

MINUTES
UNIVERSITY OF HOUSTON SYSTEM
BOARD OF REGENTS
ENDOWMENT MANAGEMENT COMMITTEE

Thursday, May 19, 2016 - The members of Endowment Management Committee of the University of Houston System convened at 9:36 a.m. on Thursday, May 19, 2016, at the University of Houston-Victoria, University North, Multi-Purpose Room, 3007 N. Ben Wilson St., Victoria, Texas, with the following members participating:

ATTENDANCE –

Present

Durga D. Agrawal, Chair
Roger F. Welder, Vice Chair
Spencer D. Armour, III, Member
Regent Beth Madison, Member
Gerald W. McElvy, Member
Tilman J. Fertitta, Ex Officio

Non-Member(s) Present

Paula M. Mendoza, Regent
Peter K. Taaffe, Regent
Welcome W. Wilson, Jr.,

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

AGENDA ITEMS

Action Items

Regent Agrawal stated there were seven (7) agenda items to be addressed – three (3) requiring committee and board approval; two (2) requiring committee approval only; and the remaining two (2) items for information only. Five (5) 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 that the recommendations from Cambridge Associates required committee approval only.

The first action item presented to the committee was the approval of minutes from the November 19, 2015 and the February 18, 2016 Endowment Management Committee meetings.

1. Approval of Minutes – Item B:

On motion of Regent Welder, seconded by Regent McElvy, and by a unanimous vote of the regents in attendance, the following minutes from the meetings listed below were approved:

- November 19, 2015, Endowment Management Committee Meeting
- February 18, 2016, Endowment Management Committee Meeting

Regent Agrawal reiterated that the first three (3) items listed on the agenda would be presented by Cambridge Associate representatives as follows:

1. Item C – Report from Cambridge Associates regarding the UH System endowment and non-endowed portfolios – University of Houston System;
2. Item D – Approval is requested to delegate authority to the Chancellor to negotiate and execute contracts for the hiring of private investment managers for the UH System Endowment Fund – University of Houston System; and
3. Item E – Approval is requested to delegate authority to the Chancellor to negotiate and execute contracts for the hiring of an investment manager for the hedge fund program for the UH System Endowment Fund – University of Houston System.

Regent Agrawal asked Interim Vice Chancellor for Administration and Finance, Mr. Jim McShan, to please introduce these items.

Mr. McShan stated there were five (5) representatives from Cambridge Associates who were present at the meeting: Mr. Kerry Kirk, who is the UH System's lead investment consultant; Ms. Erin Schuhmacher, Mr. Phil Fiske, Ms. Katherine Chu, and Mr. Mark Dalton, who will address Item C – the Report from Cambridge Associates regarding the UH System endowment and non-endowed portfolios.

Mr. Kirk expressed his pleasure at being in Victoria for the meeting. Mr. Kirk referred the Committee to the Executive Summary and presented a brief overview of the key issues Cambridge would be addressing at the meeting. The committee would hear a market update and how the market had impacted the performance of the Endowment portfolio; Strategic Plan Recommendations; Private Investments Update and Recommendation; and a Hedge Fund Update and Recommendation. Below is the summary of the various comments from the Cambridge Associates team.

Ms. Erin Schuhmacher presented the committee with a market update. The performance of global equities over the first quarter from January 1, 2016 through March 31, 2016 saw for the first time in 80 years that the market was down about 10% only to end up flat or slightly positive. There were a lot of macro trends in the first quarter that really affected markets which made it very challenging for active managers, particularly on the hedge fund side.

Ms. Schuhmacher reviewed the University of Houston's Portfolio Dashboard: a new slide outlining the portfolio's positioning and performance. The portfolio market value over time was addressed and the first quarter ended at \$562 million. On a year-to-date basis through March 2016, the portfolio's ex private investments were down 50 basis pts. Drivers of Q1 performance were addressed as follows:

- Contributors:
 - Defensive assets performed well, with U.S. bonds gaining 8.1%.
 - The marketable inflation hedge portfolio returned 7.0%.
- Detractors:
 - Hedge Funds fell -4.0% for the quarter, lagging the benchmark by -1.2%.
 - Global bonds underperformed the benchmark by 6.6%.

