MINUTES
UNIVERSITY OF HOUSTON SYSTEM
BOARD OF REGENTS
ENDOWMENT MANAGEMENT COMMITTEE

Thursday, February 19, 2015 - The members of Endowment Management Committee of the University of Houston System convened at 9:05 a.m. on Thursday, February 19, 2015, at the University of Houston, Student Center Ballroom, Room 210, Second Floor, 4800 Calhoun Road, Houston, Texas, with the following members participating:

ATTENDANCE –

Present	Member(s) Absent
Jarvis V. Hollingsworth, Chair	Tilman J. Fertitta, Ex Officio
Roger F. Welder, Vice Chair	
Durga D. Agrawal, Regent	Non-Member(s) Present
Spencer D. Armour, III, Member	Paula M. Mendoza, Regent
Beth Madison, Member	Peter K. Taaffe, Regent
	Welcome W. Wilson, Jr., Regent
	Asit R. Shah, Student Regent, non-voting

In accordance with a notice being timely posted with the Secretary of State and there being a quorum present, the Chair of the Committee, Jarvis V. Hollingsworth, called the meeting to order and moved to the first item requiring committee action, the approval of the minutes from the Endowment Management Committee meeting held on November 14, 2014.

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AGENDA ITEMS

Action Items

1. Approval of Minutes – Item B

   On motion of Regent Welder, seconded by Regent Armour, and by a unanimous vote of the committee members in attendance, the following minutes from the meeting listed below was approved:

   - November 14, 2014, Endowment Management Committee Meeting

Regent Hollingsworth stated there were seven (7) action items and four (4) informational items on the agenda for discussion. Four (4) representatives from Cambridge Associates were present at the meeting who presented several of the items listed on the agenda. It was also noted that after discussions and any recommendation(s) made from Cambridge Associates, a vote was called; and the recommendations from Cambridge Associates required committee approval only.

Following the approval of the minutes, Regent Hollingsworth moved to Item C on the agenda, a Report on External Audit Report – UH System Endowment Fund, Financial Statements and Independent Auditor's Report for FY2014 and 2013 – University of Houston System. Management – University of Houston System. Regent Hollingsworth asked Mr. Don Guyton, Chief Audit Executive to introduce this item.

Mr. Guyton stated that this item was the financial statements and independent auditor report for FY 2014 of the UH System Endowment Fund. The other supplemental information has been excluded from the Endowment Fund financial statements. This information included the schedule of noncurrent investments and the schedule of changes in net assets by Endowment. These schedules are on file in the Board of Regents' office with the complete set of financial statements. Mr. Raymond Bartlett, Associate Vice Chancellor of Finance was available to answer any questions on these statements as well as Mr. David Ellis, Executive Director for Financial Reporting. Mr. Greg Sissel, the BKD engagement partner made a presentation on these statements at the Audit and Compliance Committee meeting held later in the day. As noted in the financial statements, the Net Asset Value of the Endowment Fund as of August 31, 2014 was approximately $600 million. Mr. Bartlett had informed Mr. Guyton that the value had increased to $611 million as of December 31, 2014. It was noted that for future purposes, Regent Hollingsworth stated that a discussion within the Endowment Management Committee of the financial statements and independent auditor's report of the UH System Endowment Fund also take place in this committee as well as the Audit and Compliance Committee.

This item was presented for information only and required no committee action.

The next item addressed by the committee both for information and approval was Item D, Fundraising Campaign and Support Organization Update and Approval of the Fiscal Year 2015 University Advancement endowment assessment rate of 1.5% - University of Houston System. Regent Hollingsworth requested Ms. Eloise Dunn Stuhr, Vice Chancellor for University Advancement presented this item to the committee.

Ms. Stuhr stated she would address the assessment and how it relates to the money that has been raised for the Endowment over the past year and its comparison years; give an update on where we are with the support organizations; as well as an update on the silent phase of the capital campaign. Below is a brief summary of her comments.

- Last year, $132 million was raised of which $15.1 million of that amount went into the Endowment. The university is still in a period where we are gearing up for the fundraising very aggressively but not much of the money is going for Endowment. There are capital projects that are urgent needs as well as programmatic needs and so we expect this to continue to grow over the course of the next few years. The payback is still 3 to 1, which is very good and consistent from where we have been over the last few years.
- The assessment of the Endowment was $5.1 million.

