

UNIVERSITY OF MINNESOTA

BOARD OF REGENTS

Finance and Operations Committee

March 11, 2004

A meeting of the Finance and Operations Committee of the Board of Regents was held on Thursday, March 11, 2004 at 1:30 p.m. in the West Committee Room, 600 McNamara Alumni Center.

Regents present: William Hogan, presiding; Clyde Allen, Anthony Baraga, Dallas Bohnsack, John Frobenius, and Maureen Reed.

Staff present: Vice President Richard Pfutzenreuter; Executive Director Ann Cieslak; Associate Vice Presidents Steve Cawley, Stuart Mason, and Michael Volna.

Student Representatives present: Travis Amiot and Joshua Colburn.

STATE OF MINNESOTA ECONOMIC UPDATE

Vice President Pfutzenreuter introduced State Economist Tom Stinson, to present the State of Minnesota Economic Update, including state revenue and expenditure data for the current biennium and planning estimates for the 2006-07 biennium.

Stinson reported that the forecast indicates a \$160 million deficit, which is \$25 million less than projected in November 2003; slightly reduced revenues, offset by changes in expected spending; and a budget reserve of 2.2% of spending. He suggested the state was fortunate that the November 2003 economic forecast was fairly accurate despite the economic instability. Job growth, the uncertainty of tax year 2003 final payments and refunds; corporate income taxes, sales tax, and capital gains receipts continue to be items of concern.

The FY05-07 outlook, excluding the impact of inflation on expenditures, indicates a shortfall of \$341 million in FY05; \$360 million in FY06; and \$81 million in FY07. Revenue from income and sales tax, which represents a significant portion of the budget, is expected to increase in FY06-07, while projected spending for E-12 education will not increase and spending for health and human services will increase only slightly, due to the FY04-05 budget deficit.

BOARD OF REGENTS POLICY: *INVESTMENT TRANSACTIONS*

Vice President Pfutzenreuter presented for the committee's review proposed amendments to four Board policies as part of the Board's comprehensive policy review process. Proposed amendments include changes to reflect current practice, clarify definitions, and ensure compliance with Board of Regents Policy: *Reservation and Delegation of Authority*.

Board of Regents Policy: *Investment Transactions* governs the administration's authority to invest and deal in securities and to engage investment advisors.

A revised draft policy was distributed, (on file in the Board Office). Associate Vice President Mason summarized the changes, noting that the new language was suggested by the Office of the General Counsel to clarify the delegations of authority. In response to a question, Associate General Counsel Don Amundson explained that the policy was

reordered and all specific authority necessary to implement it are now incorporated in Subd. 2.

A motion was made and seconded, and the committee voted unanimously to recommend approval of amendments to Board of Regents Policy: *InvestmentTransactions*.

BOARD OF REGENTS POLICY: *ENDOWMENT FUND*

Associate Vice President presented the proposed policy, which sets specific strategic asset allocations for the investment of endowment funds, and sets forth the objectives of the endowment.

A motion was made and seconded to recommend approval of the proposed amendments to Board of Regents Policy: *EndowmentFund*.

In response to a question, Associate Vice President Mason stated that the Office of Asset Management will continue to report new initiatives in alternative investments and will not engage new investment managers without complete review and approval of the committee.

The committee voted unanimously to recommend approval of the amendments.

BOARD OF REGENTS POLICY: *INVESTMENT OF RESERVES*

Associate Vice President Mason presented the proposed policy, which governs the investment of short-term and long-term reserves.

In response to a question, Vice President Pfutzenreuter explained that the objective of the Group Investment Pool (GIP) is to maximize income while preserving capital balances until the principal is required to fund the intended use, such as capital improvements or infrastructure. Associate Vice President Mason added that GIP funds are not endowment funds but reserves, and the underlying strategy is to invest the funds in fixed income securities with an objective of maintaining the principal and increasing funds at a somewhat higher earnings level.

