MINUTES OF THE REGULAR MEETING OF THE
FINANCE AND ADMINISTRATION COMMITTEE OF THE
OREGON STATE BOARD OF HIGHER EDUCATION
FEBRUARY 5, 2010

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MINUTES

1. CALL TO ORDER/ROLL CALL/WELCOME

Chair Schueler called the videoconference meeting of the Committee to order at 9:01 a.m. Committee members present included Chair Kirk Schueler and Directors Allyn Ford, Brian Fox, and Tony Van Vliet. Other Board members present included Director Dalton Miller-Jones.

Others present included: Chancellor’s staff: Doug Botkin, Michael Green, Ryan Hagemann, Jay Kenton, Brian Meara, Patricia Snopkowski, and Denise Yunker. Campus representatives included: President Mary Cullinan (SOU); Vice Presidents Frances Dyke (UO), Mark McCambridge (OSU), Craig Morris (SOU), Mark Weiss (WOU), and Mary Ann Zemke (OIT); and Dee Wendler (PSU). Also present were: Roan Blackard, Larry Gross (Asst Dir, Oregon Debt Management Division), and Mike Mueller (State Treasurer’s Office).

2. DISCUSSION ITEM

a. OUS, Internal Bank Implementation

(See http://www.ous.edu/state_board/meeting/dockets/ddoc100205-FA1.pdf for the full docket material with the proposed information and http://www.ous.edu/state_board/meeting/dockets/ddoc100205-FA2.pdf for supplementation information)

DOCKET ITEM:

INTRODUCTION

Over the past several years, System management has been working with the Legislature, the State Treasurer, the Department of Justice, financial advisors, bond counsel, and key financial managers with the System to improve the treasury management practices of the System via the establishment of an Internal Bank. An Internal Bank is a separate accounting and operating entity designated to hold and invest all System operating cash balances and to manage the long-term Article XI-F(1) debt portfolio for the System. The purpose of the Internal Bank is to facilitate the long-term financial stability of the System through effective asset/liability management strategies and optimizing the organization’s capacity to access the capital markets in the amounts needed at a reasonable price.
With the passage of key legislation during the 2009 Legislative Session, the last roadblock to implementation has been removed. The benefits of establishing and implementing an Internal Bank, as well as the key policies necessary for implementation, are delineated below.

**PROCESS**
The System has sought and obtained the support of the Board, the Governor, the State Treasurer, and the Legislature to implement the Internal Bank concept for the System. Key statutory authority has been obtained over the last two legislative sessions to enable the System to implement an Internal Bank. The State Treasurer’s Office has been working hard to move these concepts forward to help the System increase its revenues and lower its costs.

The proposed debt and interest rate risk policies have been reviewed by the State Treasurer’s Director of Debt Management and all recommended changes stemming from that review have been incorporated in these proposed policies.

The Internal Bank concept has been discussed with, and is supported by institution management. The draft policies attached will be discussed with the Vice Presidents for Finance and Administration on Friday, January 29, 2010. Should any recommended changes arise out of that process, those changes will be reviewed with the Committee during the meeting on February 5.

The Operating Funds Investment Policy is under development. Staff intends to bring that policy to the Finance Committee in March.

*Staff Recommendation to the Committee:*  
This is intended to be a “first read” of these policies; approval by the Finance and Administration Committee and the full Board will be sought in March.

**COMMITTEE DISCUSSION:**

Chair Schueler called upon Associate Vice Chancellor for Finance & Administration and Controller, Mike Green, to introduce the Internal Bank Implementation concept, who then provided a pertinent description of the proposal. During discussion, Chair Schueler asked, on the bond holder, is the asset part of the security; Mr. Green noted that it is not. Director Ford asked, once the Internal Bank is established, how many more staff will be necessary to administer the bank? Mr. Green replied that staffing will be fairly minimal and it is anticipated that no additional resources will be required. He added that the overhead costs will be covered by an appropriation from the legislature, established at the last legislative session, and will be continued through future biennia.

