

MINUTES
UNIVERSITY OF HOUSTON SYSTEM
BOARD OF REGENTS
ENDOWMENT MANAGEMENT COMMITTEE

Thursday, May 21, 2015 - The members of Endowment Management Committee of the University of Houston System convened at 9:11 a.m. on Thursday, May 21, 2015, at the University of Houston, Hilton University of Houston Hotel, Conrad Hilton Ballroom, Second Floor, 4800 Calhoun Road, Houston, Texas, with the following members participating:

ATTENDANCE –

Present

Jarvis V. Hollingsworth, Chair
Roger F. Welder, Vice Chair
Durga D. Agrawal, Regent
Spencer D. Armour, III, Member
Beth Madison, Member
Tilman J. Fertitta, Ex Officio

Non-Member(s) Present

Paula M. Mendoza, 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 February 19, 2015.

AGENDA ITEMS

Action Items

1. Approval of Minutes – Item B

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

- February 19, 2015, Endowment Management Committee Meeting

Regent Hollingsworth stated there were six (6) action items and three (3) informational items on the agenda for discussion. 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 the recommendations from Cambridge Associates required committee approval only.

Following the approval of the minutes, Regent Hollingsworth moved to Item C on the agenda, an Audit Report on UH System Support Organizations – University of Houston System. Regent Hollingsworth asked Mr. Don Guyton, Chief Audit Executive to introduce this item.

Mr. Guyton stated that this item referred to the compliance review of the UH System Support Organizations and the UH System Support Organizations Report. The compliance review of the UH System Support Organizations indicated the status of the receipt of this information. The compliance review was prepared by the UH System Advancement Office and the accompanying compilation of financial information was prepared by UH System Financial Reporting. It was noted that some of the information from some of the foundations had not yet been received. Mr. Guyton did point out to the Board that the Conflict of Interest Policy had recently been received from the UH Alumni Association. Ms. Dona Cornell, Vice Chancellor for Legal Affairs and General Counsel stated that all policies were in place and an annual certification by the Support Organizations was required. A brief discussion followed.

Mr. Guyton stated the UH System Support Organizations Report was a compilation of information from audited financial statements, IRS Forms 990, investment reports and other information furnished to the UH System by the Support Organizations. The purpose of this report was to provide information on Support Organizations' activities and the Board of Regents' and UH System's responsibilities with respect to the foundations. As noted in the report, the Regents' fiduciary responsibilities to the UH System related to these organizations is addressed in agreements between the UH System and the organizations. In meeting the requirements of the Board of Regents' policy on Support Organizations, the UH System implemented a policy on Support Organizations which requires them to furnish certain information to the UH System. This requirement was spelled out in our agreements with the Support Organizations.

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

Regent Hollingsworth introduced Mr. Jim McShan, Interim Vice Chancellor for Administration and Finance and asked him to introduce the next items on the Endowment Management's agenda.

Mr. McShan stated that Cambridge Associates would be addressing the next five (5) agenda items. The first item addressed by Cambridge Associates would be Item D., the Report from Cambridge Associates regarding the UH System endowment and non-endowed portfolios – University of Houston System. This item was presented for information only. The next four (4) action items presented for the committee's consideration pertained to rebalancing and modifying policies related to the portfolio in order to change our asset mix. Mr. McShan asked Hamilton Lee, from Cambridge Associates to address these items. Below is a brief summary of their remarks.

Mr. Lee stated that over the last three months, the Cambridge team had been working on a strategic plan to improve performance in both absolute terms, and particularly, relative to peers. At this meeting, the focus was primarily going over the recommendations which encompassed not only asset allocation changes but implementation changes as well as manager changes.

