**MINUTES**
**UNIVERSITY OF HOUSTON SYSTEM**
**BOARD OF REGENTS**
**ENDOWMENT MANAGEMENT COMMITTEE**

Thursday, March 8, 2018 - The members of Endowment Management Committee of the University of Houston System convened at 8:43 a.m. on Thursday, March 8, 2018, at the Hilton University of Hotel, Conrad Hilton Ballroom, Second Floor, 4450 University Drive, Houston, Texas, with the following members participating:

ATTENDANCE –

Present
Roger F. Welder, Vice Chair
Spencer D. Armour, III, Member
Beth Madison, Member
Gerald W. McElvy, Member

Member(s) Absent
Durga D. Agrawal, Chair
Tilman J. Fertitta, Ex Officio

Non-Members Present
Paula M. Mendoza, Regent
Peter K. Taaffe, Regent
Welcome W. Wilson, Jr., Regent
Neelesh C. Mutyala, Student Regent, Non-voting

In accordance with a notice being timely posted with the Secretary of State and there being a quorum in attendance, in the absence of the Chair of the Committee, Durga D. Agrawal, Vice Chair Roger F. Welder called the meeting to order.

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## AGENDA ITEMS

Regent Welder stated there were five (5) items listed on the agenda – one (1) requiring committee and board approval; three (3) requiring committee approval only; and the one (1) remaining item for information only. There were three (3) representatives from Cambridge Associates who were present at the meeting and 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 that the recommendation(s) from Cambridge Associates required committee approval only.

Regent Welder moved to the first action item requiring committee approval, the minutes from the November 16, 2017, Endowment Management Committee meeting.

On motion from Regent McElvy seconded by Regent Madison, and by unanimous vote of the regents in attendance, the minutes from the following meeting was approved:

- November 16, 2017, Endowment Management Committee meeting

Following the approval of the minutes, Regent Welder stated the next item listed on the agenda would be presented by Cambridge Associates and he asked Mr. Raymond Bartlett, Senior

Associate Vice Chancellor for Finance to introduce Item C, a Report from Cambridge Associates regarding the UH System Endowment and Non-Endowed portfolios – University of Houston System.

Mr. Bartlett introduced the three (3) representatives from Cambridge Associates who were in attendance at the meeting: Erin Schuhmacher, Kerry Kirk, and Phil Fiske. He asked, with the Board's permission, if the Cambridge Associates representatives could give their presentations to the committee and stated that Mr. Kirk would begin with his remarks.

Mr. Kirk stated it was always a pleasure to be at the UH campus for this meeting. He said that since this was the first meeting of the new calendar year, it was generally customary that Cambridge cover three (3) matters in their Endowment Report which were as follows:

1. A summary review of the 2017 calendar year – its market themes and conditions;
2. The University of Houston's long-term endowment performance in light of this (attribution and positioning); and
3. A 2018 market outlook.

Mr. Kirk said that in general, from the market activity of 2017, the results for the University of Houston's portfolio were very good both in absolute terms relative to safe spending rate but also very good in relative terms to benchmarks. Cambridge was very pleased with the strategy that had been employed over the last few years stating that it had been productive and continues to be added to the portfolio.

Mr. Kirk pointed out that equity markets outperformed other asset classes in 2017. Basically, 2017 saw extraordinary stock market gains globally with equities up 22%; and with the emerging markets up nearly 40%; and this against the backdrop of historically low volatility. Although the returns for the diversifiers, like real assets and fixed income looked rather uninspiring, it was only because in relative comparison to the equity returns, in absolute terms the various real assets were up approximately 12%-15% from last year and fixed income (setting aside 10-year Treasury) global sovereign bonds were up approximately 7.5%, and the hedge funds up 8.5%. The U.S., in particular, defied expectations and the headlines. The average quarterly value of the VIX hit its lowest level in the 4th Quarter of 2017, as investors embraced improving economic growth estimates as indicative of smooth sailing ahead. Even if volatility was currently low, investors should guard against getting too complacent, as risks were present. 2017 real GDP growth figures were expected to be positive across all developed and emerging economies found in MSCI Indexes, a first in a decade. Moreover, 2017 earnings growth was driven primarily by Japan and emerging markets economies.