Following Ms. Stuhr's presentation on the assessment, Regent Hollingsworth called for a motion to approve the FY2015 University Advancement endowment assessment rate of 1.5%.

On motion of Regent Agrawal, seconded by Regent Armour, and unanimously approved by the committee members in attendance, the FY2015 University Advancement endowment assessment rate of 1.5% was approved.

Ms. Stuhr continued her presentation concerning the support organizations. Over the course of the last two years, a current Memorandums of Understanding (MOU) has been filed for each of the support organizations. As part of the MOU, an annual review will be completed in the form of a survey which will be going out to all of the support organizations to see whether or not the System was working well for them. Ms. Stuhr stated that as part of the MOU she became an Ex Officio member of each of these support organizations. She does attend all of their meetings which allows for continued dialogue back and forth. Once the survey results are compiled, Ms. Stuhr stated she would share those results with the committee.

Ms. Stuhr addressed the progress on the capital campaign. The total amount received thus far is slightly above $400 million. We are not making specific projections as to where we will be when we do the public launch. We certainly want it to be the majority of the campaign goal. We have a number of initiatives that are e.g., building the base; getting people interested; doing a presidential tour; going to other cities other than Houston where we are engaging alums who have not systematically been engaged before (laying the ground work and again, all of this towards the deadline of Fall 2016 for a public announcement.

The remaining presentations addressed by Ms. Stuhr were for information only and required no committee action.

Dr. Carlucci moved to Item D., the <u>Report from Cambridge Associates regarding the UH System endowment and non-endowed portfolios – University of Houston System.</u> Dr. Carlucci has had conversations with Cambridge Associates and he has asked Cambridge to address manager selection at the meeting. Asset allocation was addressed and where the UH System should be. A NACUBO Common Fund Study was completed which compared us to our peers, as well as a performance comparison of the UHS to our peers, and it raises questions about performance, specifically in certain parts of the portfolio. Dr. Carlucci requested Mr. Hamilton Lee address these issues before the committee and below is a brief summary of his remarks.

The total portfolio performance relative to its two (2) benchmarks was discussed. The policy benchmark and the dynamic benchmark were addressed. The policy benchmark are the fixed target asset allocation weights multiplied by their respective indexes. The dynamic benchmark allows those weights to float so that it isolates manager performance in the portfolio; in other words, it takes away any difference in asset allocation and highlights manager performance.

Mr. Lee addressed short- and long- term performance. Over the course of the last year, short-term performance has been very disappointing. Cambridge takes that very seriously. It is not outside the realm of expectation for an actively managed portfolio, but Cambridge has done a review to drill down and understand what drove that performance and what Cambridge can do about it. The trailing one-year number for the University of Houston portfolio was up 1.6%, lagging both of the benchmarks by approximately 100-160 bps. Two reasons for this were mentioned:

1. Continued underperformance by the U.S. equity managers and aggregate those managers were under their benchmark by approximately 300 bps; and

2. Substantial underperformance relative to the benchmark of the marketable inflation hedge driven primarily by the tremendous drop in the price of oil in the second half of 2014.

If one were to look at the longer term performance over three- and five- years, performance has been strong both in absolute terms and relative to both of the benchmarks. Underperformance of this magnitude and/or outperformance of this magnitude is not outside of the realm of usual expectations for an actively managed portfolio.

An outline of the University of Houston's portfolio performance was discussed. Contributing factors to the 4thQ performance were:

- University of Houston returned -0.7% in the 4thQ amidst plunging commodity prices and regional economic and earnings growth differences;
- The continued run up of U.S. equity and overweight positioning has been beneficial, with the asset class returning +5.2% on an absolute basis; and
- Hedged equity, which gained +2.9% versus +0.9% for the benchmark, was also a strong contributor to overall performance thanks in part to several increases in implied volatility witnessed during the quarter.

Detractions from 4thQ performance were:

- Weak oil prices weighed heavily on commodities and natural resource equities. The marketable inflation hedge portfolio returned -12.6% for the quarter, though substantial gains to REITs (+14.3%) helped to offset losses elsewhere.
- Developed international equity and developing markets returned -3.0% and -5.3%, respectively, given diverging monetary policies and continued U.S. dollar appreciation.