- Over the last five years, since Cambridge has been working with the University of Houston in an advisory capacity:
 - (a) Returns have improved meaningfully; and they have exceeded most of the objectives of the Investment Policy Guidelines. Cambridge has outperformed spending plus inflation;

- (b) Returns have exceeded the policy benchmark; in fact, prior to that period, the University of Houston was lagging its benchmarks with more risk than the benchmark; and since this conversion, we have been beating the benchmark with less risk than the benchmark.
- However, the one area where the University has fallen short was in beating our peers. The Investment Policy Guidelines state that the expectation is that the portfolio would perform in the top half of the peer group over time.
 - Cambridge believes, that given the resources and the scale that the University of Houston has, there is no reason the University should not be able to perform in the top quartile of that peer group measured over longer periods of five-to-ten years. That was the objective of the long-term targets that were put in place in 2013, the cornerstone of which was using private investments as the growth engine of this portfolio, given the ability of this portfolio to assume more illiquidity and volatility risk.
 - Cambridge stated there were three (3) primary components as to why the endowment has lagged our peers.
- (a) Per the request of some of the committee members, a historical timeline of the University of Houston's endowment was outlined as follows:
- From its inception of the Endowment until 2002, the endowment was simply a beta fund: public equities, public bonds, no alternatives and concentrated almost entirely in the United States. Essentially a 70/30 US stocks and bonds portfolio and nearly one-half of the Endowment was managed by one manager, Fayez Sarofim.
 - In 2002, Cambridge was hired on a more limited basis; and at that point, Cambridge began to diversify the portfolio by geography, by manager and by asset class. At that time, Cambridge had put in place a 5% target to privates, which was later changed to 10%, but during that time there was little appetite among the committee members to commit on a regular basis to building that out.
 - In 2008, like many institutions, the University of Houston's endowment fell by nearly one-third. Obviously, not unlike many of our peers, risk aversion among the fiduciaries rose considerably, and there was a great emphasis placed on liquidity and safety. At that time, the committee put in place a short-term Treasury bond ladder to ensure that there was no capital loss in the bond portfolio; and at that time the plan to move into illiquid investments was temporarily put on hold.
 - In 2010, as the market was recovering, the committee began to focus seriously on updating the portfolio and bringing it more in line with those of its peers who have the same resources at their disposal and were trying to accomplish the same thing. There was also a recognition that the committee needed to bring in additional resources in order to make that happen. It was at that point, the University's relationship with Cambridge was converted to an advisory contract and Cambridge brought additional resources to build-out the private investment and hedge fund portfolios. At that time, the private investment portfolio was approximately 2.4% but the target allocation was nearly doubled from 10% to 17.5%. There was a real commitment then to make private investments a part of the University's portfolio.
 - In 2013, as part of Cambridge's ongoing monitoring of the University's portfolio, an Enterprise Review was conducted of the University's finances. One of the most important takeaways of this review was that the endowment was in a very enviable position. The annual 5 ½ % payout of the endowment only represented about 3% of the operating budget of the University. It was found that since the University could

afford to take more liquidity and volatility risk, the private investment target allocation increased from 17.5% to 25%.

- In 2015, the objective of Cambridge was to discover what had driven underperformance since then and try to identify, as they continue to try to buildup the privates program, how do they close the performance gap.
- (b) Why has the UHS endowment lagged peers? There were three primary drivers of the endowment's underperformance vs. top quartile peers over the last five years as follows:
- An underweight to private investments. This has been by far the greatest driver of underperformance.
 - The size and structure of the fixed income portfolio. Part of this underperformance stems from short-duration positioning.
 - An overweight to international equities.
- (c) Why has the UHS endowment lagged peers? Lessons Learned.
- Manager selection. Manager selection has generally been excellent with the notable exception of U.S. equity. The lesson learned – focus active management on concentrated, high conviction managers who operate in least-efficient areas of the market.
 - Portfolio positioning.
 1. U.S. equity manager structure too defensive. The lesson learned – include strong elements of both offense and defense, allowing for rebalancing among managers and participation in all markets.
 2. High position in fixed income and cash, short duration position. The lesson learned – if structured properly, the fixed income allocation can be substantially reduced while still maintaining defensive attributes.