At the conclusion of the discussion, all Committee members expressed their support for the creation of an internal bank and encouraged staff to continue to develop the policies and implementation plan.
3. **ACTION ITEMS**

   a. **OUS, Managerial Reporting – Quarterly Management Report**


   **DOCKET ITEM:**

   After reviewing the Budget Projections Summary received from each university and comparing prior year results, we noted the following:

   **EDUCATION AND GENERAL – LIMITED**

   Revenue collections are projected to be 9 percent above 2008-09 mainly due to a $93 million or 17 percent increase in tuition and resource fee revenues. The increase in tuition and resource fee revenues is primarily due to a combination of tuition rate increases, a projected 6 percent increase in student FTE enrollment and change in the mix of student enrollment.

   Revenue collections year-to-date are 6 percent over the prior year due largely to increases in nonresident tuition for summer, fall, and initial winter terms. Spending is down 3 percent year-to-date; however, spending is projected to be 3 percent above the prior year spending at year-end. The increase in spending is primarily due to staffing for student enrollment increases and related supplies and services expenses.

   The ending fund balance of Education and General – Limited is projected to be $110 million, which is $30 million higher than the prior year. The June 30, 2010, ending fund balance of Education and General – Limited is projected to be 10 percent of Operating Revenues, a 26 percent increase from the beginning of the year.

   All institutions’ ending fund balance are projected to be within the recommended reserve level of 5 – 15 percent of operating revenue, WOU’s range is 10 — 20 percent.

   **AUXILIARY ENTERPRISES**

   Systemwide, Auxiliary Enterprises are projected to have total revenues of $353 million and expenditures of $347 million, resulting in $6 million of revenues over expenditures. Unrestricted Net Assets are projected to increase $4 million to $63 million. Please refer to the explanatory notes on the institution and Chancellor’s Office reports for additional information.

   **DESIGNATED OPERATIONS, SERVICE DEPARTMENTS, AND CLEARING FUNDS**

   The Projected ending fund balance of $38 million is consistent with the prior year. Please refer to the explanatory notes on the institution and Chancellor’s Office reports for additional information.
Staff Recommendation to the Committee:
Staff recommended that the Committee accept the Quarterly Management Report for December 31, 2009. The next management reports for the quarter ending March 31, 2010, are scheduled to be presented to the Committee in May 2010.

COMMITTEE DISCUSSION AND ACTION:

Chair Schueler called upon Controller Green to provide the quarterly management report. Following discussion and noting no irregularities, Chair Schueler called for a motion to accept the report. Director Tony Van Vliet made the motion and Director Brian Fox seconded; motion passed.

b. OUS, Report on Investments – As of December 31, 2009

For report details, see http://www.ous.edu/state_board/meeting/dockets/ddoc100205-FA1.pdf.

DOCKET ITEM:

The investment report for the second quarter of FY2010 is presented below. The following is a brief summary of the information contained in the report.

As of December 31, 2009, total OUS investments had a combined market value of approximately $433 million, summarized as follows:

<table>
<thead>
<tr>
<th>Fund</th>
<th>Market Value December 31, 2009</th>
</tr>
</thead>
<tbody>
<tr>
<td>Endowment Funds</td>
<td>$62,116,084</td>
</tr>
<tr>
<td>Donation Funds</td>
<td>74,330,264</td>
</tr>
<tr>
<td>Bond Building Funds</td>
<td>200,494,430</td>
</tr>
<tr>
<td>Bond Sinking Funds</td>
<td>62,275,756</td>
</tr>
<tr>
<td>Auxiliary Enterprise Building Repair and Equipment Replacement Reserves</td>
<td>33,392,754</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$432,609,288</strong></td>
</tr>
</tbody>
</table>

HIGHER EDUCATION POOLED ENDOWMENT FUND – OREGON STATE TREASURY’S DISCUSSION OF PERFORMANCE

Calendar Year 2009 did its best to relieve some of the sting left behind from 2007 and 2008. While much ground remains to be made up, from mid-March on, the equity and fixed income markets soared. From the market low on March 9th, the S&P 500 Index was up 68 percent. The broad-cap Russell 3000 Index finished the year up 28 percent. The average price to earnings ratio on the S&P 500 reached 28.2x, well above the 20-year average of 19.9x, indicating that the market may be overvalued, if earnings do not begin to grow. Looming over the market is a federal government budget projected to be $1.5 trillion in the red for 2010. Additionally,
unemployment remains in the 10 percent range, with core CPI in check, for now, at 1.7 percent, year-over-year.

