MINUTES
UNIVERSITY OF HOUSTON SYSTEM
BOARD OF REGENTS
ENDOWMENT MANAGEMENT COMMITTEE

Tuesday, August 13, 2013 – The members of the Endowment Management Committee of the University of Houston System convened at 1:45 p.m. on Tuesday, August 13, 2013, at the Hilton University of Houston Hotel, Conrad Hilton Ballroom, Second Floor, 4800 Calhoun, Houston, Texas, with the following member(s) and alternate member(s) participating. One (1) committee board member was unable to attend the meeting. Nelda Luce Blair, Chair of the UH System Board of Regents, appointed an alternate committee board member; therefore, constituting a quorum of the committee for this meeting.

ATTENDANCE –

<table>
<thead>
<tr>
<th>Present</th>
<th>Member(s) Absent</th>
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<tbody>
<tr>
<td>Mica Mosbacher, Chair</td>
<td>Jacob M. Monty, Member</td>
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<tr>
<td>Jarvis V. Hollingsworth, Vice Chair</td>
<td>Jim P. Wise, Advisory Member</td>
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<tr>
<td>Roger F. Welder, Alternate Member</td>
<td>Non-Member(s) Present</td>
</tr>
<tr>
<td>Nelda Luce Blair, Ex Officio</td>
<td>Welcome W. Wilson, Jr., Regent</td>
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<tr>
<td>Carroll Robertson Ray, Advisory Member</td>
<td>Benjamin P. Wells, Student Regent</td>
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In accordance with a notice being timely posted with the Secretary of State and there being a quorum in attendance, Chair of the Committee, Mica Mosbacher, called the meeting to order.

The first item requiring committee approval was the minutes from the Endowment Management Committee meeting held on Tuesday, May 13, 2013.

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AGENDA ITEMS

Action Items:

• Approval of Minutes – Item B

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

• May 13, 2013, Endowment Management Committee Meeting

Action/Information Items:

Regent Mosbacher noted there were five (5) action items and two (2) informational items on the agenda and stated the committee would hear presentations from Cambridge Associates; a
Cambridge Associates presented the first four (4) agenda items for the committee’s consideration.

1. Item C, the Report and Recommendations from Cambridge Associates regarding Endowed and Non-Endowed Assets;

2. Item D, Approval is requested to delegate authority to the Chancellor to negotiate and execute a contract for the hiring of an international equity investment manager for the University of Houston System Endowment Fund;

3. Item E, Approval to delegate authority to the Chancellor to negotiate and execute a contract for the hiring of a long/short equity hedge fund manager for the University of Houston System Endowment Fund; and

4. Item F Approval to fully redeem the UH System’s investment in a long/short equity hedge fund manager – University of Houston System will be addressed, respectively.

Regent Mosbacher requested Dr. Carlucci, Executive Vice Chancellor for Administration and Finance introduce these items to the committee.

Dr. Carlucci stated that due to the fact that there were two new firms being presented for the committee’s consideration as well as changes to the investment policies, he asked that Cambridge Associates give their presentations.

Mr. Hamilton Lee and Ms. Shannon Thomas, both from Cambridge Associates, addressed the committee and gave an executive summary, market update, and portfolio review. Below is a brief summary of their remarks:

- As of June 30, 2013, the University of Houston’s portfolio was up 4.0% year-to-date and 10.7% over the trailing one-year, lagging the Implementation Benchmark by 20 bps for the quarter and performing in line over the trailing twelve-months.
- Strong trailing one-year performance was largely a function of the University’s international equity (+22.2%), U.S. equity (+20.1%), and absolute return (+13.7%) portfolios.
- Over the trailing one-year, the portfolio had outpaced the inflation + 5.5% spending rate for the trailing one-year by 360 bps.
- As of June 30, 2013, all asset classes remain close to interim targets with the following notable deviations:
  - The 9.3% current allocation to cash is a result of pending disbursements.
  - Intentional underweight to U.S. equity by 2.2% given rich current valuations.
  - Underweight fixed income and overweight cash (after accounting for pending disbursements).
  - Overweight absolute return hedge funds relative to equity hedge funds, given the tactical portfolio tilt to lower volatility strategies.
All asset classes remain well within allowable ranges.
- Market turbulence in the second quarter saw solid returns from April and early May nearly washed away by the possibility of the Federal Reserve “tapering” its asset purchase program later this year.
- Despite this announcement, U.S. equities returned 2.9% for the quarter and led non-U.S. developed markets by 390 bps. The emerging markets underperformance trend continued, with emerging markets equities lagging developed markets by over 1,350 bps year-to-date.
- In addition, yields on 10- and 30-year Treasuries spiked during the quarter, resulting in the asset’s worst quarterly performance since 2010.

