

THE TENNESSEE CONSOLIDATED RETIREMENT SYSTEM ORGANIZATIONAL STRUCTURE AND GENERAL OVERVIEW INVESTMENT POLICY, OBJECTIVES AND CRITERIA

ORGANIZATIONAL STRUCTURE AND GENERAL OVERVIEW

Final authority for investing and reinvesting the assets of the Tennessee Consolidated Retirement System (System) is vested in the System's Board of Trustees (Board). T.C.A., Section 8-37-104(a). Implementation of investment policy established by the Board is hereby delegated to the State Treasurer (Treasurer) who shall put such policy into effect. T.C.A., Section 8-37-110. Assets shall be invested subject to all the terms, conditions, limitations, and restrictions imposed by the laws of the State of Tennessee upon domestic life insurance companies in the making and disposing of their investments or as otherwise provided by state law. T.C.A., Section 8-37-104(a). If the Board has issued other directions further limiting such investments, the assets shall be invested according to the criteria established by the Board.

Legal Counsel

The State Attorney General or an assistant designated by him shall be the legal advisor to the Board in all matters. In all cases where the interests of the System require additional counsel to the Attorney General, the Chairman of the Board, with approval of the Attorney General, is authorized to employ such additional counsel. T.C.A., Section 8-34-308.

Investment Advisory Council

The Treasurer shall nominate, with the advice and consent of the Board, an Investment Advisory Council (Council), consisting of five persons who have experience as investment portfolio managers, economists, or investment advisors to work with the Treasurer's investment staff, T.C.A., Section 8-37-108, to advise the Board on investment policy, T.C.A., Section 8-37-109.

The Council will assist the Treasurer, Chief Investment Officer and Investment Staff by providing advice and recommendations on the most appropriate short, intermediate and long-term investment strategy. At each meeting of the Council, the previous meetings' recommendations will be reviewed and reinforced or changed as agreed upon by the Council Members.

Chief Investment Officer

The Chief Investment Officer for the System's assets will assume the necessary authority, as granted by the Treasurer, to effectively manage the Investment Staff. He shall report to and consult with the Council in formal, scheduled meetings and informally as needed.

The Chief Investment Officer shall:

1. Have executive responsibility and authority, as delegated by the Treasurer, for the management of the assets of the System in keeping with such guidelines and policies as approved by the Board and such applicable laws of the State of Tennessee.
2. Prepare and submit reports, as required, to the Treasurer, the Council, and the Board to document investment activities.
3. Report to and consult with the Treasurer on administrative, organizational and investment activities.
4. Work with the Council on development and implementation of an appropriate investment strategy.
5. Work jointly with the Council to develop long-term economic and investment projections.
6. File with the Treasurer a disclosure statement as prescribed by the Treasurer each year in December.

Investment Staff

The Treasurer, in consultation with the Chief Investment Officer, shall maintain an Investment Staff to effectively manage all assets of the System. The Treasurer may delegate to the Chief Investment Officer and such staff the power to invest and reinvest the System's assets within criteria established by the Board. T.C.A., Section 8-37-105. Investment Staff will perform their duties in compliance with the Association for Investment Management and Research Code of Ethics and Standards of Professional Conduct. Each member of the Investment Staff shall file with the Treasurer a disclosure statement as prescribed by the Treasurer each year in December.

Reporting

The Investment Staff shall provide a detailed written review of investment activity at Board and Council meetings. This shall include a review of the purchases and sales over the period under review, a portfolio summary, a review of current investment policy, and other reports as requested.

Brokerage Firms

All brokerage firms (for stock and all other securities) shall be selected for use according to their financial standing, execution capabilities, underwriting capabilities, research capabilities, price and other services provided to the System.

Proxy Voting

It is the general policy to vote proxies in a manner which will provide the best ultimate value to the shareholders of that entity. The Chief Investment Officer will develop and maintain a proxy voting policy, and review such policy annually with the Council. In voting all proxies, the investment staff will:

1. Analyze the economic consequences of the options presented to them as shareholders, and select the option most likely to protect and enhance the value of the System's assets.
2. Document the votes (and other actions and decisions) along with the reasons for taking the action chosen. This includes maintaining a record of all attempts to solicit proxies, from outside or inside the organization.
3. The Chief Investment Officer should consult with the Council on any particularly difficult proxy questions.

Commission Dollar Arrangements

The Treasurer is hereby given approval and is authorized to obtain investment research services permitted by Section 28(e) which amends the Securities and Exchange Laws of 1934 through use of commission dollars; provided, however, that best execution of all trades shall continue to be the overriding principle in determining the broker to be used in executing any transaction. The Treasurer shall annually disclose to the Board significant provisions of each commission dollar arrangement existing on June 30 of each year. The Treasurer shall, within a reasonable period of time, disclose to the Board any new commission dollar arrangement entered into as well as other information requested. Only those research goods and services which directly enhance the investment decision-making process and which do not have a non-investment capability shall be eligible for procurement through commission dollar arrangements. Goods and services specifically permitted include performance evaluation services, securities pricing services, quotation and trading information services and analytical databases as well as technical publications which directly enhance the investment decision-making process.

