UNIVERSITY OF MINNESOTA

BOARD OF REGENTS

Finance and Operations Committee

March 9, 2006

A meeting of the Finance and Operations Committee of the Board of Regents was held on Thursday, March 9, 2006 at 9:45 a.m. in the East Committee Room, 600 McNamara Alumni Center.

Regents present: Clyde Allen, presiding; Anthony Baraga, Frank Berman, John Frobenius, and Steven Hunter.

Staff present: Senior Vice President Frank Cerra; Vice Presidents Kathryn Brown and Richard Pfutzenreuter; General Counsel Mark Rotenberg; Executive Director Ann Cieslak; and Associate Vice Presidents Stuart Mason and Michael Volna.

Student Representatives present: Joe Linder and Steve Wang.

BOARD OF REGENTS POLICY: *INVESTMENT OF RESERVES*

Vice President Pfutzenreuter and Associate Vice President Mason led the discussion of proposed amendments to Board of Regents Policy: *Investment of Reserves*, which governs the investment of short-term and long-term reserves of the institution. The proposed amendments are meant to achieve higher levels of return and cash flow through some core University reserves located in both the Temporary Investment Pool (TIP) and the Group Investment Pool (GIP) into the Consolidated Endowment Fund (CEF); and to achieve greater diversification, which will lead to lower portfolio return volatility and reduced dependence on domestic interest rates.

Mason explained the TIP portfolio composition, noting the increase in value of the fund to just over $7 million in the previous five years. He outlined the proposed amendments as described in the docket materials, stating that the primary change would enable staff to invest twenty-five percent of TIP in the CEF to maximize current income and investment returns on these reserves.

A lengthy discussion ensued. In response to a question, Pfutzenreuter stated that the proposed changes present some risks, but based on spending and revenue patterns and tracking of daily use of cash, an investment of up to twenty-five percent would leave a substantial portion of the core funds in TIP. He added that investing short-term reserves is becoming a trend among peer institutions.

Mason discussed the long-term reserves, GIP, noting that the investment objective is to maximize the total investment return while preserving capital balances until such time as the principal is required to fund the intended use. The proposed amendment would allow up to fifty percent of the overall portfolio to be invested in diversified equity related securities and or in CEF.

Committee members expressed concern about potential risks to reserves and CEF and concluded that further discussion of the proposed amendments is necessary. The policy will return for review and action at subsequent meetings of the committee.

BOARD OF REGENTS POLICY: *CENTRAL RESERVES FUND*

The discussion of proposed amendments to Board of Regents Policy: *Central Reserves Fund* was postponed to a future meeting of the committee.

ANNUAL INVESTMENT CONSULTANTS REPORT: CAMBRIDGE ASSOCIATES

Associate Vice President Mason introduced Stephen Symchych, Senior Partner at Cambridge Associates, to present the annual report regarding the Consolidated Endowment Fund (CEF) investment performance review and to discuss asset allocation versus peer college and university endowments. A copy of the report is on file in the Board Office.

Symchych reported that as of September 30, 2005 the University's return on investments was 23.9%, placing it in the top two percent of similarly sized institutions. The three-year return was 18.6% versus 15.7% for similarly sized institutions, placing the University in the top ten percent. He offered a comparison of asset allocation performance in the fifteen best-performing institutions, noting that changes in the University's investment policy makes this institution more similar to this group. He reported the institution's one-, three-, and five-year comparative returns as of December 31, 2005, noting that although the performance was excellent it remains under the mean and median when compared to other colleges and universities.

Symchych briefly discussed new asset allocation targets and stated that Cambridge is working with the Office of Asset Management (OAM) on asset allocation policy by reviewing best practices at other large universities. Symchych noted that Cambridge proposes increasing allocations in real assets such as real estate, timber, and oil and gas. The institution's Investment Advisory Committee is reviewing the recommendations.

ALTERNATIVE ASSET PORTFOLIO: COMPOSITION & PERFORMANCE

Vice President Pfutzenreuter introduced Associate Vice President Mason to discuss the existing alternative assets invested in the Consolidated Endowment Fund (CEF). The CEF totaled $814.5 million as of December 31, 2005, which represents an increase in value of $84.6 million compared to the prior twelve months.