A motion was made and seconded, and the committee voted unanimously to recommend approval of the amendments to Board of Regents Policy: *InvestmentofReserves*.

BOARD OF REGENTS POLICY: *CENTRAL RESERVES EMERGENCY FUND*

Vice President Pfutzenreuter reviewed proposed amendments to the policy, which governs the central reserves fund, defined as resources that are not allocated to any specific unit of the University, but are held in a central account within the University's financial system. The amendments eliminate the term emergency as the purpose of the fund and remove Group Investment Pool (GIP) funds from the definition of revenue sources, as GIP funds have never been placed in central reserves. Proceeds from periodic real estate sales are also deleted, as these are monitored separately.

Referring to Section III of the policy, the committee briefly discussed the size of the reserves fund and what level might be advisable considering potential economic volatility. Current policy states that under normal circumstances funds should not fall below 3.0% of all centrally allocated funds, exclusive of tuition, or \$20,000,000, whichever is greater. Pfutzenreuter indicated that at the present time, central reserves are approximately \$13 million. Other University funds are available if needed. Pfutzenreuter agreed to bring a recommendation regarding the size of the reserves fund at a later time.

The proposed amendments to the policy will be presented for action at a future meeting of the committee.

ANNUAL INVESTMENT CONSULTANTS REPORT: *CAMBRIDGE ASSOCIATES*

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

Pendergast reported that in 2003, the University's one-year return on investments was 25.6% compared to a 22.5% mean return for 130 Cambridge Associates colleges and universities. However, the institution is not well positioned in a sustaining declining market, as the University continues to have a far higher allocation to domestic equities and a far lower allocation to marketable alternatives than the fifteen top-performing institutions. To remedy this, Cambridge recommends two hedge fund strategies (diversified and event arbitrage) with two- to three-year average returns of 9-16% with 5% volatility.

The committee agreed there is a deliberate decision to increase alternative investments in accordance with asset allocations permitted by current Board policy. Expansion of alternative investments is being carefully implemented by the Office of Asset Management with advice from the Investment Advisory Committee and Cambridge Associates. The primary objective of this strategy is a solid, well-diversified portfolio that will perform relatively well in all investment climates.

SEMI-ANNUAL MANAGEMENT REPORT

Associate Vice President Michael Volna presented the Semi-Annual Management Report, which is intended to provide the Board of Regents with an overview of the University's semi-annual unaudited financial statements for December 31, 2003 and highlight significant items. Volna reported that during the reporting period net assets increased by 4.9% for a total of \$3.9 billion; total liabilities increased by 2.4% to \$1.3 billion; and total fund balances by 6.2% to \$2.6 billion.

Volna referred to materials distributed to the committee related to cash and investments, receivables, and long-term debt (a copy is on file in the Board Office). He summarized how the classification of dollars from cash to investments impacts the financial statements; that student receivables increased during the reporting period due to tuition increases and the timing of tuition billings; and how reclassification of debt and a standby letter of credit reduced long-term debt.

Volna also summarized how decreases in state appropriations and operating expenses and increases in tuition have impacted the financial statements, noting that these changes are consistent with budgetary actions of the Board. In response to a question, Volna explained that decreases in state appropriations would appear in the nonoperating revenue section of the financial statement, most evident in academic support, institutional support, and operations and maintenance of plant areas.

Volna reviewed the consolidated statement of cash flows, noting that cash flows decreased \$211.8 million in the period due to reduced state appropriations, debt retirements, and greater cash infusions in investment activities.

CONSENT REPORT

Regent Reed recused herself from the discussion because of a possible appearance of a conflict of interest. She left the meeting.