No good or service may be procured through commission dollar arrangements if such good or service benefits an employee in an individual capacity. Goods and services specifically prohibited from procurement through use of commission dollar arrangements include direct telephone lines to brokerage firms, personal computers or other office equipment, payment of travel related expenses and payment of cost of attending seminars, classes or other investment training activities. The Treasurer shall develop and implement a structured review and approval process to ensure that commission dollar arrangements entered into pursuant to this policy comply with the provisions stated herein. Any commission dollar arrangement in which commission commitment is made by the System shall be evidenced by a written agreement which specifies the nature and extent of the commission commitment as well as other significant provisions of the arrangement.

Performance Measurement

To provide the Investment Staff and the Board with guidance as to investment performance expectations, the following performance measurement standards are established. These standards are to act as guides in determining whether the Fund and individual asset classes are achieving their long term goals, both in relationship to the System's peer group of other public funds and the marketplace in general. In recognition of the System's long term perspective, these standards are to be measured through use of a five-year rolling average. This serves to reinforce the System's bias against investment decisions designed to show short term gain at the expense of long term performance.

Total Fund Performance Measurement Standards

This set of standards is designed to measure the performance of the Fund in total, including the impact that state law, investment policy restrictions and asset allocation decisions may have on the performance of the Fund. Given the current state law, investment policy and asset allocation parameters, the following standards are considered reasonable expectations for the total Fund:

The Fund's overall annualized total return (price change plus income) should exceed the return available from a policy of "rolling over" 90-day Treasury Bills (as a proxy for the inflation rate) by at least 2-3 percentage points per year measured over a period of 5 years.

The Total Fund should rank in the upper 50 percentile compared to the results of other similarly managed public fund portfolios measured over rolling five-year periods.

Asset Class Performance Measurement Standards

Each asset class is currently actively managed by the System. Since an alternative to active management exists in the form of index funds, it is proper to measure the System's performance against the most appropriate index for each asset class to determine the "value added" over time by active management. As asset classes change, indices should be reviewed to ensure that proper comparisons are being made. The following indices provide for appropriate comparison to the System's current asset classes:

<u>Asset Class</u>	<u>Index</u>
Domestic Stocks	S&P 500
Domestic Bonds	Lehman Brothers Aggregate Index
Domestic Cash	91-Day U. S. Treasury Bills
International Bonds	Salomon Non-U.S. World Bond Index
International Stocks	
Europe	Morgan Stanley Capital International – Europe
Pacific Basin – Japan emphasis	Morgan Stanley Capital International – Pacific
Pacific Basin – Japan underweight	50% Morgan Stanley Capital International – Japan and 50% Morgan Stanley Capital International – Combined
Emerging Markets	Pacific Free ex Japan
Real Estate	IFC Global Composite Russell NCREIF Property Index - Apartment

Returns are expected to exceed the benchmarks over rolling five-year periods.

INVESTMENT POLICY AND OBJECTIVES

Preservation of principal value is the primary objective in managing the System's assets. Within acceptable risk levels, achieving a superior return (both income and appreciation) is the second objective for the Fund. A third objective is to provide the liquidity needed by the System to pay beneficiaries in a timely manner.

Preservation of Principal Value

Recognizing that potential investment return is proportionate to the amount of risk taken, investment in high quality assets shall be favored over those more risky investments that, if successful, can pay a higher return. In addition to limiting investments to higher quality financial assets, a diversified portfolio shall be maintained to further reduce exposure to loss. Although the risk parameters imposed by state law shall be followed, the Investment Staff may choose to further restrict the financial criteria, depending on the overall state of the economy and upon advice of the Council.

Investment Return

The System's assets should be managed actively to attain, within acceptable risk limitations, a return on assets that will meet beneficiary payments as required. Return shall include both current income and capital appreciation. The total return objective of the System over the long term (10-15 years) will be to achieve a return equal to the rate of inflation (as measured by the GNP Price Deflator) plus an additional two to three percent. This objective is not to be a goal from year to year, but is intended as a long-term guideline to those involved in investing the System's assets. The investments of the System shall be diversified so as to minimize the risk of large losses, unless under particular circumstances it is clearly prudent not to do so.

Liquidity for System Beneficiary Payment

It appears that contributions to the Fund will be sufficient to meet beneficiary payments for some time. Continual review of the System should be conducted to assure that investments providing income for liquidity needs are purchased as the System matures.

INVESTMENT CRITERIA

Both the Board and the Investment Staff are aware of the desirability of investing within the State of Tennessee whenever quality, risk, diversification and potential return are equal to or greater than that available on like investments outside the state. The Investment Staff should encourage and be receptive to Tennessee financial proposals. However, both the Board and the Investment Staff are aware of the fiduciary responsibility of investing pension assets and should not make any investment based solely on its location in Tennessee when quality, risk, diversification, or potential return are sacrificed. T.C.A., Section 35-3-117(b). Further, the Board will not approve investment proposals designed to benefit special political, social, or economic subgroups within or external to the System's beneficiaries unless they clearly meet all fiduciary standards of investing.

In determining compliance with the percentage limitations of this policy, the assets of the System shall be valued at their market value. Accordingly, an investment may be made on any given day provided such investment does not cause any applicable limitation prescribed in this policy to be exceeded on such day. T.C.A., Section 8-37-104(b).

Common, Preferred Stock and Convertible Bonds

Growth is important to the System to attain a return that will allow for greater participant benefits and/or lower state funding requirements. Equity investments will be used to seek this growth through potential dividend increases and capital appreciation. The System will limit its investment in common and preferred stock to 75% of the System's total assets. T.C.A., Section 8-37-104(a)(1). Convertible bonds also will be counted as an equity investment and included in this limitation. The System's stock portfolio shall be actively managed by the Investment Staff to obtain a superior return. The stock of smaller, emerging companies, including new issues, should be an integral part of the total portfolio. Not more than 4.99% of the outstanding shares of any one issuer shall be purchased. Any stock purchase which does not meet the statutory definition for domestic life insurance companies shall be considered purchased under the basket clause as permitted by statute.

