MINUTES
UNIVERSITY OF HOUSTON SYSTEM
BOARD OF REGENTS
ENDOWMENT MANAGEMENT COMMITTEE

Thursday, August 24, 2017 - The members of Endowment Management Committee of the University of Houston System convened at 9:05 a.m. on Thursday, August 24, 2017, at the Hilton University of Houston Hotel, Conrad Hilton Ballroom, Second Floor, 4450 University Drive, Houston, Texas, with the following members participating:

ATTENDANCE –

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

Non-Member(s) Present
Paula M. Mendoza, Regent
Peter K. Taaffe, Regent
Neelesh C. Mutyala, Student Regent, Non-voting

Members Absent
Tilman J. Fertitta, Ex Officio

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 five (5) agenda items listed on the agenda – one (1) requiring committee and board approval; three (3) requiring committee approval only; and the remaining item for information only. There were four (4) 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 Agrawal moved to the first action item requiring committee approval, the minutes from the May 18, 2017, Endowment Management Committee meeting.

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

- May 18, 2017, Endowment Management Committee Meeting

Following the approval of the minutes, Regent Agrawal stated the next item listed on the agenda would be presented by Cambridge Associates and he asked Mr. Jim McShan, Senior Vice
Mr. McShan introduced the four (4) Cambridge Associates in attendance at the meeting: Kerry Kirk, Erin Schuhmacher, Phil Fiske, and Katherine Chu, all of whom would be presenting various items to the committee for discussion; and asked Mr. Kirk to please begin his presentation to the committee.

Mr. Kerry Kirk stated investment returns for the University of Houston System Endowment had turned over the last year or so in the direction everyone had wanted and planned for and real progress was being made both in terms of the level of absolute returns and relative to returns – relative to our spending rate and returns relative to our various policy benchmarks. Mr. Kirk asked Ms. Erin Schuhmacher to present an update on the performance of the UH Endowment and below is a brief summary of her remarks.

- Ms. Schuhmacher addressed the market returns across asset classes for both the calendar year to date and the trailing one (1) year performance.
- Since this meeting focused on the second quarter through June 30, 2017, Ms. Schuhmacher stated she would provide updated numbers to share with the committee and stated it had been a very strong market for equities with all regions performing quite well.
- It was noted that the current updated numbers for U.S. Equities were up significantly by approximately 11%; Developed International Equities up approximately 17%; and Emerging Markets up nearly 27% on a year to date basis.
- Hedge Funds have delivered decent returns and Cambridge expects them to lag Equities in these markets but be ahead of Bonds. Cambridge has also seen some mixed performances in Real Estate, Commodities and Natural Resource Equities.
- Ms. Schuhmacher presented a performance summary of the total marketable assets vs. the total portfolio. She wanted the committee to understand what the difference was between total marketable assets and total portfolio. She explained that effectively marketable assets were everything in the portfolio except for private investments while the total portfolio had everything including private investments. The reason why this was meaningful was because those private investments are priced and marked on a lag; therefore, every quarter that Cambridge presents to the Committee there is at least one quarter of the performance of the privates that is marked at zero. There is currently approximately 15% of the portfolio in privates which is meaningful when you look at this as near-term and shorter-term performance.
- From a quarter to date perspective, Ms. Schuhmacher stated that the CY 2017, 1/01/17-6/30/17 number of 7.7% was a good number through this timeframe and market ably ahead of both the policy and the dynamic benchmarks but does not include the private investments.
- Peer performance was noted. By and large, when you look at comparing performance across peer groups, the majority of any institution’s performance is due to their asset allocation.
- As one thinks of comparing those, one needs to think about implementation. So relative to our peers, with the implementation of the strategic plan, more equity has been taken with this portfolio, so there is slightly more equities and slightly less bonds than the peers.
Ms. Schuhmacher noted that the July 2017 performance was up approximately 2%, bringing the year to date up to 10.5%.

Since 2012, the Endowment has added $92 million in new gifts; generated $188 million in realized/unrealized gains; distributed $90 million to the beneficiary accounts; and paid $23 million in portfolio expenses.

As of June 30, 2017, the YTD 2017 University of Houston current assets in the Endowment totaled $641 million. It was noted that by the end of the year, this amount will decrease as a cash draw of $29 million will done.

Relative performance was addressed on an YTD basis. Returns exceeded the policy benchmarks, driven by active managers within U.S. Equities, Non-U.S. Equities, and Hedge Funds. Managers on aggregate were up 11.9%, 300 basis points better than the benchmark.

While Emerging Markets have trailed the benchmark, on an absolute level their performance has been strong.

As of June 30, 2017, the UH Endowment was moderately overweight in Equities and underweight in Hedge Funds.

The total Non-Endowed Assets was approximately $445 million.