Mason reported that current Board of Regents policy establishes a target of thirty percent for alternative investments as a percent of overall CEF portfolio. He noted that this has included increased allocations to private capital, hedge funds, and private real estates, new allocations to distressed debt, timber, oil and gas, and private debt, and continuing movement toward higher levels of alternatives to further diversify the portfolio and reduce investment return volatility, aligning this institution with best performing colleges and universities.

Mason reviewed current portfolio allocations and performance, indicating that domestic equity allocations have underperformed when compared to returns on various alternative investments. He provided a comparison of this institution's allocations based on current Board policy to those of the best performing peer institutions, noting that performance for those institutions indicates a trend toward increased allocations in alternative investments.

In response to a question, Mason agreed to provide actual historical investment returns for various asset classes and projected returns used in the modeling work done by Cambridge Associates.

CONSENT REPORT

Vice President Pfutzenreuter presented the Consent Report as detailed in the docket and materials distributed at the meeting, including Purchase of Goods and Services over $250,000 to:

- Cardinal Health for pharmaceuticals and related supplies for Boynton Health Service Pharmacy for the period May 1, 2006 through April 30, 2008 for an estimated two-year total of $6,000,000. This purchase will be paid for from the sale of prescriptions and other items to patients and from payments by University of Minnesota departments for pharmaceuticals.

- CedarCrestone, Ciber, Signature Consulting, Trissential and others for services of consultants with business analyst skills and PeopleSoft implementation experience to total $5,000,000 for the life of the Enterprise Financial System (EFS) project from March 10, 2006 to July 31, 2007. The Office of Information Technology and the Controller's Office jointly sponsor the EFS project.

- Deloitte & Touche, LLP for an additional amount of $85,000 with total payments not to exceed $505,000, related to Medicare and Medicaid refund claim services for years prior to the sale of the University hospital.

- Electronic Healthcare Systems, Inc. for $864,500 for implementation services and monthly software subscription fee for thirty-six subscription payments to purchase a complete computerized practice management system for the Community-University Health Care Center.

- Enventis Telecom for $1,300,000 to purchase network hardware and software and to provide annual Cisco Smartnet hardware and software support for the period April 1, 2006 through March 31, 2007 for Networking and Telecommunications Services, a division of the Office of Information Technology.

- Office Max, a Boise Company, for an estimated $619,140 for Hewlett Packard laser toner and ink-jet cartridges to be stocked at the University Stores for use in University departments. The renewal contract period is April 1, 2006 through March 31, 2007.

- Sedgwick for $825,821 for Claims Administration Services for the period July 1, 2006 through June 30, 2009 with two one-year options to renew beyond year three, for the Office of Risk Management Insurance.

- Learfield Communications for the Department of Intercollegiate Athletics (ICA) for an extension of current marketing and sales rights and the inclusion of radio rights for the time period June 30, 2006 to June 30, 2013. The current marketing and sales rights contract is for three years with two one-year extensions that would end June 30, 2009. The renegotiated contract will extend the partnership with Learfield by four years.

Approval of New Investment Manager

The Office of Asset Management (OAM) proposes engaging one new investment manager to invest target allocations of the Consolidated Endowment Fund. The proposed manager has been reviewed and is recommended by the Investment Advisory Committee.

Alternative Investments: Private Real Estate

Barrow Street Capital
- $10 million investment
- Value added Private Real Estate
- Small to mid sized deals
- Lower focus on multi family blends well with existing portfolio
- Historical returns of 20+%

General Contingency Fund

- Expenditure of $300,000 for Cedar Creek Outreach Center.

The committee voted unanimously to recommend approval of the Consent Report.

INFORMATION ITEMS

Vice President Pfutzenreuter referred committee members to Information Items contained in the docket, including:

- Quarterly Purchasing Report;
- Semi-Annual Management Report (December unaudited);
- Annual Asset Management Report;
- Quarterly Investment Advisory Committee Update;
- Annual Asset Management Report;
- Financial Update: Report on Central Reserves;
- Financial Oversight: Key Indicators;
- Investment Social Concerns; and
- CREB Bond Application.

The meeting adjourned at 11:50 a.m.

ANN D. CIESLAK
Executive Director and
Corporate Secretary