ferstl was authorized to request bids for listing fees.

VIII. Development of Investment Policies and Procedures – Dr. Paul Fair

Dr. Fair reported Ennis Knupp will submit a draft of the investment policies to the Investment and Policies Committees by August 1.

IX. Review of Current Real Estate Investment Guidelines – Dr. Paul Fair

By common consent, the Board agreed to refer the following items to the Policies Committee for consideration:

1. The ATRS Real Estate Manager is not authorized to seek additional projects nor to bring projects to the Screening Committee;
2. Information about ATRS real estate will be published only after review and approval by the Executive Director;
3. The Executive Director, or a designated ATRS staff member, will oversee the ATRS Real Estate Manager's workload;
4. The ATRS Real Estate Manager will be directed by the Executive Director and not board member(s).

X. Review of Real Estate Management Contracts – Wayne Greathouse

Mr. Greathouse reported the Board had received updates on the contracts, along with those of other professional services retained by the System.

XI. LMJ2 Update

Mr. Vondran made a motion to engage legal counsel as required by the partnership. The motion carried.

<u>In other business</u>

Referrals to other ATRS Properties. By common consent, the Board agreed to authorize Mr. Ferstl and the Executive Director to instruct all ATRS property managers to refer prospective tenants to other ATRS properties, should they decide not to lease from the proposed manager.

WorldCom Update. Mr. Greathouse reported as of June 26, the system experienced an unrealized loss of $50 million, and a realized loss of $6.2 million.

As there was no further business to consider, Mr. Vondran made a motion to adjourn. The motion carried and the meeting adjourned at 5:30 p.m.

Linda Parsons

Linda Parsons, Chairman

Wayne Greathouse

Wayne Greathouse, Interim Executive Director
Secretary to the Board

August 12, 2002

Date

Attachment A

Report to ATRS Board of Trustees
CRI – ATRS Joint Ventures
June 27, 2002

Madam Chairperson and members of the Board:

Thank you very much for the opportunity to come before you today to brief you on the operations of the three joint ventures in which ATRS and CRI are equity partners. In an effort to be clear and concise, I will be reading my prepared remarks. Copies will be provided to you and to members of the press who are present at this meeting. Upon completion of my prepared remarks, I will be very glad to answer any questions.

CRI is wholly owned by the family of John A. Cooper and Mildred Cooper. John Cooper, Jr., whom some of you know, and John Cooper III, who is here with me today, are actively involved in management of our parent company. The Cooper family has a long history of respect and appreciation for the public trust. As a corporate family, we are all dismayed that despite our best efforts, due to circumstances beyond our control, incomplete, erroneous, misleading and damaging information has been widely disseminated casting a shadow upon the reputations of both CRI and ATRS.

Regrettably, erroneous information was provided to the press and subsequently printed indicating that CRI no longer has any cash investment in the Two Financial Centre joint venture. To the contrary, the audited statements provided to you prove conclusively that CRI continues to hold a vested 20% cash equity position in each of our three joint ventures with ATRS. Other printed statements concerning the purchase and capitalization of Two Financial Centre were also erroneous and misleading.

CRI requested a meeting with Arkansas Business and was allowed to provide Arkansas Business with full, complete and accurate information regarding the initial capitalization of Cooper Financial LLC, the owner of Two Financial Centre in Little Rock. In addition, CRI provided Arkansas Business with copies of the audited financial statements for Cooper Financial LLC for the years 2000 and 2001 and with other relevant documents. These documents provide that CRI continues to maintain a 20% equity position in this joint venture. As a result, Arkansas Business has given me permission to inform the Board of its intent to print the correct information in the next available issue. I wish I could be here today for the sole purpose of giving you one of our periodic status reports detailing the performance of the CRI-ATRS joint ventures. I will indeed accomplish that. However, these recent events make it necessary that I first set the record straight.

My purpose here today is to provide you with full, complete and accurate information regarding the financial performance of Two Financial Centre in Little Rock, American Center in Nashville, TN, and the Crescent Center and Forum I in Memphis, TN. The accounting firm of Deloitte and Touche has independently audited the financial statements of all three joint ventures. The annual *cash on cash* returns we are presenting today are calculated using methodology universally accepted by real estate professional in the United States, and are calculated on a consistent basis with the returns previously reported to ATRS staff and the ATRS Manager- Real Estate Investments.

CRI received a request for information from the ATRS Manager-Real Estate Investments postmarked April 19, 2002, which I have included in your packages for reference as Appendix I. The suggested format attached to that request references, among other things, the *cash on cash* returns for the calendar year 2001 only. CRI provided the information to the requested format to the ATRS Manager- Real Estate Investments by two separate mailings prior to May 1, 2002. The information requested by ATRS Manger-Real Estate Investments, and provided to him in a timely fashion, is included here as Appendix II.

Only upon reading a published article did we become aware that the ATRS Manager-Real Estate Investments had adopted a position denying any knowledge of either of the two mailings. A copy of the previously provided information was faxed immediately to his office on May 24 and Federal Express delivered yet another copy to his office on May 27. It is undeniable that CRI complied fully and responsively to this request for information in a timely fashion.

Attached for your review are the following exhibits:

Exhibit A: *Financial Statements* for each of the three CRI-ATRS joint ventures independently audited by the accounting form of Deloitte and Touche.

Exhibit B: A sworn affidavit from Anthony W. Oxford, the Chief Financial Officer of CRI, stating that the return calculations for the joint ventures were based upon the audited figures.

Exhibit C: A sworn affidavit from Michael T. Pyron, Chief Operating Officer of CRI, stating the *cash on cash* computations were made consistent with the universally accepted method used in the United States and are correctly presented. Mr. Pyron holds an MAI designation from the Appraisal Institute and has signed his affidavit using his MAI designation.