Mr. Kirk stated that US interest rates moved higher in 2017 while inflation remained in check. Citing strengthening economic conditions, the Federal Reserve hiked rates three (3) times in 2017, with the target upper bound reaching 1.50% by year-end.

Ms. Schuhmacher presented an overview of the performance of the UH portfolio for 2017 for the committee's information. Ms. Schuhmacher stated there were various decisions made by the Committee/Board and Cambridge Associates over the past year and there were a few she wanted to highlight for the committee's reference as follows:

- There had been a lot of work performed over the past year. Much had been accomplished as it related to continuing to implement the strategic plan, both in terms of rebalancing within the portfolio as well as the buildout of the privates.
- The market value of the endowed assets totaled approximately $679 million.
- Total marketable assets for the Endowment were up approximately 16.4%, a very strong year on an absolute basis but also on a relative basis, 150 basis points better than policy benchmark and 100 basis points better than the dynamic benchmark.
- The difference between the total portfolio and the total marketable assets was that the marketable assets excluded private investments; and the total portfolio only included three (3) quarters worth of private investment numbers.
- The UH portfolio assets increased $92.3 million in 2017--$84.5 million from investment returns.
- Hedge funds delivered a decent year, up 8.2%, better than the benchmark.
- The UH portfolio was overweight global equities and bonds/cash as of December 31, 2017 with corresponding underweight to hedge funds and private investments.
- Over the past six (6) years, the Endowment had:
  - Added $112 million in new gifts;
  - Generated $208 million in realized/unrealized gains;
  - Distributed $112 million to the beneficiary accounts; and
  - Paid $26 million in portfolio expenses.
- Mr. Kirk addressed the non-endowed portfolio and stated the non-endowed assets totaled $465.2 million.
- The EPS outlook in developed markets was bright; and earnings growth was expected to remain strong and expected to be so across over 90% of industry sectors.
- Non-US equity valuations have never been cheaper versus US stocks; emerging markets would remain reasonably priced and the same was true of emerging markets currencies.
- Global equities were off to a bumpy start in calendar year 2018; in fact, some volatility had returned in February.
- Market experts pointed to a variety of forces to explain the recent sell off:
  - There were concerns about rising interest rates/prospective inflation;
  - Overbought conditions after record equity inflows in January; and
  - Technical selling from systematic strategies.
- While volatility could continue, Cambridge did not recommend any action at this time because:
  - Fundamentals remain positive as corporations continue to post healthy earnings; and
  - Risk assets have not sold off enough to warrant aggressive buying (global equities were up – 19% over the last 12 months).
- Diversified portfolios were designed to weather periods of equity market volatility.
- Mr. Kirk addressed the UH portfolio and where we stood as we head to 2018:

  <u>Growth Drivers – UH Portfolio Positioning and Rationale</u>

  <u>Global Equities</u> – Maintain tilt away from US equity markets where valuations are rich toward non-US equity markets; and trim into equity market strength. The rationale – earlier stage economic recoveries in non-US markets now appear sustainable, policy remains more supportive, and valuations are still undemanding; and consider value/growth mix of managers within equity portfolio.

Private Investments – Focus on best in class managers. The rationale – expected to drive total portfolio performance, as private investments have outperformed public investments over the long-term.

Risk Reducers – UH Portfolio Positioning and Rationale
Diversifiers – Maintain allocation to diversifiers with an eye to reduce and move toward the long-term targets based on the glide path. The rationale – offers differentiation given stretched valuations and prospects for rising rates.
Liquid Inflation Sensitive – Focus on the energy complex. The rationale – energy complex is more fairly valued versus other real assets.
Bonds and Cash – Hold high-quality bonds. Remain underweight but monitor for opportunities to add as rates rise. The rationale – high quality bonds bolster the portfolio's ability to protect in difficult markets; and serves as dry powder during periods of heightened volatility.

These presentations were for information only and no further board action was required.

Following Mr. Kirk's and Ms. Schuhmacher's presentations on the UH portfolio, Regent Welder moved to the next action item listed on the agenda, Item D – Approval is requested to delegate authority to the Chancellor to negotiate and execute contracts for the hiring of a non-US developed markets manager for the University of Houston System Endowment Fund – UH System, and asked Mr. Bartlett to introduce this item.

Mr. Bartlett stated that Cambridge would address the committee and make a recommendation to invest $22.0 million in a non-US developed markets, small cap manager Global Alpha, and asked Cambridge to present this item to the committee for their consideration. Cambridge Associates presented this item and below are their remarks.