Mr. Kirk presented the Strategic Plan recommendations to the committee pertaining to portfolio enhancements (#1-#4) and policy/monitoring enhancements (#5). Below were the five (5) proposals that were outlined:

- Proposal 1 - Reclassify certain asset classes
 - Create Global Equities category
 - Rename Private Investments to Private Equity/Venture Capital
 - Rename Inflation Hedge to Real Assets
- Proposal 2 – Streamline sub-asset class targets
 - Remove sub-targets to U.S. Developed International, and Developing Markets
- Proposal 3 – Update and modify near term targets
 - Reduce Global Equities and Bonds, Increase Real Assets
- Proposal 4 – Deletion and creation of one policy target
 - Delete 5% Marketable Inflation hedge target, Create 10% Real Assets target
- Proposal 5 – Benchmarking modification consistent with #1-#4 above.

Following the above portfolio enhancements, Mr. Kirk presented a brief outline of these proposals as follows:

Proposal #1 – A simple reclassification of asset nomenclature that could benefit the portfolio long-term.

<u>Current</u>		<u>Proposed</u>
Policy Target Classification		Policy Target Classification
- U.S. Equity	) Aggregates	
- Developed International Equity	) into	- Global Equities
- Developing Markets)	
- Hedge Funds	) Aggregates	
- Hedged Equity	) into	- Hedge Funds
- Absolute Return)	
- Private Investments	) Becomes	- Private Equity/Venture Capital
- Marketable Inflation Hedge	) Becomes	- Real Assets (Marketable/Private)
- Bonds		- No change
- Cash		- No Change

Proposal #2-4 – Reflects the topline effect of Proposals #2-#4 Near- and Long-Term asset allocation.

<u>Current</u>		<u>Proposed</u>			
Policy Target Classification	Near-Term Target	Policy Target Classification	Near-Term Target	Long-Term Target	Range
- U.S. Equity	17.5%)	- Global Equities	42%	40%	<u>30-50%</u>
- Developed Int'l Equity	17.5%) →	- U.S. Equity			20-35%
- Developing Markets	<u>10.0%</u>)	- Non U.S. Equity			10-20%
	45.0%)	- Emerging Markets Equity			5-15%
- Hedge Funds	<u>30.0%</u>)	- Hedge Funds	30%	20%	<u>10-30%</u>
- Hedged Equity	15.0%) →	- Long/Short Equity			10-20%
- Absolute Return	15.0%)	- Diversifiers			10-20%
- Private Investments	10.0%) →	- Private Equity/Venture Capital	10%	20%	10-30%
- Marketable Inflation Hedge	5.0%) →	- Real Assets Marketable Private	10%	10%	<u>5-15%</u> 2-8% 5-12%
- Bonds	7.5%) →	- Bonds	7%	10%	5-20%
- Cash	2.5%) →	- Cash	1%	0%	0-10%

Proposal #5 – Reflects new benchmarking for the Endowment policy portfolio commensurate with the reclassification.

<u>Current</u>		<u>Proposed</u>	
Asset Class	Benchmark	Asset Class	Benchmark
- U.S. Equity	Russell 3000)	- Global Equities	MSCI ACWI
- Developed Int'l Equity	MSCI ACWI) →		
- Developing Markets	MSCI Emerging Markets		
- Hedge Funds	HFRI Funds of Funds Composite	- Hedge Funds	No Change
- Private Investments	S&P 500 + 3% ↗	- Private Equity/ Venture Capital	Russell 3000
		- Real Assets Marketable Private	<u>Marketable:</u> No Change <u>Private:</u> 70% S&P N.A. Natural Resource Sector / 30% MSCI US REITS
- Marketable Inflation Hedge	Custom Inflation Hedging Benchmark		
- U.S. Bonds	Barclays Long-Term Treasury)	- Bonds	No Change
- Global Bonds	JPM Global Gov't Bond) →	U.S. / Global	
- Cash	BofA ML 91-Day Treasury Bills	- Cash	No Change

Mr. Kirk addressed the rationale regarding the recommended benchmark versus the current benchmark. A lengthy discussion followed.

Due to the agenda being taken out of order, Item F, the Approval to modify the UH System Endowment Fund Statement of Investment Objectives and Policies – UH System was addressed by Mr. Kirk. Following Mr. Kirk's presentation regarding the recommended proposals above, Regent Agrawal called for the vote.

On motion of Regent McElvy, seconded by Regent Welder, and by a unanimous vote of the regents in attendance, the request to modify the UH System Endowment Fund Statement of Investment Objectives and Policies was approved.