A lengthy discussion followed.

Following the discussions, Regent Hollingsworth commented that clearly the University's private markets' allocation was something that is very important to the University and while we want to move aggressively we also want to be cautious and make sure we are in the best managers.

Regent Hollingsworth entertained a motion to approve, Item E, the rebalancing plan that was recommended by Cambridge Associates with respect to the risk adjusted asset allocation to improve our performance.

On motion of Regent Welder, seconded by Regent Agrawal, and unanimously approved by the members in attendance, the rebalancing plan that was recommended by Cambridge with respect to the risk adjusted asset allocation to improve our performance was approved.

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

Regent Hollingsworth stated that the committee would consider three private investment manager recommendations from Cambridge Associates, and unless otherwise notes, all three recommendations would be heard followed by the committee's consideration of all three private investment managers.

Ms. Katherine Chu, from Cambridge Associates, stated the first recommendation Cambridge recommended for the committee's consideration was for the University of Houston to approve a \$7.5 million commitment to Denham Oil and Gas Fund, L.P. Denham Capital Management

was seeking up to \$2.5 billion in commitments for Denham Oil & Gas Fund, the first sector fund launched since Denham split its strategy into three sector verticals. Denham is targeting a first close in summer 2015 for the Oil & Gas Fund. The University is a previous investor with Denham, committing \$4.0 million to Denham Commodity Partners VI in 2011.

Denham's oil and gas strategy is managed by a highly skilled and experienced investment team, whose members have managed energy-related companies and assets together for almost ten years. Denham's in-house geological and engineering expertise is a value-add for Denham's mid-cap-sized portfolio companies and adds to the sophistication of Denham's underwriting.

Denham's strategy of providing experienced management teams with staged growth capital to develop unconventional resources and exploit undermanaged oil and gas assets is unchanged from prior funds. A commitment to Denham Oil and Gas would continue the University's relationship with a strong and established firm in the U.S. energy space.

Denham's Oil and Gas Fund, L.P.'s terms are outlined below:

- Target Fund Size - \$2.0 billion (with \$2.5 billion hard cap)
- GP Commitment – Denham will commit the lesser of 2% or \$40 million to the Oil & Gas Fund, with approximately 80% contributed by Porter, Triocoli, and Marye.
- Management Fee – To be determined.
- Carried Interest – To be determined.
- Partnership Life – 8 years from final closing date, subject to two one-year extensions with LP consent.

Phil Fiske, from Cambridge Associates, addressed the second recommendation from Cambridge Associates for the University of Houston to approve a \$7.5 million commitment to EnerVest Energy Institutional Fund XIV, L.P. EnerVest Management Partners is seeking a maximum of \$3.0 billion in commitments for EnerVest Energy Institutional Fund XIV, LP. The fund will make direct investments in oil and gas assets in North America. A first close on \$1.27 billion occurred on May 1, 2015. Rolling closes are being held through June 30, 2015 or until the fund reaches its \$3.0 billion cap.

EnerVest directly operates 36,000 wells in 15 states, whereas most energy-focused private equity sponsors outsource operations to portfolio-company management teams. This structural setup helps EnerVest build scalable, dominate asset positions in favored basins while creating economics of scale across a large operating platform.

The senior professionals have extensive experience in acquiring, financing, and developing oil and gas properties, and the team has experienced relatively low turnover at the senior level. EnerVest's investment strategy incorporates both (1) the acquisition and exploitation of proven, producing reserves, which generates current income and has minimal geological risk; and (2) the development of additional reserve, which create additional upside at a heavily discounted acquisition price.

A commitment to EnerVest Energy XIV presents a unique opportunity for the University to gain exposure to both proven and developable oil and gas assets through an experienced team with a proven ability to generate solid returns through different cycles. EnerVest's operating structure provides key strategic advantages, enabling economies of scale and more attractive

operating economics than many of its private equity competitors that execute allocator strategies.