Mr. Lee gave a brief summary of their Asset Allocation Review. Below is a brief summary of his remarks.

- Their recent review of the University’s finances (the “Enterprise Review”) suggested that the endowment may be too defensively positioned given its limited role within the annual budget.
- The University of Houston is in a strong financial position, with multiple sources of revenue and conservative debt practices.
- The annual payout of 4% from the endowment represents only 3% of the University’s total operating budget.
- Given these factors, Cambridge recommended increasing the endowment’s short-term risk (volatility, illiquidity) in order to reduce its long-term risk. This would enable the endowment to provide an increasing level of support to future generations of students, without impairing the near-term support of current students.
- Some of the top line elements that Cambridge came away with from the Enterprise Review were:
  - Increase the drivers of growth from 65.0% to 72.5% of the endowment.
    (a) The most material change is an increase in private investments from 12.5% to 17.5%.
    (b) While public equities increase from 40% to 45%, Cambridge recommended a slight reduction in U.S. equities due to relative attractiveness of other opportunities over the long term.
    (c) The overall increase of 5% in public equities is a result of increasing the Developing Markets (including Emerging Markets) allocation from 5% to 10%. From the standpoint of both valuations and potential growth, Cambridge believes the developing economies offer substantially greater potential for growth in the long run.
  - Reduce Hedge Funds from 25.0% to 20.0%.
    (a) While hedge funds – both long/short equity and absolute return – still have a meaningful role to play in both reducing volatility and driving return, Cambridge recommended gradually sourcing funds from marketable alternatives in order to increase the allocation to direct ownership assets described above.
  - Reduce Macroeconomic Hedges (inflation and deflation) from a combined 22.5% to a combined 17.5%.
    (a) The role of marketable natural resources and bonds is to provide a source of spending during periods of unexpected inflation or deflation, respectively, avoiding a forced sale of growth assets at depressed prices.
(b) While Cambridge recommended reducing bonds and marketable natural resources by 2.5% each, the remaining allocations should still provide between two and three years’ worth of payout in the event of an inflationary or deflationary environment. A brief discussion followed.

Mr. Lee discussed the Comparative Asset Allocation. Below is a summary of his remarks.

- Colleges and universities between $500 million and $700 million as of March 31, 2013 with similar assets to the University of Houston were addressed; but Mr. Lee stated that Cambridge felt it was more telling to compare UH to other colleges and universities that were in the same position where the payout represented a small percent of budget; and
- Public colleges and universities between $350 million and $1.8 billion with less than 4% endowment reliance as of March 31, 2013 were discussed. Mr. Lee stated that most of these colleges and universities’ budgets relies less than 4% on the payout. There were some very interesting differences between these two classes and moving to a new asset allocation would position UH more in the group of $500-$700 million.

Cambridge stated there would be a proposed change in allocation but also a change in categorization. Below is a brief summary of this proposal.

- Historically, UH has made allocations to private natural resources in both the inflation hedge and private equity categories. In addition to increasing the private investments allocation by 5%, Cambridge recommended the following change to how private and inflation-sensitive assets were categorized:

<table>
<thead>
<tr>
<th>Current Classification and Allocation</th>
<th>Proposed Classification and Allocation</th>
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<tbody>
<tr>
<td>Private Equity/Venture Capital</td>
<td>Private Equity/Venture Capital</td>
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<tr>
<td>Traditional Private Equity/Venture Capital</td>
<td>7.5%</td>
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<tr>
<td>Illiquid Natural Resources</td>
<td>2.5%</td>
</tr>
<tr>
<td>Inflation Hedge</td>
<td></td>
</tr>
<tr>
<td>Marketable Natural Resources</td>
<td>7.5%</td>
</tr>
<tr>
<td>Illiquid Natural Resources</td>
<td>2.5%</td>
</tr>
<tr>
<td>Total Illiquid Investments</td>
<td>12.5%</td>
</tr>
<tr>
<td>Total Inflation-Sensitive Investments</td>
<td>10.0%</td>
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</tbody>
</table>

Cambridge addressed the proposed allowable ranges for more flexibility. Below is a breakdown of the current vs. proposed targets and current vs. proposed ranges.

