Year 2002-03

UNIVERSITY OF MINNESOTA

BOARD OF REGENTS

Finance and Operations Committee

March 13, 2003

A meeting of the Finance and Operations Committee of the Board of Regents was held on Thursday, March 13, 2003, at 3:00 p.m. in the East Committee Room, 600 McNamara Alumni Center.

Regents present: Anthony Baraga, presiding; Peter Bell, Frank Berman, John Frobenius, Lakeesha Ransom, and Patricia Simmons.

Staff present: Executive Director Ann Cieslak, Associate Vice Presidents Gerald Fischer, Stuart Mason, Richard Pfutzenreuter, and Michael Volna.

Student representatives present: Jacob Elo and Aaron Street.

Regent Baraga welcomed Regents Frobenius and Simmons to the Finance and Operations Committee and noted that Regent Bell is Vice Chair of the committee.

CONSENT REPORT

Associate Vice President Pfutzenreuter presented a revised Consent Report, as distributed at the meeting and on file in the Board Office, which included:

- To C. J. Duffey Paper Co. for an estimated $432,000 for the purchase of recycled copy paper to be stocked at the University Stores for use in University departments. The renewal contract period is April 1, 2003 through March 31, 2004. Vendor was selected through a competitive process.
- To Nalco Chemical Company for $490,000 for water treatment chemicals and consulting/engineering services for the Twin Cities campuses for the period of March 17, 2003 through December 31, 2003 for the Facilities Management department. Vendor was selected through a competitive process.

A motion was made, seconded, and the committee voted unanimously to recommend approval of the revised Consent Report.

BOARD OF REGENTS POLICY:

INVESTMENT OF RESERVES

Associate Vice President Pfutzenreuter introduced Associate Vice President and Chief Investment Officer Stuart Mason, who led the discussion of proposed changes to Board of Regents Policy: Investment of Reserves. Mason recalled that in December 2002 the Board approved a resolution temporarily exempting the Office of Asset Management from some of the provisions of this policy, pending adoption of the proposed revisions as described in the docket materials.

The primary purpose of the proposed changes is to clarify, simplify, and make more specific the guidelines, restrictions, and allocations applicable to the Temporary Investment Pool (TIP) and the Group Income Pool (GIP). In particular, proposed TIP changes improve risk measurement tools and place restrictions on the use of leverage. Proposed GIP changes are intended to produce higher rates of return by allowing outside managers to invest a limited amount in equity securities and certain elements of emerging market debt within the bounds of current policy where the ultimate goal is capital preservation.

In response to questions, Mason explained that the current policy is more conservative as it prohibits investments below A-rated bonds. The proposed changes would allow investments from the full spectrum of securities, including such Baa- and BBB-rated bonds as those issued by General Mills and Target Corporation. He acknowledged that this change involves greater risks, but in exchange, the University could take advantage of current interest rate differentials and earn an additional $1.7-$1.8 million on a $50 million investment.

After further discussion related to the size of the investment pool and the appropriate term for investments, Pfutzenreuter stated that the proposed policy will come before the committee for action in April 2003.

UNIVERSITY BUDGET RESERVES REPORT

Associate Vice President Pfutzenreuter and Julie Tonneson of the Office of Budget and Finance led the discussion of University budget reserves. Pfutzenreuter compared what is reported in the University's financial statements to the budgeted balances for units. He explained that these balances not only meet the daily cash flow needs of the University, but they also are critical for academic and administrative units who use planned development balances to fund activities not funded centrally, such as refurbishment of a surgery unit in the Medical School or faculty recruitment.

Tonneson indicated that current, nonsponsored year-end reserves for FY2001-02 totaled approximately $457.6 million. She specified where these dollars are found in the University's organizational and accounting structure, where they reside by institutional fund classification, and the permitted designated uses of balances (as summarized in materials on file in the Board Office).

In response to comments by several Regents, Pfutzenreuter agreed that (1) it is appropriate to consider reserve balances the equivalent of working capital for the University's 40,000 plus units and (2) that some of these funds are dedicated. He also stressed the importance of carefully monitoring these balances in an era of tight budgets because declining reserves not only reduce the funds available for the University's Temporary Investment Pool, but also may pose cash flow problems for the institution.

Several Regents suggested that the term reserves is somewhat misleading and that the University would be better served by different terminology. Pfutzenreuter agreed to assess how best to designate these funds to assure they are used for their intended purposes.

ANNUAL INVESTMENT CONSULTANT REPORT:

CAMBRIDGE ASSOCIATES

Associate Vice President Pfutzenreuter introduced George Pendergast and Steven Symchych of Cambridge Associates, to present the Investment Consultant Report, as found in the materials on file in the Board Office. Pendergast provided background information regarding Cambridge Associates, Inc., and explained its role as the University's investment consultant.

Symchych reported that the performance of the University's endowment fund over the last five years has lagged that of the fifteen best performing colleges and universities, primarily because the University is now more heavily invested in domestic equities and underinvested in marketable alternatives. However, the University's performance compares favorably with similarly sized colleges and universities, especially for 10- and 15-year returns.

Pfutzenreuter confirmed that the University, based on recommendations of the Investment Advisory Committee, has been less aggressive than many peer institutions with regard to investments. Pendergast added that many other institutions are able to take more risks because they have larger assets and the services of alumni who are professional investors. Some adjustments to asset allocation might not only increase returns in today's market environment but also reduce volatility.

Several Regents expressed concerns about the failure of a number of investments to hit the benchmark and suggested that the University would benefit from additional guidance on potential investments. Pendergast proposed an assessment of the current portfolio, followed by adjustments to asset allocations to yield similar returns at significantly reduced risk.

INFORMATION ITEMS

Associate Vice President Pfutzenreuter referred the committee to a number of Information items detailed in the docket materials, including:

- Quarterly Asset Management Report - This document reports the quarterly results of investment performance in the area of asset management. In summary: The invested assets of the University totaled approximately $1.1 billion on December 31, 2002. The Consolidated Endowment Fund value increased $8.6 million for the previous quarter end, the net effect of positive investment performance of $17.2 million and quarterly net distributions of $8.6 million. The total investment return of the endowment was 2.9% for the quarter ending December 31, 2002, which was 2.1% below the weighted benchmark against which it is measured.

In the interests of time, the remaining items, the Quarterly Purchasing Report and the Semi-annual Management Report, were postponed to a future meeting of the committee.

The meeting adjourned at 5:10 p.m.

ANN D. CIESLAK

Executive Director
and Corporate Secretary