EnerVest Energy Institutional Fund XIV's terms are outlined below:

- Target Fund Size - \$2.5 billion (with \$3 billion soft cap)
- GP Commitment – At least 1.5% of commitments
- Management Fee – 2.0% during investment period, 1.5% post-commitment period
- Carried Interest – 20%
- Preferred Return – 9%
- Partnership Life – 10 years from initial closing date, subject to two one-year extensions with LP consent

Ms. Chu addressed the third private investment manager recommended by Cambridge Associates which was for the University of Houston to approve a \$7.5 million commitment to TrueBridge-Kauffman Fellows Endowment Fund IV. TrueBridge Capital Partners is targeting \$325 million, with a \$400 million maximum capitalization for Fund IV. The manager plans to hold a first closing in July 2015, a second closing in September 2015, and additional closings as needed. The University is a previous investor with TrueBridge-Kauffman, committing \$3.0 million to CVE-Kauffman Fellows Endowment Fund II in 2010 and \$3.0 million to CVE-Kauffman Fellows Endowment Fund III in 2013.

TrueBridge is a venture capital fund-to-funds. Most of the core GP commitments will be to U.S. early-stage, IT-focused funds, but the team will invest in multistage, non-US, growth equity, or life sciences funds opportunistically. Cofounders and partners are experienced investors and respected within the venture capital industry.

TrueBridge-Kauffman Fellows Endowment Fund IV's terms are outlined below:

- Target Fund Size - \$325 million (with \$400 million hard cap)
- GP Commitment – At least 1.0% of commitments
- Management Fee – 0.7% average over a 15-year term
- Carried Interest – 5%

Following the three private investment managers recommended by Cambridge Associates, Regent Hollingsworth called for a motion to approve the three recommendations as presented.

On motion of Regent Madison, 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 contracts for the hiring of the following three private investment managers were approved as follows:

1. A \$7.5 million commitment to Denham Oil and Gas Fund, L.P.;
2. A \$7.5 million commitment to EnerVest Energy Institutional Fund XIV, L.P.; and
3. A \$7.5 million commitment to TrueBridge-Kauffman Fellows Endowment Fund IV.

These three recommendations require committee approval only and no further board action is required.

Mr. McShan addressed the next item listed on the agenda, Item G, the Approval is requested to modify the UH System Endowment Fund Statement of Investment Objectives and Policies –

UH System. Mr. McShan stated that the following changes were being recommended as a result of a rebalancing plan that was discussed earlier in the meeting by the committee. The three Asset Classes to be modified were:

1. Absolute Return was increased from 7.5–15% to 10–20%;
2. Hedged (long/short) Equity was increased from 7.5 –15% to 10–20%; and
3. Deflation Protection (fixed income) was decreased from 7.5–30% to 5–20%

The below table summarizes the recommended changes in “**bold**” to these ranges.

Asset Class	Current Range	Proposed Range
U.S. Equity	10-30%	10-30%
Developed Non-U.S. Equity	10-30%	10-30%
Developing Market Equities	5-15%	5-15%
Absolute Return	7.5-15%	10-20%
Hedged (long/short) Equity	7.5-15%	10-20%
Private Investments	5-30%	5-30%
Marketable Inflation Protection	2.5-10%	2.5-10%
Deflation Protection (fixed income)	7.5-30%	5-20%
Cash	0-10%	0-10%

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

The next agenda item addressed was Item H, the Approval is requested to delegate authority to the Chancellor to negotiate and execute contracts for the transfer of the money market portion of the UH System non-endowed funds into Government and /or Treasury money market funds – UH System. Mr. Hamilton Lee, from Cambridge Associates addressed this item.

Mr. Lee stated that the Security Exchange Commission (SEC) had recently voted in a set of long-debated reforms to the rules governing money market funds. Cambridge’s recommendation to the committee was to transfer the money market funds (MMFs) within the non-endowed funds that were currently invested in Invesco’s Institutional Prime MMF investment vehicles to Morgan Stanley’s Treasury Securities Portfolio of money market funds. This action was recommended to protect the System’s money market investments against future volatility risk when the SEC’s new regulations governing money market funds go into effect in 2016.