Ms. Schuhmacher, from Cambridge Associates, recommended the committee consider a $22.0 million initial investment into the Global Alpha International Small Cap strategy. Cambridge's rationale behind this recommendation was addressed as follows:

- $122.0 million was currently divided between two (2) managers, representing approximately 18% of the portfolio.
- These two (2) managers have been in the portfolio for some time: Silchester, which was a long standing, value-oriented fund; and William Blair, which was a more growth oriented fund, both focusing on non-US markets.
- Global Alpha was a fund that Cambridge had been following for some time; however, they did not have a vehicle for US investors. The vehicle for US investors was very new and part of their negotiations to set up a US-based investment vehicle, Global Alpha was willing to offer Cambridge Associates' clients a 20 bps discount on management fees; therefore, it's 65 bps management fee vs. 85 bps standard fee equates to a savings of approximately $45,000 for the University.

Mr. Kirk, from Cambridge Associates, addressed the company in further detail as follows:

- Cambridge began their due diligence on this company quite some time ago; and this firm already has a five (5) year track record.
- Global Alpha was a small cap specialist, both globally and internationally.

- Together they have total assets just over $1.0 billion; and are well established; but not too small and not too big.
- Half of the $1.0 billion was in international small cap which was the product Cambridge was looking at; and the other half was in global small cap which includes US.
- This firm was founded in 2008 in partnership with a firm called Connor, Clark & Lunn (CC&L), a financial group which is a very large Canadian financial services conglomerate that together manage approximately $60 billion US dollars in assets under management. This strategy was quality growth; it's true small cap, it's true developed markets (no emerging markets in the portfolio); it's a high conviction portfolio with only 50-70 stocks in it; and they also focus both on regions and sectors but also on secular themes.
- Cambridge feels they have a very rigorous program for both portfolio construction as well as risk management. Their performance has been consistent through various cycles.
- It was run by a 5-person team and they were all equal portfolio managers, although the lead is a man by the name of Robert Beauregard. This team of 5 has an average age of 17-years in the asset management industry and they have been together since inception in 2008; there has been zero turnover since that time.

Following this presentation, Regent Welder called for a motion to approve this item as presented.

On motion of Regent McElvy, seconded by Regent Armour, and by a unanimous vote of the committee members in attendance, the request to delegate authority to the Chancellor to negotiate and execute contacts for the hiring of a non-US developed markets manager for the UH System Endowment Fund – UH System was approved. The recommendation was for a $22.0 initial investment to Global Alpha International Small Cap on 4/01/18.

This item requires committee approval only and no further board action was required.

Regent Welder moved to the next item on the agenda, Item E, the Approval is requested to delegate authority to the Chancellor to negotiate and execute contracts for the hiring of private investment managers for the University of Houston System Endowment Fund – UH System, and asked Mr. Bartlett to introduce this item.

Mr. Bartlett stated that Phil Fiske, from Cambridge Associates, would be making three (3) private investment manager recommendations for the committee's consideration and approval, each commitment in the amount of $7.5 million. This was part of the strategic plan to build-out the private equity portfolio.

Mr. Fiske began his presentation by stating the University of Houston's Private Investment (PI) program was still relatively immature, but had produced an attractive 13.7% return on an annualize basis versus a benchmark of 9.2% since inception, outperforming 450 bps per year.

Mr. Fiske stated the first recommendation for the committee's consideration was for a $7.5 million commitment to Kelso Investment Associates Fund X. Kelso & Company was targeting $2.6 billion for its tenth US buyouts fund. Fund X will continue its strategy of making control investments in US middle-market companies; and for Fund X, the manager was targeting a 2.5 gross multiple of invested capital (MOIC) and 20% to 25% gross internal rate of return (IRR).

Kelso's 14 investment partners have been investing together at Kelso for an average of 23 years. The continuity of the team contributes to their ability to maintain long-term relationships and institutional knowledge. The general partners (GP) expect to commit $250 million in cash to Fund X, representing 10% of the target fund size – a notably high GP commitment relative to industry standards. In addition, senior partners will be allocated a smaller share of the carried interest than in the prior fund, leaving larger allocations to motivate the more active, less-tenured team members who are now driving deals. The senior partners will remain aligned through their higher proportion of the GP commitment.