<table>
<thead>
<tr>
<th>Current vs. Proposed Targets</th>
<th>Current vs. Proposed Ranges</th>
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<tbody>
<tr>
<td>Developed Markets -</td>
<td>Developed Markets</td>
</tr>
<tr>
<td>U.S. Equity</td>
<td>20.0% vs. 17.5%</td>
</tr>
<tr>
<td>Dev. Int’l Equity</td>
<td>15.0% vs. 17.5%</td>
</tr>
<tr>
<td>Developing Markets -</td>
<td>5.0% vs. 10.0%</td>
</tr>
<tr>
<td></td>
<td>30.0% to 65.0%</td>
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<tr>
<td></td>
<td>12.5%-30% vs. 10%-30%</td>
</tr>
<tr>
<td></td>
<td>10%-30% vs. 10%-30%</td>
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<tr>
<td></td>
<td>2.5%-7.5% vs. 5%-15%</td>
</tr>
<tr>
<td>Current vs. Proposed Targets (cont’d)</td>
<td>Current vs. Proposed Ranges (cont’d)</td>
</tr>
<tr>
<td>-------------------------------------</td>
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</tr>
<tr>
<td>Hedge Funds - 25.0% vs. 20.0%</td>
<td>Hedge Funds - 15%-35% vs. 15%-30%</td>
</tr>
<tr>
<td>Hedged Equity 12.5% vs. 10.0%</td>
<td>Hedged Equity 7.5%-17.5% vs. 7.5%-15%</td>
</tr>
<tr>
<td>Absolute Return 12.5% vs. 10.0%</td>
<td>Absolute Return 7.5%-17.5% vs. 7.5%-15%</td>
</tr>
<tr>
<td>Private Investments - 12.5% vs. 17.5%*</td>
<td>Private Investments - 0%-12% vs. 5%-20%</td>
</tr>
<tr>
<td>Mktbl. Inflation Hedge - 7.5% vs. 5.0%</td>
<td>Mktbl. Inflation Hedge -5%-15% vs. 2.5%-10%</td>
</tr>
<tr>
<td>Fixed Income - 15% vs. 12.5%</td>
<td>Fixed Income - 10%-30% vs. 10%-30%</td>
</tr>
<tr>
<td>U.S. 10.0% vs. 8.5%</td>
<td>U.S. NA vs. 7.5%-25%</td>
</tr>
<tr>
<td>Global 5.0% vs. 4.0%</td>
<td>Global NA vs. 2.5%-10%</td>
</tr>
<tr>
<td>Cash - ---% vs. ---%</td>
<td>Cash 0%-10% vs. 0%-10%</td>
</tr>
<tr>
<td>TOTAL 100% vs. 100%</td>
<td>TOTAL ---% vs. ---%</td>
</tr>
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*Effective current target is 12.5% because 2.5% in private timber investments are currently classified in the marketable inflation protection asset class. Therefore, effective LT target change is 5% not 7.5%.

Prior to approval of Item G, the Approval to modify the UH System Endowment Fund Statement of Investment Objectives and Policies (IPS) – University of Houston System to change the long-term target asset allocation and allowable ranges within asset classes of the endowment fund and update the rebalancing section of the IPS, Dr. Carlucci also noted there was some cleanup language in the policy including the section that confirms the implementation of rebalancing on the advice of Cambridge. A brief discussion followed.

After the discussion, Regent Mosbacher called for a motion to approve this item with the amended text as italicized in bold below.

**Proposed**

Any rebalancing action taken by the Treasurer and Investment Consultant shall be communicated to the entire Committee by the Executive Vice Chancellor in a timely manner, but in any case no later than the next Committee meeting.

After further committee discussion, the following amended text in italics and bold was added and approved by the committee.

**Amended and Approved Text**

Any rebalancing action taken by the Treasurer and Investment Consultant shall be communicated to the Chair of the Endowment Management Committee and to the Committee by the Executive Vice Chancellor in a timely manner, but in any case no later than the next Committee meeting.