The portfolio remains relatively in line with Near-Term Targets, with an overweight to hedge funds and underweights to private investments and the marketable inflation hedge allocation.

Global equities (+0.4%) ended the year on a positive note in the 4thQ, though this masked divergence across markets. U.S. equities (+4.9% outperformed developed peers (-3.6%), while equity returns in emerging market (-4.5%) reflected a healthy gain for Asia that was more than offset by losses elsewhere. Key stories for the quarter also included the roughly 40% plunge in oil prices and the ongoing ascendance of the U.S. dollar versus developed and developing currencies.

Mr. Lee addressed all issues and a lengthy discussion followed. Following the discussion, it was suggested that Cambridge review not only our performance against our peers in terms of return, but it would be beneficial to see our risk profile versus our peers. It may be that our U.S. equity managers have taken a more conservative stance. As we continue to move in the current marketplace it does appear that we are currently well positioned. Cambridge advises and makes recommendations to the Board and the Board makes asset allocation decision based on their recommendations, but the Board relies on these recommendations with respect to manager selection and this should be reviewed further.

Mr. Mark Dalton, from Cambridge, presented a Hedge Fund Update. He stated that Cambridge did not have any hedge fund recommendations for the committee to consider at this meeting, he did summarize the hedge fund program. The University of Houston's hedge fund program was designed to provide diversified “market-like” source of return at lower levels of risk over the long-term. For FY2014, the Hedge Fund Program returned 2.8%

Since its inception, the hedge fund allocation has outperformed the HFRI benchmark by 2.2% while achieving 67% of the return of global equities with approximately 38% of the volatility over the same time period.

What worked in the 4th quarter was mentioned as follows:
- SRS Partners, up 4.9%, outpaced the hedged equity composite benchmark by 2.0%, and was the strongest performer in Q4. Both the long and short book were additive up, 3.7% and 1.3%, respectively.
- A strong showing in December added to Sheffield’s 4th Q performance run, up 3.5%, and outpacing the hedged equity composite benchmark by 5 bps.

What did not work in the 4thQ:
- Mason had another tough quarter especially on the short side, and broken risk arbitrage deals such as AbbVie/Shire were costly. However, the team thinks the 2015 opportunity set is much improved and is focusing on commodities-based credit shorts.
- Davidson Kempner (DKI), down -1.4% in Q4, also struggled and underperformed the absolute return benchmark by -1.1%. Losses stemmed from the breakdown of the Shire deal, and their investments in the shipping space which DK noted is somewhat correlated to the energy industry.

Ms. Katherine Chu, from Cambridge, addressed private investments. Ms. Chu stated the University of Houston’s Private Investment (PI) program was still relatively immature; and in 2014, the University of Houston had committed $27.5 million to the PI program. Since its inception, the University’s PI program has returned 15.9%. The University approved increasing the long-term PI allocation from 17.5% to 25.0% of total assets. The University also approved an increase in the PI commitment pace to ~$40-$50 million per year (from ~ $25-$35 million per year at a 17.5% long-term target allocation).

US Venture Capital is overvalued and Cambridge advised to selectively commit to top-quality managers. Venture capital deal valuations have reached record levels, as funds have sharply accelerated the pace of both fund raising and investment. US Private Equity and European Private Equity are very overvalued, and it is important to very selectively commit to top-quality managers. Distressed Investing: Non-Control is overvalued. The opportunity in large defaulted credit is limited and managers appear to be selling into strength and holding cash. US Private Property, UK Private Property, Europe ex UK Private Property, and Private Oil, Gas, and Other Energy were all fairly valued, so it was advised to selectively commit to top-quality managers.

Prior to bringing the private investments to the committee, Mr. Lee presented a review of the non-endowed portfolio. Mr. Lee stated that as the liquidity reserve of the University, the primary objective of the non-endowed funds was to ensure the liquidity and safety of assets, with return being a tertiary objective. According to the non-endowed investment policy, the purpose of the fund is to “provide for liquidity to meet obligations as they come due.” Therefore, “safety of principal is a primary objective.” Given these objectives, the policy allocation of these funds is 50% in cash investments with a one-year horizon and 50% in a "liquidity" pool with a horizon of one to five years.