Notes, Bonds, and Mortgages

Public issues of notes and bonds shall make up the majority of fixed income investments. Bonds generally will be purchased and held to maturity, but it will be necessary to actively manage this sector of the portfolio in times of volatile interest rate swings to either shorten the average maturity to protect principal value or lengthen maturities to lock up a long-term stream of income. The only issues subject for purchase are investment Grade Bonds (four highest ratings) as rated by one of the recognized rating agencies. It is further provided that no acquisition can be made which would cause the domestic fixed income portfolio to have more than seven percent (7%) in triple B bonds. The total sum invested in notes and bonds and other fixed income securities exceeding one (1) year shall not exceed seventy-five percent (75%) of the total funds of the System. T.C.A., Section 8-37-104(a)(2).

Private Placements

Any debt issues purchased which do not have an active secondary market shall be thoroughly researched from a credit standpoint and shall be viewed by the Investment Staff as having the credit quality equivalent of an AA rating on a publicly traded issue. Not more than 15% of the total fixed income portfolio shall be placed in private placements. Private placements may be considered for purchase when they yield a return over equivalent quality public issues that is sufficient to compensate for their lack of marketability. Except in the case of notes purchased by the System pursuant to standby note purchase agreements wherein the System receives a market rate of return, tax exempt securities of any state are not considered a prudent investment for the System.

Stock Options

Call options may be written on stock positions owned by the System. Options should not be written on more than 10% of the total stock portfolio. Options may not be purchased but positions can be closed out. Rules and Regulations of the State of Tennessee, Chapter 0780-1-32.

Bond Futures

The Investment Staff may write call options on U.S. Treasury bond futures, provided such options are not written on more than 10% of the total assets in the System's portfolio. T.C.A., Section 56-3-303(a)(15).

Domestic Stock Index Futures

The System may purchase or sell domestic stock index futures contracts for the purpose of making asset allocation changes in a more efficient and cost effective manner, and to improve liquidity. Such futures contracts shall be subject to the following terms and conditions:

1. The Investment Staff will not enter into futures transactions for the purpose of speculative leveraging. Speculative leveraging is defined as buying financial futures where the amount of the contract obligation is an amount greater than the market value of the System's cash and short-term securities.
2. The total amount of the System's financial futures contract obligation should not exceed five percent (5%) of the market value of the System's total assets.
3. The sum total of the domestic equity portfolio together with the value of the stock index futures contract obligation should be within the asset allocation range for domestic equity securities. While stock index futures contracts are outstanding, the Investment Staff shall maintain a comparison of the System's equity asset allocation against its invested position including futures contracts.
4. The System may use cash and obligations of the U.S. government or any of its agencies to meet the variation margin requirement.
5. The only stock indexes upon which financial futures contracts may be written are as follows: S&P 500 Index, S&P Midcap 400, and Russell 2000 Index.
6. Futures transactions will be conducted with only a few of the highest quality domestic money center banks and domestic brokerage firms. The criteria to be used in selecting such banks and brokerage firms should include, but should not be limited to, their experience and expertise in the financial futures market.
7. A transaction record shall be maintained which contains the following:
 - a) The amount of stock index futures contracts purchased and the reason therefor.
 - b) The amount of stock index futures contracts sold and the reason therefor.
8. The Investment Staff shall submit a quarterly financial futures report to the Board. This report will describe with specificity the financial futures transactions during the previous quarter. The report shall summarize the investment strategies employed during the period reviewed and the proposed strategy for the present quarter. Each report shall list the banks and brokerage firms authorized to conduct financial futures transactions with the System. T.C.A., Section 8-37-104(a)(7).

Short-term Investments

All monies waiting to be placed in a more permanent investment should be actively managed to obtain the best return available. Yield should be sacrificed for safety in short-term investments, and thus only the highest quality short-term debt issues should be purchased. These investments can include both publicly and privately negotiated short-term borrowing agreements. Commercial paper should be rated in the highest tier by all rating agencies which rate the paper. Rating modifiers (+, -) should not be considered when determining the highest rated tier. A minimum of two ratings is required. Commercial paper cannot be purchased if a rating agency has the commercial paper on a negative credit watch. Commercial paper cannot have a remaining maturity of more than 180 days from the date of purchase. The maximum amount of a specific corporation's commercial paper that can be purchased is \$100 million, but commercial paper maturing on the next business day shall not apply to this limit. A credit analysis report shall be prepared on a corporation before the corporation's commercial paper can be acquired. A credit analysis report should include a company profile, business description, financial profile, rating information, strengths and opportunities, weaknesses and threats, and an outlook and recommendation.

Securities Lending

Both debt and equity securities may be loaned for a fee to a select few of the highest quality securities firms and banks. Loans shall be limited so that the total amount of the securities lent does not exceed 30% of the market value of the total assets in the System's portfolio. Eligible collateral shall be required for each loan. For purposes of this provision, eligible collateral means:

1. Bonds, notes, and treasury bills of the United States or other obligations guaranteed as to principal and interest by the United States or any of its agencies;
2. Obligations guaranteed as to principal and interest by the Federal Home Loan Mortgage Corporation, Federal National Mortgage Association, Student Loan Marketing Association and other United States government sponsored corporations or enterprises; and
3. Cash.