On motion of Regent Hollingsworth, seconded by Regent Welder and by a unanimous vote of the committee members in attendance, the approval to modify the UH System Endowment Fund Statement of Investment Objectives and Policies – University of Houston System with
the above amended text was approved. This item approved by the committee will be placed on the Board’s Consent Docket Agenda for final board approval at the Wednesday, August 14, 2013 meeting.

Ms. Shannon Thomas, from Cambridge Associates, addressed William Blair. She reminded the committee that William Blair was a current developed ex-U.S. manager and recently the PM had announced his retirement. This is a significant personnel turnover and is currently being addressed, but a conclusion has not yet been reached.

Ms. Thomas presented the committee with a manager overview of MFS International Equity. She stated their team had established one of the most consistent and longstanding track records in the global ex-U.S. asset class. With half of its analysts positioned outside U.S. borders, the firm’s global presence is well-established; and the institutional mutual fund vehicle is attractively priced at 75 bps.

Following a discussion with the committee, Item D, approval to delegate authority to the Chancellor to negotiate and execute a contract for the hiring of an international equity investment manager for the University of Houston System Endowment Fund was tabled until the next committee meeting.

Regent Mosbacher requested the next item on the agenda, Item E, approval to delegate authority to the Chancellor to negotiate and execute a contract for the hiring of a long/short equity hedge fund manager for the University of Houston System Endowment Fund be presented to the committee.

Mr. Gene Lohmeyer, from Cambridge Associates, stated Cambridge had a number of recommendations to present to the committee as noted below.

1. Full redemption from Three Bridges Capital;
2. New $7.5 million investment with Sheffield Asset Management; and
3. Additional $1.5 million investment in BlueCrest AllBlue

The hedge fund program’s performance as of June 30, 2013 was also addressed. The University of Houston’s hedge fund allocation had outpaced its HFRI benchmark and global equities for the first half of 2013. On a 3-year basis, the program had achieved 60% of the return of global equities with approximately 30% of the volatility and a beta of 0.25.

Mr. Lohmeyer stated that pre-event and event driven equities worked well. The ability of creditworthy firms to borrow at 2.5% pre-tax had proven to be a meaningful catalyst for M&A activity. Credit strategies also worked well. Several managers continue to benefit from a multitude of credit strategies including, mortgages, structured credit, European distressed, and bankruptcy investments had worked.

What had not worked, Mr. Lohmeyer stated that -
1. Asia – asset prices in the Asia Pacific region had been heavily influenced by macro-economic and policy factors, to include a deceleration of growth in China and the use of aggressive reflationary monetary policies in Japan; and
2. Global macros strategies – fears of rising interest rates in the U.S. and economic weakness in China caused sharp reversals in global currency and fixed income markets during May and June.

Cambridge then outlined the recommendations for the committee’s consideration as follows:

1. Three Bridges is a long/short equity fund focused on mid and large cap European equities that the University of Houston originally invested in effective April 1, 2011. There were two primary reasons for Cambridge’s termination recommendation:
   (a) inconsistencies in the application of the fund’s stated investment approach; and
   (b) personnel turnover.

2. Cambridge recommended the redemption from Three Bridges as of 9/30/2013, which would require notification prior to 8/29/13 (30 days’ notice).

On motion of Regent Hollingsworth, seconded by Regent Welder, and by a unanimous vote of the committee members in attendance, the redemption from Three Bridges as of 9/30/13 was approved by the committee. This action requires committee approval only and no further board action is required.

Mr. Lohmeyer addressed the proposed new $7.5 million investment with Sheffield Asset Management and stated that at the very highest level, on the surface, this is not a manager markedly different from others in the portfolio in terms of the mechanics of the strategy and the underlying philosophy, but if you were to dig a little deeper, they are differentiated in some important ways from other firms.