Mr. McShan stated the next item addressed by Cambridge Associates would be Item D, the Approval is requested to delegate authority to the Chancellor to negotiate and execute contracts for the hiring of private investment manager for the UH System Endowment Fund – UH System.

Ms. Katherine Chu from Cambridge Associates recommended that the University of Houston approve a \$7.5 million commitment to Embarcadero Capital Investors Five. Embarcadero Capital Investors Five is a real estate fund that invests in office properties located in major West Coast markets, including the San Francisco Bay Area, Los Angeles and Seattle. It is a \$300 million fund. The manager's strategy is to pursue investments with some element of complexity, such as distressed or dysfunctional ownership entity. The team will continue to target a minimum gross internal rate of return (IRR) of 15% and a multiple on invested capital (MOIC) of 2.0%.

A commitment to Embarcadero Capital Fund Five represents an opportunity for the University to invest with an experienced team executing a focused strategy. The principals average 30 years of real estate investment experience and are well networked in the major West Coast office markets. The team has generated a strong track record over its history, with the first three funds generating first-quartile performance and the most recent fund generating second-quartile performance for their respective vintage year C/A US Real Estate Benchmarks.

Embarcadero Capital Investors Five's terms (as of March 31, 2016) are outlined below:

- Target Fund Size – \$300 million
- GP Commitment – 2%
- Management Fee – 1.2%
- Carried Interest – 20%
- Partnership Life – 8 years, subject to two 1-year extensions

Following this presentation on the private investment manager recommended by Cambridge Associates (Item D), Regent Agrawal called for a motion to approve the recommendation of a \$7.5 million commitment to Embarcadero Capital Investors Five as presented.

On motion of Regent Welder, seconded by Regent McElvy, and by a unanimous vote of the members in attendance, the motion to approve the recommendation of a \$7.5 million commitment to Embarcadero Capital Investors Five was approved. This recommendation requires committee approval only and no further board action is required.

Mr. McShan 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 hiring of an investment manager for the hedge fund program for the University of Houston System Endowment Fund – University of Houston System.

Mr. Mark Dalton addressed this item and presented the committee with a Hedge Fund Program update prior to the Cambridge's recommendation of hiring AQR Style Premia Fund in the amount of \$11 million for the UH System Endowment Fund.

Mr. Dalton stated the University of Houston's Hedge Fund Program was designed to provide a diversified "market-like" source of return at lower levels of risk over the long-term. Since inception, the hedge fund allocation has outperformed the HFRI benchmark by 1.7% while achieving 62% of the return of global equities with approximately 38% of the volatility over the same time period.

What worked in the first quarter was HBK returned 1.4% for the quarter, outperforming its benchmark by 200 bps. What did not work in the first quarter was that global long/short equity managers struggled, with SRS Partners declining -15/8% and PFM down -9.6%; and U.S. long/short equity manager Brahman was down -10.3% for the quarter.

Mr. Dalton presented the Cambridge Associates recommendation of hiring of a hedge fund manager, AQR Style Premia Fund in the amount of \$11 million. AQR was founded in 1998. The firm has garnered a reputation for prudent institutional investing and applied academic research. An academic focus continues to permeate the culture, as research on risk factors and their interactions have been interlaced in AQR strategies since the firm's founding.

The AQR Style Premia Funds (SPF) applies a factor-based asset-allocation strategy that blends discretionary and systematic trading styles. The basic concept underpinning the SPF product is recognition that more robust diversification can be achieved by constructing portfolios that are equally exposed across three main dimensions: (1) asset classes, (2) macro factors, and (3) investing styles. The fund should provide investors with a rich and valuable form of diversification over time and should complement an existing hedge fund program.

The Management Fee is 1.5% with no incentive. A typical hedge fund usually charges a 20% incentive fee of profits and this product has no incentive fees. It is also a mutual fund, it's daily liquidity. Cambridge is trying to innovate the program in the context of lowering the overall fees; increasing the liquidity; increasing the flexibility; and then increasing the defensive nature of the program.

On motion of Regent Armour, seconded by Regent Madison, and by a unanimous vote of the members in attendance, the motion to approve the hiring of a hedge fund manager in the amount of \$11 million, approximately 2.0% initial investment in AQR Style Premia Funds effective July 1, 2016 was approved. This recommendation requires committee approval only and no further board action is required.