- The cash pool is invested in Invesco Prime Money Market Fund, Invesco Liquid Assets Money Market Fund, and Columbia Treasury Reserves. This pool includes short-term commercial paper, bank obligations, repos, government obligations, and other securities with a weighted average maturity of around 30 days.
- The liquidity pool is managed by J.P. Morgan.

While returns on safe, short-term investments are at historical lows, Cambridge believes the need for liquidity and asset preservation outweigh the need for strong return from these combined pools; and Cambridge believes that the non-endowed assets are appropriately invested at this time.

Mr. Lee commented on the recent SEC regulations governing money market funds. On July 25, 2014, the SEC voted in a set of long-debated reforms to the rules governing money market funds (MMFs). The reforms, which will take effect in 2016 to allow managers and investors time to adapt, are aimed at preventing a replay of the dangerous 2008 run on MMFs triggered when the Reserve Primary Fund "broke the buck." The principle change to a variable pricing framework is aimed at institutional funds with corporate-credit exposure. The effectiveness of these new rules will not be known until they are tested in a liquidity crisis. While the two-year implementation delay means UH need not take immediate action, Cambridge recommends the Non-Endowed Portfolio select a different "cash" vehicle and at the May meeting, the will recommend a government money market fund which are not part of this change in rules. The government fund will be more liquid; will certainly be considered higher credit quality; and the return to deferential between 0 and 0.0 is little.

Following Mr. Lee's presentation on the non-endowed portfolio, Dr. Carlucci stated that there were no recommended changes to Item F, the <u>Annual review and approval of the UH System Investment Policy for Non-Endowed Funds – UH System.</u>

On motion from Regent Welder, seconded by Regent Agrawal, and by a unanimous vote of the regents in attendance, the annual review and approval of the UH System Investment Policy for Non-Endowed Funds – UH System was approved with no changes to the policy.

Regent Hollingsworth asked Mr. Raymond Bartlett, Associate Vice Chancellor for Finance, to present Item G, <u>Approval is requested to modify the UH System Endowment Fund Statement of Investment Objectives and Policies – UH System.</u> Mr. Bartlett stated that at the previous Endowment meeting, the board had approved a modification to the policy that put some limits and/or parameters around our private investments both on a funded and unfunded basis. From this recommendation, it was requested that the staff come back to the May meeting with some additional recommendation for edits to the Endowment Investment Policy, and specifically, to provide for the Chair of the Board and the Chair of the Endowment Management Committee to, in extremely unusual but possible circumstances, to waive any requirement to comply with the policy thresholds in terms of asset allocation if we were to cross one of the ranges. Below in bold is the recommended change to the policy for reference:

The objective of this rebalancing policy is to improve the compound return of the portfolio and to ensure that it is invested in accordance with long-term asset allocation targets. It is not the intention of this policy to force the University to take any action that may endanger the safety or impair the long-term return of the portfolio simply in order to remain in compliance with allowable ranges.

A clear illustration of such a scenario might be major correction that reduces the value of the portfolio's marketable assets to an extent that forces the private investment allocation (the valuation of which lag those of marketable securities) beyond the allowable limits prescribed above. In order to stay in compliance in such a scenario, the University may be forced to sell interests in its private investment portfolio on the secondary market at a loss, impairing the overall Endowment's ability to recover from a correction of that magnitude.

Therefore, in the event of market action that forces any allocation outside its allowable ranges, the ***chair of the Endowment Management Committee,*** *in conjunction with the Board chair, with the advice of staff and consultant (if any), may temporarily waive the allocation limits imposed above if it is determined that remaining in compliance may cause harm to the long-term return potential of the endowment.*

On motion of Regent Agrawal, seconded by Regent Madison, and unanimously approved by the committee, the request to modify the UH System Endowment Fund Statement of Investment Objectives and Policies – University of Houston System was approved.

Regent Hollingsworth moved to the next item on the committee agenda, Item H, the Approval is requested to delegate authority to the Chancellor to negotiate and execute contracts for the hiring of private equity managers for the University of Houston System Endowment Fund – UH System and asked Dr. Carlucci to introduce this item.

Dr. Carlucci stated that there were private investments that would be recommended to the committee for their consideration.