Securities received as collateral shall have a market value of at least 102% of the market value of the security loaned. Cash received as collateral shall have a value of at least 100% of the market value of the security loaned. Collateral should be closely monitored. Securities collateral should be marked to market each business day so that the aggregate market value of the collateral allocated to all then outstanding loans to a single security firm or bank equals 102% of the market value of such loans and the interest accrued thereon. If at any time the aggregate market value of the securities collateral allocated to all then outstanding loans to a single security firm or bank is less than 100% of the market value of such loans, more collateral should be requested. Cash received as collateral may be invested by or on behalf of the System in any investment instrument in which the System's assets may be directly invested. Such cash may also be invested in short-term investment funds provided the portfolio of such funds contains only those investment instruments in which the System's assets may be directly invested. The Treasurer, through securities lending agreements, may further restrict the collateral requirement outlined in this policy. Securities lending agreements entered into shall be reviewed, commented upon, and approved as to form and legality by the Attorney General and Reporter. T.C.A., Section 8-37-104(a)(6).

Reverse Repurchase Agreements

The System may loan securities under reverse repurchase agreements. Loans shall be limited so that the total amount of the securities lent does not exceed 10% of the total assets in the System's portfolio. This is an extension of the lending program whereby securities are sold for cash with the agreement to buy that same security back at the same price on a specified date. The System retains all the incidents of ownership for the security and receives a fee during the period it is on loan. Cash is received as collateral. As in regular securities lending, reverse repurchases only should be done with a select few top quality securities firms and banks. T.C.A., Section 56-3-303(a)(15).

Standby Note Purchase Agreement

The System may enter into contracts to serve as a standby note purchaser for the Tennessee State School Bond Authority, the Tennessee State Funding Board and the Tennessee Local Development Authority provided said contracts contain the following provisions:

1. The System receives an annual commission representing a fair market value fee, adjusted for any additional cost incurred by the state agency due to the System serving as the standby note purchaser.
2. If called upon to purchase such notes, the System receives a market rate of return exceeding the prime rate.

T.C.A., Section 8-37-104(a)(8).

10% of Assets Restriction

The 10% of assets restriction for bond futures and reverse repurchase agreements is cumulative, e.g., if 5% of the total assets of the System are invested in bond futures, the System may invest only 5% of the total assets of the System in reverse repurchase agreements. T.C.A., Section 56-3-303(a)(15).

International Investments

An amount not to exceed 15% of the System's total assets may be invested in the international markets of Argentina, Australia, Austria, Belgium, Brazil, Chile, China, Colombia, Denmark, Finland, France, Germany, Greece, Hong Kong, India, Indonesia, Ireland, Italy, Japan, Luxembourg, Malaysia, Mexico, Netherlands, New Zealand, Norway, Peru, Philippines, Portugal, Singapore, South Africa, South Korea, Spain, Sweden, Switzerland, Taiwan, Thailand, Turkey, the United Kingdom and Venezuela. Such securities must be actively traded in a public market and be of the same kinds, classes and investment grades otherwise eligible for investment. T.C.A., Section 8-37-104(a)(3).

Foreign Currency Hedging

The System may engage in forward contracts to hedge the foreign currency exposure of the fund under the following guidelines:

1. The overall strategy will be a tactical defense designed to reduce risk and protect the System's international portfolio from a strong dollar.
2. The foreign currency exposure will be hedged by selling and purchasing currency using only forward contracts.
3. The allowable currencies for hedging purposes are limited to the currencies of those countries authorized pursuant to this policy.
4. Portfolio currencies may be hedged no more than 80% of international portfolio exposure for any given currency based on market value.
5. Portfolio currencies may be sold for U.S. dollars only and not for another portfolio currency.
6. Hedging will be conducted through the System's custodial bank and a few of the highest quality money center banks and brokerage firms. T.C.A., Section 8-37-104(a)(5).

Canadian Investments

The System may purchase Canadian securities which are actively traded in a public market provided they are substantially of the same kinds, classes and investment grades as those otherwise eligible for investment. Such investments shall not be subject to the 15% restriction imposed on international investments.

Real Estate

Introduction

The following is the Real Estate Investment Policy ("Real Estate Investment Policy") which is one of several documents that guide the planning, implementation and monitoring of the Tennessee Consolidated Retirement System's ("TCRS") real estate investment program. These documents include this Real Estate Investment Policy, the Real Estate Investment Guidelines and the Investment Plan. In addition, the real estate portfolio will be reviewed and monitored quarterly through the Performance Measurement Report.

The Real Estate Investment Policy sets forth long-term objectives and policies for investment and management of the asset class of real estate. The objectives, benchmark returns and risk management policies are applicable to equity oriented investments in real estate.

In order to meet the objectives outlined herein, the Staff, with the assistance of the Consultant, will be responsible for the development of the Real Estate Investment Guidelines (the "Guidelines"). The Guidelines will include procedures and guidelines for reviewing, selecting and overseeing real estate investment advisors; reviewing and analyzing acquisition and disposition proposals; overseeing the asset management of the portfolio; and reviewing the performance of the investments made on behalf of TCRS. The Guidelines will be in compliance with the Real Estate Investment Policy and will be reviewed and administered by the Treasurer. In the event of any conflict between the Guidelines and this Real Estate Investment Policy, the Real Estate Investment Policy shall prevail.