In 2016, institutional prime MMFs will float their net asset values (NAV) based on underlying security market valuations. This floating NAV is prohibited by our Investment Policy for Non-Endowed Funds. Government and Treasury MMFs are exempt from the new SEC regulations.

Cambridge recommended this action in order to get ahead of this impending change to avoid potential liquidity issues as other institutional investors seek to switch their funds into Government and Treasury funds.

On motion of Regent Madison, seconded by Regent Agrawal, and by a unanimous vote of the members in attendance, the request to delegate authority to the Chancellor to negotiate and execute contracts for the transfer of the money market portion of the UH System non-endowed funds into Government and/or Treasury money market funds was approved. This action required committee approval only and no further board action is required.

The next action item, Item I, the Approval is requested to liquidate an endowment from the UH System Endowment Fund – UH System. Mr. McShan presented this item requesting the approval to liquidate an endowment from the Victoria Rotary Fund that was created in 1987 in order to provide scholarships to students who were transferring from the Victoria College to the UH-Victoria campus. There were stipulations within that endowment that if there was significant change in the structure they would be able to withdraw the funds; and with the downward expansion of UH-Victoria, they have requested to withdraw those funds. This has been reviewed by the Legal Department and they concurred. This endowment has a value of \$83,000.

On motion of Regent Madison, seconded by Regent Agrawal, and by a unanimous vote of the members in attendance, the request to liquidate the Victoria Rotary Fund from the UH System Endowment Fund was approved.

The last action item presented to the committee, Item J, the Approval is requested to modify the investment resolutions for the University of Houston System – UH System. Mr. McShan presented this item requesting approval to delete Dr. Carl Carlucci from the authorized list of authorized persons who may conduct investment transactions for the UH System and add Mr. Jim McShan. These changes were due to personnel changes at the University of Houston.

On motion of Regent Welder, seconded by Regent Agrawal, and by a unanimous vote of the members in attendance, the request to modify the investment resolutions for the University of Houston System was approved.

At the conclusion and approval of this item, Regent Hollingsworth made the motion to place the 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 Agrawal, seconded by Regent Welder, and by a unanimous vote of the regents in attendance, the following three items will be placed on the Board of Regents' Consent Docket Agenda for final board approval at the May 21, 2015 Board of Regents' meeting as follows:

1. Approval is requested to modify the UH System Endowment Funds State of Investment Objectives and Policies - UH System;
2. Approval is requested to liquidate an endowment from the UH System Endowment Fund – UH System; and
3. Approval is requested to modify the investment resolutions for the University of Houston System – UH System.

The final agenda item was addressed for information only, Item K, Report on the UH System's invested fund and bank deposits, and Mr. Raymond Bartlett, 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 28, 2015. There was \$1.23 billion of investable funds and bank deposits as of this date. 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 10:30 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:

Jim McShan	Mark Dalton	Hamilton Lee
Paula Myrick Short	Katherine Chu	Erin Schuhmacher
Dona Cornell	Raymond Bartlett	Phil Fiske
William Flores	Don Guyton	Dana Rooks
Vic Morgan	Wayne Beran	Steve Wallace
Eloise Dunn Stuhr	Dan Maxwell	Mike Emery
Ramanan Krishnamoorti	Jeffrey Cass	Mark Clarke
Richard Walker	Don Price	Shannon Harrison
Dick Phillips	Sabrina Hassunami	Katie Brown
Patrick Peters	Phil Booth	Jeanne LaMontagne

Others Present: (cont'd)

Brian Thomas	Joe Brueggman	Jon Aldrich
Nick Bowen	Abner Fletcher	Ben Aldrich
Phil Aldrich	Marquette Hobbs	Brenda Robles
Gerry Mathisen		