1. Blackstone Real Estate Partners VIII, L.P.; and
2. Encap Energy Capital Fund X.

Ms. Chu stated that Cambridge had two private investments to recommend to the University. The first recommendation was for the University of Houston to approve an up to $7.5 million commitment to Encap Energy Capital Fund X. A first close is planned for the week of February 25, 2015, and a second and final close is expected on March 31, 2015. The University of Houston has a long history with Encap, the manager. The last time that the University of Houston committed to their primary investment fund was in Fund VII.

Encap Energy Capital Fund X's terms are outlined below:

- Target Fund Size - $5.0-6.0 billion (no formal hard cap)
- GP Commitment – 3% of commitments
- Management Fee – 1.5% of commitments.
- Carried Interest – 20%
- Partnership Life – 10 years, subject to two one-year extensions

On motion of Regent Madison, seconded by Regent Welder, and by a unanimous vote of the committee members in attendance, the request to delegate authority to the Chancellor to negotiate and execute a contract for the hiring of a private equity manager, Encap Energy Capital Fund X, to commit up to $7.5 million for the UH System Endowment Fund was approved. This action requires committee approval only. No further board action is required.

Ms. Chu addressed the next recommendation from Cambridge that was for the University of Houston to approve up to a $7.5 million commitment to Blackstone Real Estate Partners VIII, L.P. Blackstone Real Estate Advisors (BREA), a subsidiary of The Blackstone Group, is seeking $13 billion with a soft cap of $15 billion for its eighth private global real estate fund, Blackstone Real Estate Partners Fund VIII. A first close is expected on March 16, 2015; and a second close is planned for April and a final close at the end of the summer.

BREA will target large, complex situations in which the BREA team sees limited competition and cn move faster than the small number of other managers in this space. Consistent with prior funds, BREA will invest opportunistically in mostly office, multifamily, retail, industrial and hotel properties, primarily located in the U.S.

Blackstone Real Estate Advisors terms are outlined below:

- Target Fund Size - $13 billion (with $15 billion soft cap)
- GP Commitment – $300 million
- Management Fee – 1.50% on committed capital with a 0.30% acquisition fee
- Partnership Life – 10 years, subject to two one-year extensions

On motion of Regent Welder, seconded by Regent Madison, and by a unanimous vote of the committee members in attendance, the request to delegate authority to the Chancellor to negotiate and execute a contract for the hiring of a private equity manager, Blackstone Real Estate Fund X, to commit up to $7.5 million for the UH System Endowment Fund was approved. This action requires committee approval only. No further board action is required.

Dr. Carlucci presented Item I, the <u>Approval is requested to delegate authority to the Chancellor to negotiate and execute a contract for the hiring of a fixed income manager for the University of Houston System Endowment Fund – UH System;</u> and Item J, the <u>Approval is requested to terminate an investment manager and to delegate authority to the Chancellor to negotiate and execute contracts for the hiring of an investment manager for the University of Houston Endowment Fund – UH System.</u> Dr. Carlucci stated that it was recommended by Cambridge that the UH System terminate State Street Global Advisors as an investment manager for the UH System Endowment Fund due to the management fee increasing beyond an acceptable level for an indexed strategy. Mr. Lee stated that the restructure of the fixed income portfolio had been approved in August 2014 and there were a series of managers we tried to make this work with but due to fee and legal issues, Cambridge found Longfellow, which is a woman-owned firm with strong risk controls and trading capabilities. Barbara McKenna is the lead portfolio manager and majority stakeholder. Longfellow will manage the $19.0 million mandate in a separate account for an annual management fee of 15 basis points.

On motion of Regent Armour, seconded by Regent Agrawal, and by a unanimous vote of the committee members in attendance, the request to delegate authority to the Chancellor to negotiate and execute a contract for the hiring of Longfellow, a fixed income manager for the University of Houston System Endowment Fund was approved. This action requires committee approval only. No further board action is required.

Mr. Lee addressed Item J, the termination of an investment manager. As of December 31, 2014, the University of Houston had $46.4 million (~7.6%) invested with passive large cap index manager, State Street Global Advisors (SSgA) Russell 1000. SSgA notified UH that it had reviewed the University's investment in their separate account and determined that it was no longer profitable to manage under the current fee arrangement. The current agreement featured a minimum annual management fee of $50,000 (11 bps) but would increase to $75,000 (16 bps) if the University agreed to stay invested.