Ms. Schuhmacher turned to Mr. Kirk to continue with his remarks. Below is a brief summary of his comments.

Mr. Kirk discussed the threefold objectives of the Return Distribution Analysis which were as follows:

1. To review the statistical range of possible returns that can be expected based on UH’s current and long-term asset allocation targets;
2. To review current valuation metrics of major asset classes providing context for where we are in the market cycle today; and
3. To discuss the plan in which the Endowment Management Committee could rely upon when (not if) we experience another equity bear market.

Before the modeling was discussed, Mr. Kirk stated it was important to remember the following:

1. The UH Strategic Plan, adopted in 2015, was a very equity dominant portfolio. The reasoning was to attain long-term growth of purchasing power.
2. Embedded in this position was the mathematical fact that losses would be incurred along the way on an annual basis. As noted in 2000-02 and 2008-09, those losses could be substantial.
3. The future cannot be predicted.

When the Enterprise Review had been completed shortly before Mr. Kirk joined the team, it was revealed that the UH Endowment was in a very strong position, not only because the dependency of the operating budget on this Endowment was quite low, but also the fact that there were other revenue streams, tuition, fundraising, grants, state funding, and so forth and that the Endowment was not encumbered by debt issuance of any significant way. All of this lead to the risk profile that the extra risk could be taken.

There were three (3) principles that Cambridge wanted to point out should the risk be taken:

1. Equity exposure drives growth;
2. Bonds are ballast in bad times; and
3. As a result of 1 and 2 above, it was prudent to have exposure to both.
• Equities have beaten Bonds since 1900 by 400 bps annualized; but Equities can be highly (downside) volatile in the short run; and bear markets were actually fairly common.
• Over time, keeping in mind that UH was currently not at the target as yet, UH’s expected return and volatility using Cambridge Associates’ long-term equilibrium assumptions would be a little over 7% after inflation.
• Last 5-Years: UH actual returns vs. benchmark returns vs. modeled returns was discussed by Mr. Kirk. Over a year, one and two standard deviations of underperformance results in AACRs of -6.4% and -19.6%, respectively was mentioned and over 5 years, one and two standard deviations of underperformance results in AACRs of +1.1% and -4.8%, respectively were given.
• UH’s current policy illustrates the point that low (and high) return environments were possible. Volatility should be expected over short- and intermediate-term time periods, but return distributions should approach their average over longer time periods.

Ms. Schuhmacher addressed the plan stating that the UH Endowment portfolio was built to have liquidity for spending and capital calls even under a 2008-type scenario.
• In terms of three take-aways with respect to this analysis, the UH risk profile is designed to maintain purchasing power over the long-term.
• In the short-term, there is a high possibility that the Endowment could lose between -6 to -20% over one year; and with that said, UH would still have liquidity within the portfolio to withstand a 2008-like scenario to meet our spending and capital calls.
• When, not if, this happens, what is the plan; what do we do as it relates to the Endowment Management Committee, and what are the steps we should take as we think about appropriately managing the portfolio through a downturn to get us through the other side.
• Four (4) action items were discussed:
  1. Reaffirming the policy – the asset allocation policy is designed such that, over the long-term, the portfolio should earn its expected return.
  2. Rebalancing – Historically, rebalancing during periods of a significant drawdown has resulted in buying low and selling high and the most successful institutions have shown the wherewithal and “guts” to do just that.
  3. Review spending – UH is in an enviable position where at 3%, the Endowment payout is a small portion of the budget.
  4. Add funds to the Endowment – This is difficult to do in challenging times, adding cash into the Endowment from operating reserves would allow for additional purchases of assets at depressed prices.

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

Regent Agrawal introduced the next item on the agenda, 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 University of Houston System Endowment Fund – UH System. Mr. Kirk asked Mr. Phil Fiske, with Cambridge Associates to present this item.

Mr. Fiske stated that Cambridge would present two (2) recommendations for the committee’s consideration. He mentioned that Cambridge has been pleased with the performance of the Private
University of Houston System

Investments ("PI") Program and stated that since its inception the returns have been 13.9% which is 280 bps above the benchmark. Mr. Fiske asked Katherine Chu, from Cambridge Associates to present the first recommendation for the committee’s approval.

Ms. Katherine Chu presented the first private investment recommendation to the committee and below is a brief summary of Ms. Chu’s presentation.

Cambridge Associates recommended that the University of Houston approve a $7.5 million commitment to Francisco Partners Fund V. This is an existing manager in the University of Houston’s portfolio, with the last commitment being made to Fund IV in 2014 in the amount of $5 million. Since that time, the average check-size that the University has committed into private investment managers has increased to $7.5 million.

Francisco Partners is targeting $3.25 billion for its fifth core private equity fund. While no legal hard cap has been established, the manager does not expect the fund to exceed $4.0 billion. A first close is planned for the end of September 2017.

