

UNIVERSITY OF HOUSTON SYSTEM
Endowment Management Committee Meeting
Wednesday, November 4, 2009
2:30 p.m. – 4:30 p.m.

AGENDA

UNIVERSITY OF HOUSTON SYSTEM ENDOWMENT MANAGEMENT COMMITTEE MEETING

REVISED

DATE: Wednesday, November 4, 2009

TIME: 2:30 p.m.

PLACE: University of Houston
Athletics/Alumni Center
Melcher Board Room 100B
3100 Cullen Boulevard
Houston, Texas 77204

Chair: Jarvis V. Hollingsworth

Vice Chair: Carroll Robertson Ray

Members: Jim P. Wise
Welcome W. Wilson, Sr., Ex Officio

Advisory

Members: Michael J. Cemo
J. Christopher Jones

ENDOWMENT MANAGEMENT COMMITTEE

- A. Call to Order
- B. Report on Fundraising and Use of Institutional Advancement Assessment Fee – UH System EM – 1
- Action:** Information
- C. Reports and Recommendations Regarding Endowed and Non-Endowed Assets and Presentation by an Investment Manager – UH System EM – 2
- Action:** Information and/or Approval
- D. Report on a Plan for Increasing the Internal and External Resources to the Endowment – UH System EM – 3
- Action:** Information and/or Approval

- E. Approve an amendment to the existing contract with Cambridge Associates to increase their level of service offering from general investment consulting to comprehensive advisory services and modify the fee structure from a fixed price per year to basis points of total assets – UH System

EM – 4

Action: Approval

- F. Adjourn

**UNIVERSITY OF HOUSTON SYSTEM
BOARD OF REGENTS AGENDA**

COMMITTEE: Endowment Management

ITEM: Report on Fundraising and Use of Institutional Advancement Assessment Fee

DATE PREVIOUSLY SUBMITTED:

SUMMARY:

The Committee will receive a report on fundraising at the University of Houston System and discuss the role and use of the Institutional Advancement fee assessment that is charged against the endowment fund.

FISCAL NOTE:

**SUPPORTING
DOCUMENTATION:**

ACTION REQUESTED: Information

COMPONENT: University of Houston System

PRESIDENT



DATE

10/16/09

EXECUTIVE VICE CHANCELLOR

Carl Carlucci

DATE



CHANCELLOR

Renu Khator

DATE

10-21-09

**UNIVERSITY OF HOUSTON SYSTEM
BOARD OF REGENTS AGENDA**

COMMITTEE: Endowment Management

ITEM: Reports and Recommendations Regarding Endowed and
Non-Endowed Assets and Presentation by an Investment Manager

**DATE PREVIOUSLY
SUBMITTED:**

SUMMARY: The Committee will receive reports and recommendations from its investment consultant, Cambridge Associates, discuss investment strategies for the System's Endowment Fund and Non-Endowed Funds, and receive a presentation from Smith Asset Management, one of the endowment fund's large cap equity investment managers.

FISCAL NOTE:

**SUPPORTING
DOCUMENTATION:**

ACTION REQUESTED: Information and/or Approval

COMPONENT: University of Houston System

PRESIDENT



EXECUTIVE VICE CHANCELLOR

Carl Carlucci

DATE

10/16/09

DATE

CHANCELLOR



Renu Khator

10-21-09

DATE

**UNIVERSITY OF HOUSTON SYSTEM
BOARD OF REGENTS AGENDA**

COMMITTEE: Endowment Management

ITEM: Report on a Plan for Increasing the Internal and External Resources to the Endowment

**DATE PREVIOUSLY
SUBMITTED:**

SUMMARY: The Committee will receive a report on a plan for increasing the internal and external resources to the endowment including establishing a separate Office of Investments dedicated to endowment management. The transition plan consists of 3 options: option 1 is a 1-year plan, option 2 is a 3-year plan, and option 3 is a 5-year plan. Increasing the level of resources dedicated to endowment management will allow us to reach our long-term asset allocation targets more quickly and increase performance of the fund over time.