The Investment Plan is the tactical plan designed to implement the Real Estate Investment Policy and Guidelines. The Investment Plan will contain specific investment recommendations for the ensuing year to govern the

investment activity of the real estate portfolio. The Investment Plan will be reviewed periodically by Staff. The Investment Plan will be in compliance with the Real Estate Investment Policy and the Guidelines and will be reviewed and approved by the Treasurer. In the event of any conflict between the Investment Plan and this Real Estate Investment Policy, the Real Estate Investment Policy shall prevail.

Reference: Tennessee Code Annotated Section 8-37-104(a)(9).

Definitions

The following definitions are used hereafter with respect to participants involved in TCRS:

<u>Term</u>	<u>Definition</u>
TCRS	The Tennessee Consolidated Retirement System
Board	The Board of Trustees of TCRS, including its Investment Committee. The Investment Committee is comprised of members of the Board. The Board is ultimately responsible for the approval of the establishment of real estate portfolio objectives, policies and procedures; the review of the real estate portfolio performance; and the compliance of the real estate portfolio with objectives and policies set forth herein and in the Investment Plan.
Treasurer	The State Treasurer of Tennessee, to whom the implementation of the Real Estate Investment Policy has been delegated by the Board.
IAC	The Investment Advisory Council ("IAC") will assist the Treasurer and Staff by providing advice and recommendations on the most appropriate short, intermediate and long-term real estate investment strategy for TCRS.
Director	The Director of TCRS, who is responsible for the administration and management of TCRS.
Staff	The Staff is comprised of the Chief Investment Officer ("CIO"), Director of Real Estate ("DRE") and such other staff maintained to effectively manage the assets of TCRS. Staff is responsible on a day to day basis for the management of TCRS's investment activities, including those related to real estate, as further defined in the Guidelines.
Advisor(s)	Real estate investment advisors to be selected to locate, evaluate, acquire, manage and dispose of real estate investments for TCRS.
Consultant	A firm with substantial experience in providing institutional real estate consulting services selected by TCRS to assist TCRS in the establishment of objectives, policies and procedures and with the ongoing performance reporting and supervision of the Advisors in connection with TCRS.

Portfolio Objectives

1. Introduction

It is anticipated that, over the long term, inclusion of equity oriented real estate investments will enhance the risk/return characteristics of TCRS. The purpose of this Real Estate Investment Policy is to set forth the objectives and investment policies for investment in the asset class of equity real estate.

2. Asset Allocation

The TCRS allocation to the asset class of real estate is limited such that no investment may be acquired which would, at the time of acquisition, cause the aggregate market value of the TCRS real estate investments to exceed more than five percent (5%) of the market value of the total assets of TCRS.

3. Role of Real Estate

The role of real estate is to diversify TCRS's total investment portfolio and supplement the total return of the portfolio, which is comprised predominately of fixed income and equity assets. Real estate is expected to provide competitive, stable risk adjusted returns relative to other asset classes. A secondary role of real estate is to provide an inflation hedge.

4. Investment Philosophy

Investment decisions regarding the real estate portfolio should be primarily guided by the following objectives: (i) maximize long term total cash returns; (ii) achieve a total return competitive with other asset classes; and (iii) maintain a broad diversification of assets. Controlling risk in the real estate portfolio is equally as important as seeking higher returns. TCRS will follow prudent risk management policies that will seek to manage risk through control over the investment process and investment vehicles and ensure prudent diversification of assets, locations and investment advisors.

5. Benchmark Returns

The benchmark return for the Core real estate portfolio (as hereafter defined) is to provide a total return equal to 200 to 400 basis points above ten (10) year Treasury securities measured over rolling five (5) year periods. Secondary portfolio benchmarks will be established for each property type and investment category to reflect the composition of the TCRS real estate portfolio.

6. Investment Categories

Traditionally, equity real estate investments have been categorized by the risk and return features of the underlying real estate assets. TCRS recognizes three investment categories: Core investments (operating and substantially leased properties); Non-core investments (all other types of investments); and publicly traded real estate investment trusts ("REITs"). The Core and Non-core investment categories are private market investments, and possess different return and risk attributes than the publicly-traded REITs.

These categories are defined below:

a. *Private Core ("Core") Investments*

These investments are operating and substantially leased (i.e., 80% or greater leased at time of acquisition) institutional quality, well located assets in the traditional property types: office, apartment, retail, and industrial. These properties generally offer relatively high current income returns and as a result a greater predictability of returns. The income component typically represents a majority of the expected total return of Core investments. These investments are of comparatively low risk and provide a stable foundation for the TCRS real estate portfolio.

b. *Non-Core ("Non-core") Investments*

Non-core investments are broadly defined to cover a variety of risk and return relationships, property types and investment vehicles. Non-core investments offer TCRS the opportunity to obtain higher risk adjusted returns arising from the relatively inefficient real estate markets or real estate capital market imbalances. Non-core investments generally possess higher risk and expected return attributes than Core investments. Non-core investments should provide expected returns in the range of 75 to 400 basis points higher than Core investments, and should provide returns commensurate with the risks.