Francisco Partners ("FP") will seek to invest Fund V in middle-market technology companies in North America, Europe, and Israel. The fund will invest across the technology spectrum, focusing on software; financial technology; healthcare IT; communications and security; and systems and hardware. FP is targeting between a 25% and 30% gross IRR and between a 2.5 and 3.0 gross MOIC for Fund V.

FP was founded in 1999 and the current leader of the firm, Dipanjan Deb has taken over the firm since 2005. There are nine (9) investment partners who have averaged 13 years at FP. This team is viewed as very stable and very tenured. They are highly opportunistic with their mandate. FP has a barbell strategy approach to investing, targeting both companies that are value-oriented opportunities where it believe the company is undermanaged and also growth-oriented opportunities exhibiting revenue growth of 15% or more. Ms. Chu stated that Cambridge believes that this manager would be complimentary to the UH portfolio.

The summary of the Francisco Partners Fund V fundraising terms were as follows:
- Target Fund Size – $3.25 billion
- Management Fee – During the commitment period, 1.5% of commitments. Following the commitment period, 1.25% of investment contributions less distributions and write-offs.
- GP Commitment – $100 million
- Preferred Return – 8%
- Carried Interest – 20%

Mr. Phil Fiske presented the second private investment recommendation to the committee and below is a brief summary of his presentation.

Cambridge Associates recommended that the University of Houston approve a $7.5 million commitment to EnCap Flatrock Midstream Fund IV (“EFM IV”). EnCap Investments (“EnCap”) is targeting $3.0 billion for Fund IV. The manager plans to hold a first close in late 2017. As with
prior funds, EFM IV will provide growth capital to management teams that target energy infrastructure projects in low-cost hydrocarbon basins. The team is targeting a gross 2.0 MOIC. The University is a previous investor with Flatrock Midstream II having committed $3.0 million in 2012 and Flatrock Midstream III in the amount of $5.0 million in 2014.

EFM was formed in 2008 as a partnership between Flatrock Energy Advisors, a midstream energy consultancy, and private equity firm EnCap Investments LP. The venture was created to manage a series of midstream energy-focused private equity funds and combines FEA’s unique midstream operating expertise with EnCap’s depth of energy investment experience. The lead team of managing partners each has over 30 years of experience in the midstream sector, much of it together.

EnCap Flatrock will provide growth capital to experienced management teams in North America to develop greenfield projects and acquire existing midstream assets. As with prior funds, EFM IV will target operations in the most economically attractive resource basins where significant new upstream production requires substantial infrastructure build out.

The summary of the EnCap Flatrock Midstream Fund IV fundraising terms were as follows:
- Target Fund Size – $3.0 billion
- Management Fee – 1.5% on commitments during the commitment period; thereafter, 1.5% on net invested capital.
- GP Commitment – 2.0% of aggregate commitments
- Carried Interest – 20% of net profits with an 8% hurdle
- Partnership Life – 10 years (subject to two 1-year extensions)

Following the presentation of this item, Regent Agrawal called for a committee vote.

On motion of Regent McElvy, seconded by Regent Armour, 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 hiring of private investment managers for the University of Houston System Endowment Fund was approved.

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

Regent Agrawal stated the next item listed on the agenda was Item E, Approval is requested to revise the near-term asset allocation targets for the University of Houston System Endowment Fund – University of Houston and asked Mr. McShan to introduce this item.

Mr. McShan introduced this item which was to request approval to modify the near-term asset allocation targets for the UH System Endowment Fund. He stated that this would be an ongoing process as the University moves toward their long-term targets. This is to ensure the Endowment portfolio maintains a proper distribution as changes were constantly occurring; and he asked Cambridge Associates to address this item and give their remarks.
Ms. Schuhmacher stated that as the PI program was being built out and the allocation increases over time, Cambridge recommends adjusting the near-term targets to capture changes in asset allocation.

Below is a table outlining the current policy target classification, current allocation, current near-term target and the proposed near-term target. Highlighted in bold and italics were the recommendations proposed by Cambridge to the committee.

<table>
<thead>
<tr>
<th>Current Policy Target Classification</th>
<th>Current Allocation</th>
<th>Current Near-Term Target</th>
<th>Proposed Near-Term Target</th>
</tr>
</thead>
<tbody>
<tr>
<td>Global Public Equities</td>
<td>46.1%</td>
<td>42%</td>
<td>42%</td>
</tr>
<tr>
<td>Hedge Funds</td>
<td>26.8%</td>
<td>30%</td>
<td>26%</td>
</tr>
<tr>
<td>Private Equity/Venture Capital</td>
<td>8.4%</td>
<td>10%</td>
<td>12%</td>
</tr>
<tr>
<td>Real Assets (Public/Private)</td>
<td>10.8%</td>
<td>10%</td>
<td>10%</td>
</tr>
<tr>
<td>Bonds and Cash</td>
<td>7.9%</td>
<td>8%</td>
<td>10%</td>
</tr>
</tbody>
</table>

Ms. Schuhmacher pointed out that were if you were to compare where we are on a current near-term perspective and over the long-term, the goal was to reach the following in each target classification:

- 40% in Global Public Equities
- 20% in Hedge Funds
- 20% in Private Equity/Venture Capital
- 10% in Real Assets (Public/Private)
- 10% in Bonds and Cash

Following this presentation, Regent Agrawal called for a vote from the committee.

