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

August 12, 2009

The Chair of the Committee, Carroll Robertson Ray, convened the Endowment Management Committee of the University of Houston System Board of Regents, in the Athletics/Alumni Center, Melcher Board Room 100B, 3100 Cullen Boulevard, Houston, Texas, on Wednesday, August 12, 2009 at 1:07 p.m., with the following members present: Jim P. Wise, Vice Chair, Calvin W. Stephens, Kristen Lindley, Welcome W. Wilson, Ex Officio, and Michael J. Cemo and J. Christopher Jones, as Advisory Members.

Regent Ray introduced the following four items that would be presented before the committee and turned the meeting over to Dr. Carlucci, Executive Vice Chancellor for Administration and Finance, who introduced the items.

- Report and Recommendations regarding Endowed and Non-Endowed Assets – UH System;
- Approval of the UH System Endowment Fund Statement of Investment Objectives and Policies – UH System;
- Approval of the UH System Investment Policy for Non-Endowed Funds – UH System; and
- Approve an Amendment to the existing contract with Cambridge Associates – UH System.

Dr. Carlucci stated monthly briefings with Cambridge Associates had taken place and these calls had been very productive. Dr. Carlucci asked Hamilton Lee, from Cambridge Associates, to give his report to the committee.

Mr. Lee gave a Market Update Report. He stated the credit markets were stabilizing but the housing market was still the main problem. Consumer confidence was below the level experienced during the 1990’s recession but stabilizing. 2008 corporate earnings plummeted 82% to levels not seen since 1986. Mr. Lee emphasized that the second quarter had seen a dramatic rally in equity and bond markets in the US and overseas with the S&P 500 up nearly 16% on the quarter, while developed international markets rose over 25%. Emerging markets equities rose over 34%, with Asia gaining 44%. The global government bond gains were somewhat more modest, but still in positive territory at 2.95%.

A Performance Update through June 30, 2009 was addressed. Small caps outperformed their large-cap counterparts for the quarter. The UH System Endowment returned 11.8% during the second quarter, which was slightly ahead of the Cambridge Associates Endowment Median return and ahead of either of its benchmarks. The Endowment had gained 6.2% year-to-date, just behind the Cambridge median return, but well ahead of both portfolio benchmarks.
Cambridge Associates had conducted a comprehensive review of the UH System’s Investment Policy and the basic elements of the policy were found to be both prudent and appropriate. Below is a brief outline of three questions which were reviewed by Cambridge:

1. Does the policy provide for sufficient diversification to reduce short-term volatility and enhance long-term return?

   Mr. Lee stated diversification was a powerful tool for reducing and increasing return, but works best when the portfolio is regularly rebalanced back to target. The University’s Investment Policy recognizes this fact, e.g. when an asset class is 5% above or below its allowable range, automatic rebalancing is triggered.

2. Does it ensure that the Endowment is protected against economic disaster scenarios such as deflation and unexpected inflation?

   The Endowment Management Committee has included permanent target allocations both to high-quality bonds (15%) and to real assets (10%). Cambridge felt that a hedge representing 3-4 years’ payout should be sufficient to help maintain spending for the duration of a given economic crisis.

3. Does it effectively match the investment objectives of the Endowment to the financial objectives of the University?

   The purpose of the Endowment is to provide support for the educational mission of the University; and as such, the most basic purpose of the Investment Policy is to ensure that the endowment is able to fulfill that purpose — by defining asset allocation and outlining risk controls.

   The University depends on a payout of 5% from the Endowment each year to carry out its educational mission; however, it was decided last year to lower the payout to 4% in order to reduce the burden on the Endowment in the wake of the recent market correction. In addition to the payout, according to the Investment Policy, a University Advancement fee of 1.5% was assessed to offset fundraising costs.

The following recommendations were made by Cambridge Associates regarding the UH System’s Endowment Fund’s Investment Policy:

1. Delete text permitting a pro-rata payout on current fiscal year gifts.

2. The following changes were recommended by Cambridge to the asset allocation lower and upper ranges:

<table>
<thead>
<tr>
<th>Asset Class</th>
<th>Current Range</th>
<th>Proposed Range</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fixed Income</td>
<td>15% - 30%</td>
<td>10% - 30%</td>
</tr>
<tr>
<td>Mid to large cap equities</td>
<td>20% - 40%</td>
<td>15% - 35%</td>
</tr>
<tr>
<td>Non-US equities</td>
<td>10% - 30%</td>
<td>15% - 35%</td>
</tr>
<tr>
<td>Asset Class</td>
<td>Current Range</td>
<td>Proposed Range</td>
</tr>
<tr>
<td>-----------------------------------</td>
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</tr>
<tr>
<td>Absolute Return</td>
<td>5% - 10%</td>
<td>5% - 15%</td>
</tr>
<tr>
<td>Long/Short Equity Mgrs</td>
<td>5% - 10%</td>
<td>5% - 15%</td>
</tr>
<tr>
<td>Non-marketable Equity Mgrs</td>
<td>0% - 10%</td>
<td>0% - 12%</td>
</tr>
</tbody>
</table>

Regent Wise moved committee approval to modify the UH System Endowment Fund Statement of Investment Objectives and Policies. Regent Wilson seconded the motion, which passed unanimously. This item will be placed on the agenda for the August 18, 2009 Board of Regents Meeting for final approval.

The UH System Investment Policy for Non-Endowed Funds was addressed. Mr. Lee stated additional language had been added to the rebalancing section which provides guidance to staff on rebalancing in between committee meetings should the upper or lower ranges of any investment pool (cash, liquidity, or core) be breached. This language is similar to what is in the rebalancing section of the Endowment Investment Policy.

The following requirements were also added to the UH System Investment Policy for Non-Endowed Funds:

- Any money market fund or mutual fund must be SEC 2a-7 compliant. This is codifying in policy an existing practice.
- Any money market fund or mutual fund investment must be rated AAA or its equivalent by the two nationally recognized statistical rating organizations that rate our debt. Current language only requires one nationally recognized statistical rating organization. This was an important modification since the two organizations that currently rate our debt discount our liquidity if the mutual funds are not SEC 2a-7 compliant and rated AAA.
- Require a review of the Investment Policy at least once a year.

Regent Wise moved committee approval to modify the UH System Investment Policy for Non-Endowed Funds. Regent Wilson seconded the motion, which passed unanimously. This item will be placed on the agenda for the August 18, 2009 Board of Regents Meeting for final approval.

One of the Endowment’s real estate managers, Berwind Property Group (BPG), was seeking to raise an $85 million mezzanine facility in order to deleverage and refinance six properties in their Fund VII. It was offering right of first refusal to current Limited Partners, with a rate of 20% compounded annually on the mezzanine financing. BPG would provide a more detailed due diligence package on all of the properties by mid-August. This was discussed in detail and the committee decided that appraisals should be done on the properties and more information gathered before a final decision is made.

The last item on the agenda, Approve an Amendment to the Existing Contract with Cambridge Associates – UH System, was tabled by the committee.
There being no further business to come before the committee, the meeting was adjourned at 4:17 p.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       Hamilton Lee       Raymond Bartlett
Dona Comell        Bruce Myers        Tom Ehardt
Eli Ciprano        Karen Clarke       Barbara Stanley
Jon Aldrich        Marquette Hobbs    Gerry Mathisen