Cambridge recommended full redemption from SSgA and reinvest the $40.0 million in Northern Trust Russell 1000 Index Strategy, an equivalent passive strategy that features a non-lending commingled vehicle with a 7 bps annual management fee.

On motion of Regent Madison, seconded by Regent Armour, and by a unanimous vote of the committee members in attendance, the request to terminate an investment manager, State Street Global Advisors (SSgA) and to delegate authority to the Chancellor to negotiate and execute a contract for the hiring of an investment manager, Northern Trust, for the University of Houston System Endowment Fund was approved. This action requires committee approval only. No further board action is required.

Regent Hollingsworth moved to Item K, the <u>Approval is requested to modify the investment resolutions and approve a Certification Authority for the University of Houston System – UH System</u> and asked Dr. Carlucci to introduce this item.

Dr. Carlucci stated that this was a housekeeping item. The investment resolutions had two changes: a request to delete Tom Ehardt, who had recently retired and also deleting the Assistant Treasurer position from the authorized list until the position is filled. The Certification of Authority was requested by Merrill Lynch, Pierce, Fenner & Smith Inc. in lieu of our investment resolutions which was approved by our Legal Department.

On motion of Regent Armour, seconded by Regent Madison, and by a unanimous vote of the committee members in attendance, the request to modify the investment resolutions and approve a Certification of Authority for the University of Houston System was approved.

At the conclusion and approval of this item, Regent Hollinsgworth made the motion to place three action items unanimously approved by the committee and requiring the approval of the full board be placed on the Board of Regents' Consent Docket Agenda for final board approval.

On motion of Regent Armour, seconded by Regent Agrawal, and by a unanimous vote of the regents in attendance, the following items will be placed on the Board of Regents' Consent Docket Agenda for final board approval at the February 19, 2015 Board meeting as follows:

1. Approval of the Fiscal Year 2015 University Advancement endowment assessment rate of 1.5% - UH System;

2. Annual review and approval of the UH System Investment Policy for Non-Endowed Funds – UH System;

3. Approval is requested to modify the UH System Endowment Fund Statement of Investment Objective and Policies – UH System; and

4. Approval is requested to modify the investment resolutions and approve a Certification of Authority for the University of Houston System – UH System.

The final agenda item was addressed for information only, Item L, Report on the UH System's invested fund and bank deposits, and Mr. Raymond Bartlett, Treasurer for the UH System presented this item.

Mr. Bartlett stated this report was given to the committee each quarter which summarizes the UH System's invested funds and bank deposits. This report was for fiscal quarter ending November 30, 2014. There was $1.2 billion of investable funds and bank deposits as of this date. There was approximately $112 million in bond proceeds that get spent down over time; and restricted for capital projects. This information is also posted to the Treasurer's website within 60 days of the end of each fiscal quarter and submitted annually to the State Auditor's Office, Legislative Budget Board, Texas Comptroller of Public Accounts, and the Governor's Office of Budget, Planning and Policy.

This item was presented as information only and requires no committee action.

There was no Executive Session held.

There being no further business to come before the Committee, the meeting adjourned at 10:48 a.m.

All documentation submitted to the Committee in support of the foregoing action items, including but not limited to "Passed" agenda items and supporting documentation presented to the Committee, is incorporated herein and made a part of these minutes for all purposes; however, this does not constitute a waiver of any privileges contained herein.

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Others Present:

Carl Carlucci	Mark Dalton	Hamilton Lee
Paula Myrick Short	Katherine Chu	Shannon Thomas
Dona Cornell	Raymond Bartlett	Dan Maxwell
William Flores	Don Guyton	Michelle Dotter

Others Present (cont'd):

Vic Morgan	Jeffrey Cass	Carl Stockton
Bill Staples	Dana Rooks	Ed Hugetz
Eloise Dunn Stuhr	Brett Collier	Wayne Beran
Jason Smith	David Bradley	Fujio Watanabe
Richard Walker	Emily Messa	Sasha Ryder
Elywn Lee	Mark Clarke	Phil Booth
Dick Phillips	David Ellis	Oscar Gutierrez
Ray Roulerson	Mike Emery	Don Price
Brian Thomas	Steve Wallace	Joe Brueggman
Anita Cough	Jon Aldrich	Brian Alexander
Marquette Hobbs	Brenda Robles	Gerry Mathisen