The HIED account performed quite well in the current quarter, up 4.8 percent, exceeding the policy benchmark by 16 basis points. All of the HIED active managers in the public markets continued to post excellent returns, with each manager exceeding their benchmark for the quarter and calendar year. It bears repeating that this is not a normal outcome—typically, manager performance is more sporadic. Because of this outstanding performance, the HIED account returned 25 percent over the past 12 months, exceeding the policy benchmark by nearly 2 percent. Western Asset beat their benchmark by nearly 20 percent for the year.

As reported to the Board last year:

Within the alternative equity portfolio, the two fund-of-funds previously managed by HRJ Capital have been transitioned to Capital Dynamics, as a result of HRJ’s financial difficulties which have been reported over the past several months in the financial press. While the buy-out and real estate portfolios underlying these portfolios will certainly be challenged to perform going forward, due to the depths of the global market decline, OST staff are confident in the management of Capital Dynamics to provide the back office support the portfolios need at this stage of the investment cycle.

In fact, the write-downs of the two Capital Dynamics funds (fka HRJ) were quite dramatic: -16.1 percent in Q3 2008, and –28.6 percent in Q4 2008. However, due to a delay in the quarterly valuations during the transition from HRJ to Capital Dynamics, these write-downs were not captured in the quarterly return data previously presented. These numbers should have been reflected in performance during Q4 2008 and Q1 2009, respectively. To correct this, the historical performance of the fund was restated. Additionally, we used this opportunity to record the performance of the asset class since inception. The most recent quarterly valuation was properly reported and captured. Going forward, we expect Capital Dynamics to report in a more timely manner (even though fund-of-funds can have considerable reporting lags).

While the valuation of the overall fund remains $61.2 million, as of December 31, 2009, the historical performance of the fund was impacted by the change in the alternative asset class performance revisions. Below is a summary of the impact, at the total fund level:

| Revised 1-year: | 25.01% | (prior report: 31.59%) |
| Revised 3-year: | -3.65% | (prior report: -0.86%) |
| Revised 5-year: | 1.86%  | (prior report: 3.63%)  |
| Revised 10 year: | 2.01%  | (prior report: 2.89%)  |

The more “traditional” asset allocation of the HIED fund has served it well in these tumultuous markets. Larger, big name endowment funds have suffered mightily during the recent market downturn. For the one-year period through June of 2009, Harvard and Yale’s endowments were
each down 30 percent (WSJ, September 11, 2009). For the same period, the HIED fund was
down approximately one-third of that, 21.4.

As we embark on an asset/liability review for the HIED fund, the asset allocations used by the
average endowment will be considered. However, it is a markedly different one; according to
the National Association of College and University Business Officers (NACUBO), the average
asset allocation was:

<table>
<thead>
<tr>
<th>Asset Type</th>
<th>Allocation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Equity</td>
<td>40.0%</td>
</tr>
<tr>
<td>Fixed Income</td>
<td>13.6</td>
</tr>
<tr>
<td>Hedge Funds</td>
<td>21.0</td>
</tr>
<tr>
<td>Private Equity</td>
<td>11.6</td>
</tr>
<tr>
<td>Real Estate</td>
<td>6.5</td>
</tr>
<tr>
<td>Other</td>
<td>7.3</td>
</tr>
</tbody>
</table>

**POOLED ENDOWMENT FUND ASSET ALLOCATION**

With the addition of Alliance Bernstein Global to the asset mix of the Pooled Endowment Fund,
the actual asset allocation, as compared to the policy allocation ranges, became a bit obscured
in the Investment Summary (attached). This is because Alliance Bernstein includes both U.S.
and Non-U.S. investments. For the purposes of measuring the actual asset allocation against
the policy allocation ranges, it is necessary to prorate the Alliance Bernstein Global Fund
between U.S. and Non-U.S. equities.