1. Sheffield is located in Chicago and is an important factor to consider in terms of the soft form of geographic diversification.
2. Sheffield has two senior portfolio managers, each having over 15 years of investment experience and co-portfolio managers at Sheffield since 2004. Meanwhile, AUM has been in the $400 to $600 million range throughout most of the fund’s existence and asset growth has been extremely disciplined.
3. They offer investors discounted management and incentive fees (1% and 17.5%) for the fund’s 2-year rolling lock share class.
4. Sheffield was founded in 2003 by Brian Feltzin with approximately $25 million; and in 2004 was joined by co-portfolio manager Craig Albert, who was previously a partner at Osparie Fund, a long/short fund focused on natural resource equities. Feltzin and Albert have known each other for over 20 years.
5. The fund typically holds 15 to 20 long positions and 40+ short positions. Net and gross exposures have averaged approximately 40% and 130% throughout the fund’s history, with moderate fluctuations over time.
6. Sheffield employs 10 people, including 5 investment professionals, and manages approximately $650 million out of a single office located in Chicago, IL. The fund’s
investor base is comprised of approximately 25% fund-of-funds, 8% endowments and foundations, 55% high net worth (9% insider), 12% insurance companies.

Mr. Lohmeyer also mentioned some additional issues of consideration as follows:

1. The fund’s top 10 positions typically comprise 50%+ of NAV, and occasionally 70%+. This concentration, along with the fund’s tendency to own out of favor companies, may result in high levels of interim volatility.

2. Within the past few years, Sheffield altered its short selling process by incorporating thematic baskets of equities for approximately 50% of short exposure, with the remainder focused on alpha generative single name short positions. To clarify, the baskets were not ETF’s or indices – all of the underlying holdings were hand-picked and individually selected by the investment team.

3. Sheffield has generally maintained a lean investment team comprised of 5 to 7 analysts.

4. A strategic alliance with Grosvenor Capital, a Chicago-based fund-of-funds, who has a passive interest in Sheffield’s economics and also provides operational support to the firm, including accounting and fund administration services.

Sheffield’s Summary of Terms was addressed by Mr. Lohmeyer as follows:

- Fund/product: Sheffield International Partners, Ltd., Class B shares
- Fees: 1.0% management fee, 17.5% incentive fee subject to a modified high water mark
- Exit Terms: 24 month rolling hard lock-up, 90-day notice period for redemptions.

On motion of Regent Welder, seconded by Regent Hollingsworth, and by a unanimous vote of the committee members in attendance, the new $7.5 million investment with Sheffield Asset Management was approved by the committee. This action requires committee approval only and no further board action is required.

Dr. Carlucci requested the committee consider and approve Item C, the report and recommendations from Cambridge Associates which included one (1) rebalancing of the investment of $1.5 million of proceeds from Maverick redemptions into BlueCrest AllBlue.

On motion of Regent Welder, seconded by Regent Hollingsworth, and by a unanimous vote of the committee members in attendance, the rebalancing of the investment of $1.5 million of proceeds from Maverick redemptions into BlueCrest AllBlue was approved by the committee. This action requires committee approval only and no further board action is required.

Item H, Report on Securities Lending – University of Houston System was addressed. Mr. Raymond Bartlett, Treasurer stated that the University of Houston does not do securities lending; the policy does not allow for it without board approval. Mr. Hamilton Lee discussed the issue of securities lending and there have been some changes made in this area. The committee stated they were open to hearing further details concerning this issue at a future meeting. This item was for information only and required no committee action.
The last item presented to the committee was Item I, Report on the UH System’s Invested Funds and Bank Deposits – University of Houston System. Mr. Raymond Bartlett gave a summary report to the committee of these funds which totaled $1.2 billion as of May 31, 2013. Most of these funds are restricted. The Endowment Fund has a total of $577.9 million. The Bond Proceeds Project Funds and the Debt Service Funds totaled $185.1 million and $22,000, respectively; and these project funds represent the investment of bond proceeds for various capital projects and are drawn down as projects progress through time. The Non-Endowed Funds totaled $448.9 million which is UH’s liquid reserves invested in money market funds and short-term fixed income. This information is also posted to the Finance 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.

No Executive Session was called.

There being no further business to come before the Committee, the meeting adjourned at 3:25 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:

Renu Khator  Raymond Bartlett  Hamilton Lee
Carl Carlucci  Shannon Thomas  Phil Fiske
Dona Cornell  Gene Lohmeyer  Eloise Dunn Stuhr
Jim Blair  Nam My Le  Anita Couch
Tom Ehardt  Victor Duran  Jon Aldrich
Ed Jones  Marquette Hobbs  Brenda Robles
Gerry Mathisen