On motion of Regent Welder, seconded by Regent McElvy, and by a unanimous vote of the members in attendance, the request to revise the near-term asset allocation targets for the University of Houston System Endowment Fund was approved.

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

Regent Agrawal stated that Item F, the Approval is requested to rebalance the portfolio for the University of Houston System Endowment Fund – UH System would be the next item addressed on the agenda and he asked Mr. McShan to introduce this item.

Mr. McShan stated that this item was for rebalancing the portfolio for the UH System Endowment Fund. Mr. McShan noted that normally between the August and October timeframe, the University liquidates cash from the Endowment in order to disburse the payouts for that particular year which typically is approximately $25 million annually. He asked Ms. Schuhmacher to continue to discuss this item.
Ms. Schuhmacher thanked Mr. McShan for summarizing what Cambridge was recommending but crystalizing gains, and then in anticipation of the payout, manage geographical exposures, and slightly reduce equities given strong performance across all regions, the following redemptions were recommended by Cambridge as follows:

1. $7.0 million redemption from Northern Trust Russell 1000 Index
2. $2.0 million redemption from Columbia
3. $3.0 million redemption from Oldfield
4. $3.0 million redemption from Somerset
5. $3.0 million redemption from Wellington Diversified Inflation Hedge
6. $4.0 million addition to Smith Graham Intermediate Aggregate

Following the presentation of this item, Regent Agrawal called for the vote.

On motion of Regent Armour, seconded by Regent McElvy, and by a unanimous vote of the members in attendance, the request to rebalance the portfolio for the University of Houston System Endowment Fund was approved.

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

Regent Agrawal introduced the last action item listed on the agenda, Item G, Approval is requested to liquidate an endowment from the University of Houston System Endowment Fund – UH System and asked Mr. McShan to present this item.

Mr. McShan stated that this item was requesting approval to liquidate the Peggy and Bill Shiffick, endowed scholarship. This particular endowment was a 20-year term endowment and was established in 1997 to provide scholarship funding for students at the University of Houston who demonstrated financial need. The current market value of this endowment was $31,445 as of July 31, 2017. Per the terms of the agreement, the endowment is to revert to the University of Houston’s general scholarship fund on August 31, 2017; and if approved, these funds will be transferred to the Office of Scholarship and Financial Aid for awarding scholarships.

Before calling for the vote, Regent Agrawal recommended to the committee that since the amount being considered by the board was so low, in order to liquidate an endowment from the portfolio going forward, a higher threshold should be set by policy which would require going to the board for approval in the future. Mr. McShan agreed and stated he would work with Ms. Cornell on this change and bring the policy to the board for their consideration.

On motion of Regent Armour, seconded by Regent McElvy, and by a unanimous vote of the members in attendance, the request to liquidate the Peggy and Bill Shiffick endowment from the UH System Endowment Fund was approved.

Following the approval of this item by the committee, Regent Agrawal made the motion to place this action item, unanimously approved by the committee, on the Board of Regents’ Consent Docket Agenda for final board approval.
On motion of Regent Armour, seconded by Regent McElvy, 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 August 24, 2017, Board of Regents’ meeting held later in the day as follows:

1. Approval is requested to liquidate an endowment from the UH System Endowment Fund – UH System.

There was no Executive Session held.

There being no further business to come before the committee, the meeting adjourned at 9:57 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
Jim McShan
Paula Myrick Short
Dona Cornell
Eloise Dunn Brice
Amr Elnashai
Lisa Holdeman
Richard Walker
Mike Johnson
Ray Paulersen
Nader Ibrahim
Shannon Harrison
Brenda Robles

Erin Schuhmacher
Kerry Kirk
Raymond Bartlett
Don Guyton
David Bradley
Macie Kelly
Sabrina Hassumani
Mike Britt
David Oliver
Nestor Infanzon
Phil Booth
Brian Thomas
Gerry Mathisen

Phil Fiske
Katherine Chu
Oscar Duberney
Glen Houston
Ryan Harrison
Traynor Swanson
Glen Houston
Mary Ann Ottinger
Jon Aldrich
Pam Muscarello
Dan Maxwell
Marquette Hobbs