Risk attributes which may be present include higher property level risk (leasing, renovation, development or repositioning required); a degree of business or operating risk (e.g., hotels, senior housing or investments in real estate operating companies); or non-traditional formats or properties (e.g., distressed assets, international investing, private to public market arbitrage activities).

c. *Public Market REITs*

The public market equity component consists of REITs and other real estate related companies that are publicly traded (collectively referred to as "REITs"). Public REITs currently do not provide the same diversification or inflation hedging attributes of private equity real estate. However, REITs do provide the potential for greater flexibility due to greater liquidity than private equity real estate. In addition, public REITs may provide a vehicle for TCRS to gain exposure to (i) Core property types which may not be available to TCRS under this Real Estate Investment Policy (e.g., large Central Business District office buildings and regional malls, which is due to their size and correspondingly large purchase price), (ii) other non-traditional property types, or (iii) otherwise complement the Portfolio.

7. Targeted Portfolio Composition

All percentages and limits herein are based on the total real estate allocation. The real estate allocation currently is limited such that no investment may be acquired which would, at the time of acquisition, cause the market value of the total real estate investments to exceed 5% of the market value of the total TCRS assets. In light of the role of real estate in the TCRS portfolio, the initial targeted portfolio composition is relatively low risk. Core investments shall comprise from 80% to 100% of the total real estate allocation in order to create a portfolio comprised of relatively stable, low risk, income-producing investments. Public REITs may comprise from 0% to 20% of the total real estate allocation. It is anticipated that investments in public REITs may be made after the initial funding of the Core portfolio.

As the Core portfolio is created, and if market conditions warrant, TCRS may make Non-core real estate investments to enhance the real estate portfolio's expected returns or its diversification. Investments in Non-core properties will be subject to Board approval.

8. Co-Investments and Direct Investments

TCRS prefers to invest utilizing separate account investment structures (rather than commingled fund account structures) because of the greater control separate accounts provide over the decisions in connection with the ownership of the underlying real estate assets. Such investments may be made through co-investments with comparable institutional investors ("Co-Investments") or a separate account where TCRS is the only institutional investor ("Direct Investments"). All Co-Investments and Direct Investments will be non-discretionary (i.e., TCRS will retain the control of its rights with respect to acquisition, disposition and other major asset management and financing decisions).

Staff shall review all proposed acquisitions and dispositions to ensure compliance with the Real Estate Investment Policy, Investment Plan and Guidelines. Staff intends to present proposed investments and dispositions to the IAC for its review and comment prior to presentation to the Investment Committee to request final approval. Each Advisor shall be required to make real estate investment recommendations consistent with this Real Estate Investment Policy and applicable investment criteria determined by Staff. These criteria shall be set forth in an Advisor Investment Plan prepared by the Advisor and reviewed and approved by Staff.

In addition, Staff shall conduct a review and approve the annual budget and management plan for real estate operations prepared by the Advisor for all Co-Investments and Direct Investments. Management decisions consistent with the approved budget are delegated to the Advisor. The Staff shall be responsible for monitoring the Advisors through monthly, quarterly and annual reporting requirements. The Staff shall be responsible for overseeing the Advisors to ensure they comply with the Real Estate Investment Policy and Investment Plan and execute their duties consistent with institutional real estate industry standards.

9. Public REITs

TCRS may invest in public REITs up to 1.0% of the market value of TCRS' total assets, measured at the time of acquisition. It is anticipated TCRS will invest in public REITs to obtain exposure to certain property types or operators that complement Co-Investments or Direct Investments. TCRS may also invest in public REITs that exhibit attractive pricing relative to comparable private Core Co-Investments or Direct Investments.

10. Compliance with Laws

TCRS will only consider investments that comply fully with all applicable federal, state and local laws and regulations, including all applicable environmental laws and regulations. The Guidelines specify that all prospective investments shall be evaluated with respect to environmental conditions and shall be made in full compliance with all applicable laws and regulations.

11. Legal

Where the interest of TCRS requires the use of outside legal counsel, Advisors may recommend to TCRS that such outside counsel be employed and may present to TCRS a list of outside counsel with the expertise to handle the problem or transaction at issue. Any such recommendation shall be accompanied by the Advisor's reasons for using outside counsel and the list of such outside counsel shall be accompanied by

each of such counsel's qualifications and experience in handling matters of the type for which they are recommended to be employed. The selection of outside counsel shall be made by the Treasurer in consultation with Staff and the Counsel for TCRS and with the approval of the Attorney General. The Treasurer, in consultation with Staff and the Advisor, shall be responsible for oversight and review of outside counsel, including billing and performance, and shall have sole authority to retain or replace outside counsel.

Risk Management Policies

There are numerous investment risks associated with real estate, including the risk that the actual income and total return may vary from the expected or projected return targets. TCRS shall manage this investment risk by implementing the following policies:

1. Institutional Quality

A proposed investment must exhibit institutional quality, which is defined as similar, in risk and quality, to investments traditionally made by institutions (e.g., pension funds and insurance companies). Institutional quality investments are investments providing long-term stable income returns and are typically located in stable and diversified economic markets with appropriate supply and demand balance, or demonstrable evidence of projected growth in demand and constraints on supply, evidencing high quality design and construction and are in a competitive position within the immediate market area of such investment.