Kelso Investment Associates Fund X's terms are outlined below:

- Target Fund Size – $2.6 billion
- GP Commitment – $250 million commitment as of the initial closing, representing 10% of the target fund size
- Management Fee – 1.5% of commitments during commitment period; 1.0% of outstanding invested capital thereafter
- Carried Interest – 20%
- Fund Life – 10 years, subject to 3 one-year extensions

The second recommendation from Cambridge Associates for the committee's consideration was for a $7.5 million commitment to Penzance DC Real Estate Fund. Penzance Properties was seeking $200 million in commitments, with a hard cap of $275 million, for its first fund, Penzance DC Real Estate Fund. The manager raised approximately $100 million from a number of high-profile investors during its first close in October 2017, and was aiming to hold a final close in the first quarter of 2018.

Penzance invests exclusively in value-add properties and development projects located in the DC metro area (which encompasses Washington, DC; northern Virginia; and southern Maryland), with a particular emphasis on office and multifamily investments, though it may also invest selectively in retail and mixed-use assets. Penzance generally targets complex situations such as under-utilized, under-managed or poorly capitalized properties where it can add value through restructuring, improved leasing and deleveraging.

This firm was founded in 1996 by Julia Springer Tolkan and Victor Tolkan. This firm was 51% owned by cofounder Julia Springer Tolkan and, as one of its two managing partners, was a key contributor to the successful execution of the strategy. Her ownership makes this a majority woman-owned firm. They focus on the DC area and know the market extremely well. This is the first institutional fund they are raising.

Penzance DC Real Estate Fund's terms are outlined below:

- Target Fund Size – $200 million ($275 million hard cap)
- GP Commitment – Lesser of 2.5% of commitments or $5 million
- Management Fee – Commitment period: 1.5% of commitments; Post-commitment period: 1.5% of net equity invested
- Carried Interest – 20%
- Preferred Return – 8.0%
- Fund Life – 10 Years, subject to two one-0year extensions by the GP with the approval of the advisory committee

Lastly, Cambridge Associates recommended that the University of Houston approve a $7.5 million commitment to Hastings Equity Fund IV. Hastings Equity Partners was targeting $250 million, with a $300 million hard cap, for Fund IV. The manager launched fundraising for Fund IV in the first quarter of 2018. Hasting expects there to be approximately $100 million to $150 million of capacity for new LPs. The firm has a fairly experienced team of investors and the senior people have been working together for some time. They have a solid track record and they manage well through cycles.

Fund IV will make control growth equity and buy-and-build investments in small-cap companies in the oilfield services and equipment industry. Hastings plans to invest about 50% of the portfolio in upstream companies operating in the Permian basin and about 50% in downstream companies to dampen its commodity price exposure; it will avoid midstream-related investments.

Hastings Equity Fund IV's terms are outlined below:

- Target Fund Size – $250 million (with $300 million hard cap)
- GP Commitment – At least 3.0% of commitments
- Management Fee – 2.0% of committed capital during investment period; 1.5% of invested capital thereafter
- Carried Interest – 20% after 8% preferred return
- Fund Life – 10 years

Regent Welder asked if there were any further questions regarding the three (3) recommendations made to the committee prior to the vote.

Mr. Bartlett noted for the committee's information that in the agenda item it had been referenced that there was a fourth private investment fund listed in the materials but the university was not able to gain access to that fund.

It was noted that before calling for the vote, Regent Welder stated that Regent Spencer Armour would recuse himself from voting on this item.

On motion of Regent McElvy, 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 contracts for the hiring of three (3) private investment managers for the University of Houston System Endowment Fund – UH System was approved as follows:

- $7.5 million commitment to Kelso Investment Associates Fund X
- $7.5 million commitment to Penzance DC Real Estate Fund
- $7.5 million commitment to Hastings Equity Fund IV

This item required committee approval only and no further board action was required.

Regent Welder moved to the next item on the agenda, Item F, the <u>Annual review and approval of the UH System Investment Policy for the Non-Endowed Funds – UH System</u> and asked Mr. Bartlett to present this item to the committee.

Mr. Bartlett stated that this item was for the annual review and approval of the UH System Investment Policy for the Non-Endowed Funds. This policy was reviewed once a year, along with Cambridge Associates. Should any changes be required prior to the annual review, they would be brought to the committee for their review and approval at that time as well. Presently, there were no recommended changes or updates to this policy.