The weighting used to break out the U.S. and Non-U.S. portion of the Alliance Bernstein Global
Fund is based on the MSCI All Country World Index. The current break out is: 48 percent U.S.
and 52 percent non-U.S. When this fund is prorated between domestic and international
equities using these percentages, the totals fall within the policy allocation ranges as shown
below.

<table>
<thead>
<tr>
<th>HIED</th>
<th>Policy</th>
<th>Target</th>
<th>$ Thousands</th>
<th>Actual</th>
</tr>
</thead>
<tbody>
<tr>
<td>Domestic Equities</td>
<td>25-35%</td>
<td>30%</td>
<td>$18,165</td>
<td>29.7%</td>
</tr>
<tr>
<td>International Equities</td>
<td>25-35%</td>
<td>30%</td>
<td>20,238</td>
<td>33.0%</td>
</tr>
<tr>
<td>Alternative Investments</td>
<td>0-10%</td>
<td>10%</td>
<td>5,016</td>
<td>8.2%</td>
</tr>
<tr>
<td>Total Equities &amp; Alternatives</td>
<td>65-75%</td>
<td>70%</td>
<td>43,419</td>
<td>70.9%</td>
</tr>
<tr>
<td>Fixed Income</td>
<td>25-35%</td>
<td>30%</td>
<td>17,045</td>
<td>27.8%</td>
</tr>
<tr>
<td>Cash</td>
<td>0-3%</td>
<td>0%</td>
<td>773</td>
<td>1.3%</td>
</tr>
<tr>
<td>TOTAL HIED</td>
<td></td>
<td></td>
<td>$61,237</td>
<td>100.0%</td>
</tr>
</tbody>
</table>
ALTERNATIVE INVESTMENTS
During the fiscal year, OUS’ two alternative assets previously managed by HRJ have been transferred to Capital Dynamics. Subsequently, the HRJ Global Real Estate III, L.P. fund was renamed Capital Dynamics Real Estate III, L.P. During the quarter, OUS made additional capital contributions totaling $80K to the Capital Dynamics Real Estate III, L.P. fund. As of December 31, 2009, OUS has contributed $4.3 million of the total $5 million commitment to the HRJ Growth Capital II, L.P. fund and $3.7 million of the total $4 million commitment to the Capital Dynamics Real Estate III, L.P. fund. Also, OUS has made total capital contributions of $411,000 to the JP Morgan Venture Capital IV, LLC fund. OUS’ total commitment to this fund is $5 million.

OTHER QUARTERLY EVENTS
As of December 1, 2009, the former Barclays Global Investor entities are owned and controlled by BlackRock, Inc.

DONATION AND OTHER INVESTABLE FUNDS
Donation and other funds available for investment were invested in the Oregon State Treasury Short-Term Fund and returned 0.18% for the quarter, which exceeded the 91 Day T-Bill rate of 0.01 percent.

Staff Recommendation to the Committee:
Staff recommended the Committee accept the Investment Report as of December 31, 2009.

COMMITTEE DISCUSSION AND ACTION:
Chair Schueler called upon Controller Green to provide the report on investments and Controller Green advised that Mr. Mike Mueller, State Treasurer’s Office, was also on the call to answer any questions. Green informed the Committee that a revised report had been emailed to the Committee (this revised report supersedes the original report and is provided above). Following a brief discussion, Chair Schueler called for a motion to accept the report. Director Tony Van Vliet made the motion and Director Brian Fox seconded; motion passed.

4. ADJOURNMENT

Upon conclusion of business, Chair Schueler adjourned the meeting at 10:37 a.m.