FISCAL NOTE:

**SUPPORTING
DOCUMENTATION:**

ACTION REQUESTED: Information and/or Approval

COMPONENT: University of Houston System

PRESIDENT



DATE

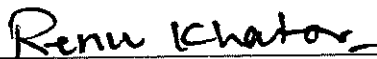
EXECUTIVE VICE CHANCELLOR

Carl Carlucci

DATE

10/10/09

CHANCELLOR



Renu Khator

DATE

10-21-09

**UNIVERSITY OF HOUSTON SYSTEM
BOARD OF REGENTS AGENDA**

COMMITTEE: Endowment Management

ITEM: Approval is requested to delegate authority to the Chancellor to negotiate and execute an amendment to the existing contract with Cambridge Associates to increase their level of service offering from general investment consulting to comprehensive advisory services and modify the fee structure from a fixed price per year to basis points of total assets.

DATE PREVIOUSLY SUBMITTED: August 2009

SUMMARY: Approval is requested to delegate authority to the Chancellor to negotiate and execute an amendment to the existing contract with Cambridge Associates to increase their level of service offering from general investment consulting to comprehensive advisory services and modify the fee structure from a fixed price per year to basis points of total assets. Under the comprehensive advisory arrangement, the endowment would have unlimited access to Cambridge resources, and we would have a broader array of asset class consultants, researchers, and analysts at our disposal to build out direct investments in the marketable and non-marketable alternative asset classes. Increasing the level of resources dedicated to endowment management will allow us to reach our long-term asset allocation targets more quickly and increase performance of the fund over time. This arrangement would also result in savings from the elimination of the additional fund-of-funds fee structure. The endowment fund would save the \$32,544 annually based on the current allocation to alternative assets. When the alternative assets portfolio is built out to its long-term target allocation under the comprehensive advisory arrangement, the endowment would save \$453,478 annually compared to the existing cost structure.

FISCAL NOTE: Estimated annual fee: \$830 thousand based on Cambridge annual fee equal to 20 bps of the market value of total assets for first \$500 million with a minimum annual fee of \$200 thousand.

SUPPORTING DOCUMENTATION: Summary of existing level of service versus comprehensive advisory services and cost analysis

ACTION REQUESTED: Approval

COMPONENT: University of Houston System

PRESIDENT



EXECUTIVE VICE CHANCELLOR

Carl Carlucci

DATE

DATE

10/16/09

CHANCELLOR



Renu Khator

DATE

10-21-09

CAMBRIDGE ASSOCIATES PROPOSED SERVICE AGREEMENT

In light of rapidly shifting market conditions and an increasingly uncertain economic environment, the Endowment Management Committee, along with staff and Cambridge Associates, have recognized that more frequent and more proactive monitoring of the University's Endowment is warranted in the current environment. Furthermore, the Endowment Management Committee has made clear its desire to bring the allocation to non-marketable alternatives (or private equity, broadly defined) up to the long-term target of 10%. It has also been noted that, given the recent run-up in valuations and the bleak economic outlook, the potential for strong returns from public equities may be diminished. It has been suggested that the Endowment may be better served by placing capital with managers that have a broader tool set, who can either preserve capital in difficult markets or even generate a modest profit regardless of market direction. This might include hedged equity or absolute return managers.

As currently designed, however, the Cambridge Associates contract is somewhat restricted in the resources available to accomplish these goals as efficiently as possible. Under the terms of the current contract:

- Manager searches are limited to either traditional asset classes such as equities or bonds, or to funds-of-funds for hedge funds and private equity managers. Funds-of-funds add an additional layer of fees on top of those charged by the underlying managers.
- Performance measurement is limited to quarterly reporting.
- Attendance by a team of one to two generalist consultants is limited to six meetings per year.
- Consulting time outside of Endowment Management Committee meetings is limited to 12 hours per year.
- *Not* included in the current contract are:
 - Searches for and monitoring of individual alternative investment managers (hedge funds or private equity).
 - Monthly performance reporting.
 - Conference calls or any other meetings outside of regularly scheduled Endowment Management Committee meetings.
 - Administrative assistance with investment contracts and documentation.
 - Consulting time beyond the 12-hour limit, which is exceeded each year.

Over the past several months, staff has been in discussions with Cambridge to determine what level of service would be necessary to facilitate more proactive management of the Endowment, including a more direct approach to building out private equity and hedge fund portfolios.