On motion of Regent McElvy, seconded by Regent Madison, and by unanimous vote of the members in attendance, the request for the annual review and approval of the UH System Investment Policy for the Non-Endowed Funds was approved.

Following the approval of this item by the committee, Regent Welder made the motion to place the following action item, unanimously approved by the committee, on the Board of Regents' Consent Docket Agenda for final board approval.

On motion of Regent McElvy, seconded by Regent Madison, and by a unanimous vote of the members in attendance, the following action item was approved and will be placed on the Board of Regents' Consent Docket Agenda for final board approval at the March 8, 2018, Board of Regents' meeting held later in the day as follows:

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

The last item listed on the agenda was for information only, Item G, the <u>Quarterly update on "Here, We Go" campaign progress – UH System.</u> Regent Welder asked Ms. Eloise Dunn Brice, Vice Chancellor for University Advancement to present this item to the committee.

Ms. Brice presented this item to the Board and presented a PowerPoint presentation. Below is a brief summary of her remarks.

- Ms. Brice addressed the progress towards the goal and the campaign was currently ahead of schedule.
- She stated this was typically the hardest time in a multi-year campaign; that is, we have approached and have had conversations with many of those who were close to the university, so it's a time where we were sowing new seeds, so to speak.
- The university was optimistic for this year, even though it had been slow at the start, but one huge help at this time in the campaign was there were some new initiatives, including the post-College of Medicine, which has generated much excitement.
- Ms. Brice pointed out that a major characteristic of this campaign was to have volunteer partnerships which have been very successful for the Here, We Go campaign. The university has a wonderful Campaign Executive Committee and one of the co-chairs of this committee, Regent Beth Madison has been engaging some other individuals who have not been involved to this point.
- The Board of Visitors was not a fundraising or campaign board but has been hugely helpful in terms of developing ambassadors and advocates which, in turn, get individuals excited about the university and, in turn, want to support the university.
- The Energy Advisory Board was also not a fundraising or campaign board although a number of the members through their corporations and as individuals have supported the campaign.

- Each of the colleges have been developing college campaign committees and will carry over into post-campaign, as well as the next campaign, as those were all new initiatives getting volunteers to get comfortable with fundraising.
- The campaign was not only attacking Houston but also the nation. It has been the plan for the Chancellor to visit four (4) cities per year and engage the alumni in those cities: Dallas, Los Angeles, New York, and Washington, D.C.
- The UH System launches have also occurred this year – UH-Downtown, UH-Clear Lake and UH-Victoria have had events in the last six months.
- Ms. Brice presented a snapshot of the basic statistics thus far as follows:
  - 165,883 -- Campaign donors;
  - 119,265 -- First-time donors
  - 139,243 -- Donors under $1,000
  - 190 -- Gifts of $1.0 million plus
  - 3 -- Donors of $20 million plus
- Ms. Brice stated that to date $194.6 million had been raised for Endowments.

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

There was no Executive Session held.

There being no further business to come before the committee, the meeting adjourned at 9:40 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:

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| Renu Khator | Erin Schuhmacher | Joe Brueggman |
| Jim McShan | Raymond Bartlett | Jon Aldrich |
| Paula Myrick Short | Don Guyton | Nader Ibrahim |
| Dona Cornell | Kerry Kirk | Brian Thomas |
| Eloise Dunn Brice | Phil Fiske | Ryan Harrison |
| Amr Elnashai | Joana Romero | Susan Koch |
| Lisa Holdeman | Lindsey Ellis | Glen Houston |
| Richard Walker | Ray Raulerson | Usha Mathew |
| Mike Johnson | Sabrina Hassumani | Paul Roch |
| Juan Sánchez Muńoz | Robert Belt | Kevin Draper |
| Raymond "Vic" Morgan | Karin Livingston | Mike Atterbury |
| David Oliver | Ed Hugetz | Jeff Collier |
| Dan Maxwell | Sara Brown | Darwin Morrow |
| Matt Castello | Ward Martaindale | Devonte Hill |
| Don Becker | Lisa Gossett | Marquette Hobbs |
| Greg Sissel | Brian Krueger | Brenda Robles |
| Ivan Mascano | Chris Stipes | Gerry Mathisen |