2. Investment Advisory Services

a. Fiduciary Duty Standard of Care

All investments shall be analyzed and due diligence performed, managed and disposed of, if necessary, by a qualified investment real estate advisor which has an established, successful record of providing advisory services to institutions and is deemed able to deliver similar services in the future ("Advisor"). Although TCRS as a state pension plan is not subject to the Employee Retirement Income Security Act of 1974, as amended ("ERISA"), it is the intent of TCRS that an Advisor shall act as a "fiduciary" to TCRS as that term is defined in Section 3(21)A of ERISA and as that term is otherwise judicially interpreted, and shall discharge its duties to TCRS accordingly.

b. Advisor Characteristics

Unless otherwise determined by the Board and/or Staff, an Advisor shall exhibit the following characteristics:

- 1) is registered as an investment advisor under the Investment Advisor Act of 1940, or is exempt from registration under the regulations promulgated thereunder;
- 2) the responsible personnel of such Advisor shall have at least five (5) years of institutional real estate experience;
- 3) has a minimum of \$250 million of institutional real estate assets under management;
- 4) no single client (including any affiliates) shall control or have authority over more than fifty percent (50%) of the market value of the Advisor's total net assets under management at the time of selection and approval by TCRS;
- 5) has a proven and verifiable record of competitive performance returns; and
- 6) has a proven and verifiable record of well-articulated and executed real estate investment strategies.

3. Diversification

Over the longer term, the equity real estate portfolio shall be diversified by property type, economic/geographic location and Advisor with the purpose of reducing portfolio risk by minimizing the impact any investment or Advisor may have on the total return of the real estate portfolio. The following diversification

criteria shall be reviewed on a periodic basis, not less than annually, in connection with the review of the Investment Plan and the Advisor Investment Plans.

a. *Property Type*

TCRS shall invest primarily in traditional, institutional grade office, retail, industrial and multifamily properties. The Core investments shall be limited to these property types; TCRS may acquire other non-traditional property types when making investments in the Non-core and Public REIT categories, particularly when TCRS is investing in collective investment vehicles and does not control the purchase decision.

Due to the relatively inefficient markets for the real estate asset class, statistical analysis yields limited benefits in establishing appropriate property type diversification targets, as the results of such analyses often are time dependent. However, to avoid concentrations within certain property types and to ensure prudent diversification over the longer time periods, no investment may be made which would cause, at the time of acquisition, the market value of TCRS holdings in any single traditional property type to exceed 2.0% of the market value of TCRS' total assets.

b. *Location*

Properties shall be distributed by location to attain geographic and economic diversification. Over the long-term, economic diversification should result in a real estate portfolio that is sensitive to the diversification of the national U.S. real estate market. However, TCRS recognizes this is also dynamic, and thus this Real Estate Investment Policy permits an emphasis, or large allocation for, regions that are projected to have greatest economic expansion within the applicable projection period. The diversification limitations set forth herein are intended to allow TCRS and its Advisors the flexibility to capture such opportunities without violating the Real Estate Investment Policy and prudent diversification objectives.

TCRS shall limit real estate investments such that at the time of acquisition, no more than 1.0% of the market value of TCRS' total assets shall be invested in any single Standard Metropolitan Statistical Area ("SMSA").

The Staff shall select specific target locations for proposed investments based on recommendations by Advisors. The Advisors shall make recommendations based on research substantiating positive economic growth during the life of the investment, a diversified economic base, geographic or regulatory supply constraints and tenant demand, among other factors. All investments shall be limited to properties located in the United States.

In any event, TCRS cannot acquire real estate located in the State of Tennessee unless such acquisition is in the shares or interests of a regulated investment company, mutual fund, common trust fund, investment partnership, real estate investment trust, or similar organizations or vehicles which are commingled and investment determinations as to which real estate assets to purchase or acquire are made by the investment sponsor or investment manager, or persons other than TCRS.

c. *Investment Advisor*

TCRS shall limit its exposure to any single Advisor to mitigate potential advisor or firm specific risk. No Advisor, at the time of an acquisition, shall be permitted to asset manage more than 2.0% of the market value of TCRS' total assets.

4. *Investment Vehicles*

Investments may be made by means of any legally permissible investment vehicles, subject to Tennessee laws, including separate account Co-Investments and Direct Investments. Other investment vehicles may include group trusts, commingled funds, private and public REIT's, real estate operating companies ("REOCs"), partnerships and corporations.

TCRS expects that it will make a substantial majority of its real estate investments, in particular its Core investments, through Co-Investments or Direct Investments presented by selected Advisors. Direct Investments made through a separate account structure provide greater control over the investment

decisions related to the underlying real estate assets and greater flexibility in the management of the investment.

TCRS will consider Co-Investments with comparable institutional investors with similar investment objectives, but it recognizes Co-Investments provide a lesser degree of control or flexibility over the investment decisions related to the underlying real estate assets or the disposition of its real estate investments. To mitigate this factor, TCRS will seek to co-invest with only one or two other institutional investors. Co-Investments may enhance portfolio diversification by enabling TCRS to acquire a greater number of real estate investments. Co-Investments also may be attractive to TCRS in order to gain exposure to larger Core property types that may not be directly available to TCRS under this Real Estate Investment Policy (e.g., large Central Business District office buildings and regional malls).

TCRS may own such investments in its own name or, to the extent permitted by law, through title holding entities, and may transfer real estate properties from direct ownership to a title holding entity, or from a title holding entity to direct ownership, during the course of the holding period of the investment.

TCRS may seek investments through collective investment vehicles, such as commingled funds, including partnerships, group trusts, limited liability companies and other forms of pooled investments, to the extent permitted by law. TCRS may make such investments directly or through formal and informal secondary markets. In order to mitigate the higher levels of expected risk, TCRS may utilize collective investment vehicles for Non-core investments.