Exhibit D: A sworn affidavit from Thomas E. Reed, a practicing appraiser based in Springdale, Arkansas, and a newly appointed member of the ATRS Real Estate Investment Advisory Committee, stating the *cash on cash* computations were made consistent with the universally accepted method used in the United States and are correctly presented. Mr. Reed also holds an MAI designation from the Appraisal Institute and has signed his affidavit using his MAI designation.

The one and only correct method to compute *cash on cash* returns is to divide the *cash flow before taxes* flowing into the joint venture by the *total equity investment*. There are no alternative methods to perform this calculation. The returns submitted to the ATRS Manager-Real Estate Investments are the correct *cash on cash* returns computed in this manner.

We have no doubt that you will recall that ATRS and CRI, by mutual agreement, decided to retain a portion of the cash flow in each respective joint venture account as *funded reserves* for replacement, tenant improvements, and leasing commissions. The balance of ATRS's share of the cash flow was transferred to another ATRS account outside the joint ventures. This is a more conservative approach to ownership of income producing real estate and is a discipline which CRI imposes on its wholly owned investments as well. ATRS's total *cash on cash* return is correctly computed based on ATRS's' 80% share of the cash which flows out of each piece of real estate into the joint venture which owns that particular property.

This is the only way to get an apples-to-apples comparison with your other investments. To create a comparison regarding performance of an asset based **solely** on cash moved from the joint venture to an ATRS account outside the joint venture denies the existence of the legal structures of the CRI-ATRS join ventures, ignores all customary and established accounting practices and, due to its selective and incomplete approach, will consistently result in a false and misleading conclusion. Notwithstanding the foregoing, it must be stressed that the amount of cash moved periodically to an ATRS account outside the joint venture was reflected in monthly reports provided to the Real Estate manager and to ATRS staff. The true *cash on cash* return and the total amount of cash flowing into each joint venture for the benefit of ATRS were also clearly shown on these monthly reports.

At this time I wish to direct your attention to a series of exhibits which will be shown on the screen behind me:

Exhibit E is a table showing ATRS's share of the cash flowing into the joint ventures in 2001, the amounts of cash retained as reserves, and the amounts of cash which have been moved from the ATRS joint venture accounts to another ATRS account outside the joint ventures.

Exhibit F shows you the *cash on cash* returns generated in 2001 from each of the three joint ventures and also the weighted average *cash on cash* return for all your investments with CRI. The weighting is based on the ATRS cash equity investments. Please note the portfolio weighted average return of 8.54% exceeds your 8% goal.

Exhibit G shows the amounts of reserved cash held for ATRS in each joint venture on May 31, 2002. This cash belongs to ATRS. It has been held for ATRS's benefit inside the joint venture. This was done because this Board agreed with CRI's proposal to fund a reserve account to be held as part of the joint venture. An identical percentage of CRI's share of the cash generated by each joint venture is also retained within the joint venture, held for the benefit of CRI. The amounts of cash retained inside each joint venture have been reported to you monthly. The cash as always been there for ATRS. ATRS has always had access to it and it has never been concealed in any way.

Exhibit H shows the ATRS cash on cash returns from inception dates through April 30, 2002. Please note once again the portfolio weighted average return of 8.50% exceeds our 8% goal by 50 bps. When compared with pro forma returns (what CRI predicted at the time of purchase), the actual returns for both Two Financial Centre and American Center have a material positive variance, while the actual returns for Crescent Center and Forum I have a slight negative variance. The portfolio weighted average return is nicely positive.

In fairness to our projects, we failed to predict the events of 9/11 and the resulting impact of the tragedy. However, several very positive things have happed recently for the Crescent Center and Forum I in Memphis. The most notable is that we recently procured a 10-year lease extension with Perkins Family Restaurants which will keep them in the Crescent Center though May of 2013. This lease is for 50,000 sq. ft. and represents gross income of over $12 million. I would like to read the following quote from a recent article in the Memphis Business Journal regarding the Crescent Center.

"I think it's one of the top Class A buildings in the East Memphis market and certainly in terms of architecture design, landscaping and overall appeal. With the work Cooper Realty Investments has committed to doing and is doing in terms of renovations, they're making it a premiere Class A Building. They've done a great job at upgrading their tenant base and restoring the building to its previous level of quality."

The speaker was Mr. Tracy Speake, the managing director of the Memphis office of Grubb & Ellis/Centennial, a large nationally affiliated leasing brokerage firm located in Memphis, Mr. Speak represented the law firm of Butler, Snow, O'Mara, Stevens & Cannada when they expanded from 26,000 sq. ft. to 32,000 sq. ft. this month after moving into the building at the beginning of the year.

We appreciate the trust and confidence the Board has placed in CRI. We are diligent in our effort to enhance that leave of respect and continue to provide additional investment opportunities in the future for the teachers of Arkansas. In summary:

1) I have demonstrated to you the following:

    a. ATRS's *cash on cash* returns are correctly computed and properly stated in our presentation today and are derived from independently audited financial statements for the years 2000 and 2001. There is one and only accepted method of computing *cash on returns* on a real estate investment. It is the method we have employed and clearly the method requested. It is indisputable that we were and are in full and complete compliance with the info4rmation request attached as Appendix I.
    b. CRI has a hard cash equity position of 20% in each of the CRI/ATRS joint ventures.

2) The *cash on cash* returns you have received to date exceed your stated goal of 8% by 50 bps and are over 16% higher than our original projections.

3) CRI has provided good stewardship of the cash retained inside the joint ventures. While we still recommend the more conservative approach which we utilize in all of our other investments of maintaining cash reserves at the joint venture level, we stand ready to comply with any directive from this Board.

Thank you for your attention. I will now be glad to answer any questions you might have.