A motion was made and seconded to recommend approval of the Consent Report as detailed in the docket materials, and including:

Purchase of Goods and Services Over \$250,000

- To Boise Cascade Office Products for an estimated \$956,500 for Hewlett Packard laser toner and ink-jet printer cartridges to be stocked at the University Stores for use in University departments. The renewal contract period is from April 1, 2004 through March 31, 2005.
- To Dell Computer Corporation for \$961,000 for the hardware components, software products, and professional services required to implement an Enterprise Storage System.
- To Delta Dental for an estimated \$710,500 and HealthPartners Dental for an estimated \$260,000 for estimated total of \$970,500 for administering a self-funded UPlan dental plan option offered through the University of Minnesota Office of Human Resources Employee Benefits for the period January 1, 2004 through December 31, 2004.
- To Entuity for \$600,500, which includes license fees for the first year of support for network management

software for the Office of Information Technology Networking & Telecommunications Services department.

- To HealthPartners Administrators, Inc., for an estimated \$4,517,500, Wausau Benefits for an estimated \$1,513,200, PreferredOne Administrative Services, Inc., for an estimated \$853,800 and Definity Health Corporation for an estimated \$448,000, for an estimated total of \$7,332,500 for administering a self-funded UPlan medical plan option offered through the University of Minnesota Office of Human Resources Employee Benefits for the period January 1, 2004 through December 31, 2004.
- To LaVision, Inc., for \$281,222 for a Dual Scale Stereoscopic PIV System for the Department of Aerospace Engineering and Mechanics.
- To renew a contract with the following medical insurance carriers for the purchase of Medicare supplemental insurance offered through the University of Minnesota Office of Human Resources Employee Benefits for the period January 1, 2004 through December 31, 2004:

Retiree Paid Coverage:

- Blue Cross Blue Shield of Minnesota:

University of Minnesota Retiree Plan \$2,945,600

- HealthPartners:
HealthPartners 65+ \$1,000,500
- Medica:
Medica Group Prime Solution \$ 216,000
- UCare:
UCare for Seniors \$ 417,000

- To renew a contract with Minnesota Life/ING for purchase of life insurance coverage offered through the University of Minnesota Office of Human Resources Employee Benefits for the period January 1, 2004 through December 31, 2004:
- University paid coverage:
Basic Life and AD&D \$2,125,600
- Employee paid coverage:
Additional Employee Life \$1,020,000
Spouse/Same-Sex Domestic Partner Life \$ 330,000
Child Life \$ 25,000
Optional Employee AD&D \$ 57,000
Optional Spouse AD&D \$ 8,700
- To Xerox Corporation for \$3,600,000 (\$1,200,000 annual) for monthly copier maintenance offered to all University departments, on all campuses, covering the period January 1, 2004 through December 31, 2006.

Endowment Change

The chair of the Duluth campus Department of History, with approval of the Office of the General Counsel, has requested that the purpose of an endowment previously established be reverted back to its original use, that of funding research purposes in Duluth.

New Investment Managers

The Office of Asset Management (OEM) proposes engaging the following investment managers to invest target allocations of CEF. The proposed investments have been reviewed and are recommended by the Investment Advisory Committee and Cambridge Associates.

Small Cap Domestic Equity

Burgundy Asset Management

- \$15 million investment
- Small Cap “deep value” manager
- Commingled fund structure

- Top Quartile Performance

Private Real Estate

O'Connor North American Property Partners, LP

- \$10 million commitment
- Diversified value added/opportunistic manager
- Up to 25% may be invested in Mexico and Canada
- Target return: 18-20% net IRR to LPs

New Boston Institutional Fund VI

- \$5 million commitment
- Diversified value added/opportunistic manager
- Most of the fund will be invested in the northeast
- Target return: 20% net IRR to LPs

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

INFORMATION ITEMS

Associate Vice President Pfitzenreuter referred the committee to three information items as detailed in the docket materials:

- Quarterly Purchasing Report;
- Quarterly Asset Management Report; and
- Quarterly Investment Advisory Committee Update

The meeting adjourned at 3:38 p.m.

ANN D. CIESLAK
Executive Director and
Corporate Secretary