5. Investment Size

At the time of acquisition, the minimum investment size for an individual property is \$5 million, unless the investment is part of an accumulation strategy of multiple properties in a given market or submarket. The maximum investment size in any one property shall be limited to one-half of one percent (0.5%) of the market value of TCRS' total assets.

6. Guidelines

Staff, with the assistance of Consultant, shall prepare comprehensive investment and asset management guidelines and procedures to monitor the investment, management and disposition of real estate investments by Advisors on behalf of TCRS. The Guidelines will include guidelines and procedures with respect to: (i) making new investments, including the preparation and review of Investment Proposal Packages and annual Advisor investment plans; conducting site inspections, and other acquisition related procedures; (ii) asset management, including the preparation and review of annual budget and management plans for real estate operations, quarterly and annual reports and oversight reviews; (iii) industry standard financial and accounting policies and procedures; and (iv) dispositions analyses, including preparation and review of annual hold/sell analyses for all real estate investments. The Treasurer shall review and administer the Guidelines.

7. Property Valuations

All Co-Investments and Direct Investments shall be valued by a qualified independent appraiser(s) who are Members of the Appraisal Institute ("MAI") at regular intervals, and not less frequently than every three years. Appraiser selection or approval with respect to all Co-Investments and Direct Investments will be determined by Staff based on organizational qualifications, capabilities, personnel, references and resources. Appraisers shall be rotated as determined by the Staff. Advisors will internally estimate the market value of each Direct Investment or Co-Investment in those years independent appraisals are not performed. The Advisor's valuation will be used for performance measurement purposes.

8. Environmental Conditions

TCRS will only consider investments that fully comply with all local, state and federal governmental regulations regarding acceptable levels of exposure to environmental contaminants that have or may potentially impair public safety. Advisors will engage third parties to perform all necessary studies on all proposed investments to confirm that the real estate to be acquired is either free of asbestos, toxic wastes and or other hazardous waste materials at the site following reviews conducted in compliance with the Guidelines, or where such contaminants are present, evidence that the contaminants have been contained and are being

managed or remediated in accordance with all local, state, federal government statutes, laws, regulations and standards.

9. Engineering; Structural; Architectural.

In addition to environmental reviews in compliance with the Guidelines, Advisors shall ensure that comprehensive engineering, structural and architectural reviews of investments have been completed by qualified professionals in compliance with the Guidelines, with satisfactory results.

10. Property Management

Direct or supervisory property management is acceptable. TCRS shall favor Advisors having clearly articulated and successfully implemented property management strategies. The objective is to ensure the most qualified property management services are provided to each TCRS real estate investment given its location and property type. In addition, the fees paid by TCRS for property management services (to a third party or an affiliate) shall be at a rate consistent with the markets rates for comparable property management firms in that market for properties of like kind and quality. All property management agreements will contain a clause that permits TCRS to terminate without cause upon no more than thirty (30) calendar days' notice.

11. Lease Structure

TCRS shall seek an appropriate mix of single and multi-tenanted properties, with staggered lease termination dates in order to diversify the lease termination dates of the entire portfolio. Multi-tenanted properties with staggered lease termination dates are preferred to properties with an undue concentration of similar lease termination dates, unless such concentration further diversifies the lease termination dates of the entire real estate portfolio. Single tenant properties with relatively long (preferably greater than seven years) leases will be considered for investment if: the tenant is a creditworthy tenant; the lease will provide lease structure diversification within the total real estate portfolio; the tenant is financially sound; and, if appropriate, the property can be converted to multi-tenant use at a reasonable cost.

12. Insurance Requirements

Real estate investment advisory agreements between TCRS and its Advisors shall require that appropriate types and levels of property and liability insurance is maintained and overseen at all times by the Advisor.

13. Prudent Expert Standard

An Advisor's acquisition, management and disposition of real estate investments will be guided by the "prudent expert" standard, which shall be the standard of care required of Advisors and set forth in real estate investment advisory contracts with TCRS. An equity real estate investment shall be made only if said investment was evaluated and recommended by an Advisor.

14. Registration Procedure

TCRS will engage multiple Advisors to recommend an investment in real estate. In order to enable the Advisors to obtain more competitive pricing structures for acquisitions, and to avoid overbidding on behalf of TCRS during property acquisitions, TCRS will implement a registration procedure. The Staff will permit each Advisor to register up to eight transactions at any one time. Upon acceptance of a registration, the Advisor shall be TCRS's exclusive representative relative to the registered transaction. Staff will provide Advisors with notice in advance of any changes to the registration procedure.

15. Investment Plan

The Investment Plan will set forth investment activities consistent with the Real Estate Investment Policy. The Investment Plan shall serve as the tactical implementation of the Real Estate Investment Policy and endeavor to move TCRS toward its target real estate allocation in a prudent manner. Investment activity should adhere to the policies and procedures set forth herein.

T.C.A., Section 56-3-305(5).

THE BOARD OF TRUSTEES OF THE TENNESSEE CONSOLIDATED RETIREMENT SYSTEM
ADOPTED THIS REVISED POLICY AT ITS BOARD MEETING ON MARCH 29, 2001.

A handwritten signature in cursive script that reads "Steve Adams". The signature is written in black ink and is positioned above the printed name.

**STEVE ADAMS, CHAIRMAN
BOARD OF TRUSTEES
TENNESSEE CONSOLIDATED RETIREMENT SYSTEM**