Cambridge has suggested that the University convert to its Comprehensive Advisory Service, which will not only provide those resources but will, in the end, actually save the University money—net of any increase in fees—by eliminating the additional layer of fund-of-funds fees for alternative managers. Under the terms of the proposed service agreement, Cambridge would provide:

Unlimited access to all of the firm’s resources, including:

- A team of up to three generalist consultants, with attendance at an unlimited number of in-person meetings or conference calls.
- Monthly and quarterly performance reporting.
- Access to all Cambridge research, including extensive due diligence reports on select alternative managers.
- Unlimited consulting time.
- A dedicated Non-Marketable Alternative Specialist consultant. This Specialist will help build out the Endowment’s 10% private equity allocation through direct investments in individual, top-quality managers, diversified by year, strategy, market, geography and manager. This will eliminate the need to pay an additional level of fund-of-fund fees, and will offer the University exposure to only the highest-quality managers.
- A dedicated Marketable Alternative Specialist Consultant, who will help construct a customized hedge fund portfolio of direct investments in individual, top-flight hedge fund managers. Again, this will eliminate the fund-of-fund fees the endowment is currently paying, as well as control the quality of managers included in the program.
- Administrative assistance with gathering and completing the necessary documents for all investments, as well as tracking document flow and monitoring the custodian’s receipt and disbursement of cash with respect to new and terminated investments.
- Upon request, Cambridge will provide audit support materials relating to the endowment’s alternative investment assets that describe Cambridge’s initial and ongoing due diligence process in detail and Cambridge’s valuation tracking process for Marketable Alternative Investment Assets.

The following page illustrates the potential savings from eliminating fund-of-funds fees from both the hedge fund and private equity portfolios.

Table 1 represents the cost savings available to the endowment immediately due to eliminating hedge fund-of-fund fees using the endowment’s existing hedge fund portfolio and cost structure. Non-Marketable Alternative fund-of-fund fees are not taken into account here due to the small current allocation and to the fact that existing partnerships will not be wound down for a few years. Even excluding private equity fund-of-fund fees, the immediate net savings to the endowment is \$32,544.

Table 2 represents the net savings available to the endowment taking into account the private equity program. This analysis assumes a 10% allocation to private equity, and essentially compares the cost savings available by making direct investments in individual private equity

managers through Cambridge's Comprehensive Advisory Service versus using funds-of-funds. Under this scenario, the total net savings to the endowment by converting to the Comprehensive Advisory Service is over \$453,478.

In sum, the proposed service agreement represents not only reduces overall expenses due to the elimination of fund-of-fund fees but in provides a substantial increase in personnel, time, research, and administrative support available to the University with the expectation of improved returns.

Table 1
Comprehensive Advisory Service
Short-Term Annual Cost/Benefit
Excluding Non-Marketable Alternatives

Proposed Comprehensive Advisory Services ¹	\$829,381
Less current bundled services contract	(219,500)
Less current Marketable Alternative Asset fund-of-funds fees ²	(642,425)
Net Annual Savings / (Cost)	\$32,544

Table 2
Comprehensive Advisory Service
Pro Forma Annual Cost/Benefit
Including 10% Allocation to Non-Marketable Alternatives

Proposed Comprehensive Advisory Services ¹	\$829,381
Less current bundled services contract	(219,500)
Less current Marketable Alternative Asset fund-of-funds fees ²	(642,425)
Less estimated Non-Marketable Alternative Asset Fund-of-Funds fees ³	(420,934)
Net Annual Savings / (Cost)	\$453,478

Table 3
Assumptions

Marketable Alternatives	Market Value	Fee	Annual Cost
Crestline	21,592,307	1.25%	269,904
Barlow Partners	37,252,079	1.00%	372,521
Subtotal - MALT			642,425
Non-Marketable Alternatives	42,093,406	1.00%	420,934

¹Based on an annual fee of 20 bps and a market value of \$421M (net of \$15.6M in payout)

²Please refer to assumptions in Table 3 above. Marketable Alternatives refer to hedge funds.

³Total non-marketable alternative fund-of-funds fees assumed to be 1% and based on a 10% allocation. Non-marketable alternatives refer to private equity.