Mr. McShan presented Item G, the Approval is requested to appropriate for expenditure from certain underwater endowments in accordance with the UH System Endowment Fund Statement

of Investment Objectives and Policies. Mr. McShan stated that in February 2016, the Board had approved the spending of endowments between 80-100%. It is required that once a year the Board actively approves the actual endowments that meet this criteria. He reminded the Board that for those endowments that are between 90-100%, they will receive a 3% interest or 75% of the payout; those between 80-90% , they will receive 2% interest or 50% of the payout; and anything below 80% will not receive any distribution.

On motion of Regent Armour, seconded by Regent McElvy, and by a unanimous vote of the members in attendance, the request to appropriate for expenditure from certain underwater endowments in accordance with the UH System Endowment Fund Statement of Investment Objectives and Policies was approved.

Item H was the next item addressed, the Approval is requested for the Chancellor to delegate authority to the Senior Vice Chancellor for Administration and Finance and/or the Senior Associate Vice Chancellor for Finance to negotiate and execute investment contracts approved by the Board of Regents of the University of Houston System. Mr. McShan presented this item and stated this is an effort to make it more effective and efficient due to the extent of the negotiations that sometimes occur with some of the managers that the University is investing in. These are items that the Board has already approved at a meeting and rather than just having the Chancellor allowed to sign, it also gives the Senior Vice Chancellor for Administration and Finance and/or the Senior Associate Vice Chancellor for Finance the authority to sign these documents.

On motion of Regent McElvy, seconded by Regent Welder, and by a unanimous vote of the members in attendance, the request for the Chancellor to delegate authority to the Senior Vice Chancellor for Administration and Finance and/or the Senior Associate Vice Chancellor for Finance to negotiate and execute investment contracts approved by the Board of Regents of the University of Houston System was approved

At the conclusion and approval of this item, Regent Agrawal made the motion to place the following three (3) action items unanimously approved by the committee on the Board of Regents' Consent Docket Agenda for final board approval.

On motion of Regent Madison, seconded by Regent Armour, and by a unanimous vote of the members in attendance, the following three (3) action items were approved and will be placed on the Board of Regents' Consent Docket Agenda for final board approval at the May 19, 2016 Board of Regents' meeting held later in the day:

1. Approval is requested to modify the UH System Endowment Fund Statement of Investment Objectives and Policies – UH System;
2. Approval is requested to appropriate for expenditure from certain underwater endowments in accordance with the UH System Endowment Fund Statement of Investment Objectives and Policies – UH System; and
3. Approval is requested for the Chancellor to delegate authority to the Senior Vice Chancellor for Administration and Finance and/or the Senior Associate Vice Chancellor for Finance to negotiate and execute investment contracts approved by the Board of Regents of the University of Houston System – UH System.

The final agenda item for information only was Item I, the Report on the UH System's invested funds and bank deposits. Mr. Raymond Bartlett, Senior Associate Vice Chancellor for Finance 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 February 29, 2016. There was \$1.4 billion of investable funds and bank deposits as of this date. The bond and debt service funds are invested in triple AAA-m-f rated money market funds and spent down over time as construction expenditures are incurred or debt service is paid. 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 for information only and required no committee action.

There was no Executive Session held.

There being no further business to come before the Committee, the meeting adjourned at 10:42 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.

Others Present:

Renu Khator	Lisa Shumate	Kerry Kirk
Jim McShan	Erin Schuhmacher	Mark Dalton
Paula Short	Phil Fiske	Katherine Chu
Dona Cornell	Ed Hugetz	Chris Stanich
Lisa Holdeman	Don Guyton	Ashlee Ross
Eloise Stuhr	Emily Messa	David Bradley
Michael Olivas	Wayne Beran	Russ Hoskins
Raymond "Vic" Morgan	Raymond Bartlett	Brett Collier
William Staples	Jesse Pisors	Travis Gundeloch
Mike Johnson	Mark Clarke	Sabrina Hassumani
David Oliver	Caesar Moore	Katie Brown
Iggy Harrison	Shannon Harrison	Phil Booth
Brian Thomas	Jon Aldrich	Joe Brueggman
Ben Aldrich	Sandra Dahlke	Joe Galvan
Matt Castillo	Mary Ann Ottinger	Kathy Walton
Faye Landry	Nancy Moffett	Beth Mason
Brenda Robles	Gerry Mathisen	