MINUTES

BOARD OF REGENTS' COMMITTEE ON BUDGET AND FINANCE MEETING

FEBRUARY 11, 2016

I. CALL TO ORDER

Committee Chair Jan Sullivan called the meeting to order at 12:45 p.m. on Thursday, February 11, 2016 at the University of Hawai‘i at Mānoa, Information Technology Building, 1st Floor Conference Room 105A/B, 2420 Correa Road, Honolulu, Hawai‘i 96822.

Committee members in attendance: Committee Chair Jan Sullivan; Committee Vice Chair Barry Mizuno; Regent Simeon Acoba; Regent Wayne Higaki, Regent Coralie Matayoshi; Regent Michael McEnerney; Regent Lee Putnam.

Others in attendance: Regents’ Chair Randy Moore; Regents’ Vice Chair Eugene Bal; Regent Jeff Portnoy; Regent Michelle Tagorda; Regent Stanford Yuen; Regent Ernest Wilson, Jr. (ex officio committee members); President David Lassner; Vice President for Administration Jan Gouveia; Vice President for Legal Affairs and University General Counsel Carrie Okinaga; Vice President for Budget & Finance/Chief Financial Officer Kalbert Young; UH Mānoa (UHM) Chancellor Robert Bley-Vroman; UH Hilo (UHH) Chancellor Don Straney; Executive Administrator and Secretary of the Board of Regents Cynthia Quinn; and others as noted.

II. APPROVAL OF MINUTES OF THE NOVEMBER 4, 2015 MEETING

Committee Vice Chair Mizuno moved for approval of the minutes of the November 4, 2015, Regent Higaki seconded the motion, and the minutes were unanimously approved.

III. PUBLIC COMMENT PERIOD

Executive Administrator and Secretary of the Board Cynthia Quinn announced that the Board Office received one late written testimony, and two individuals had signed up to give oral testimony.

The following individuals provided testimony:

1. Michael Angelo, Chair of the Committee on Administration & Budget (CAB), UHM Faculty Senate (UHMFS), provided written and oral testimony regarding concerns about lack of faculty participation in development the current UHM budget allocation model and providing a status update on the CAB’s development of a different budget model.

2. Bob Cooney, UHMFS Executive Committee Chair, provided oral testimony regarding the importance of a budget reform process for UHM that includes input and addresses the critical needs of academic units across the campus; the desire
of UHM faculty for a responsibility-centered management system; and the need for agreement between UHMFS and the UHM Chancellor on the best budget model to achieve these goals.

IV. AGENDA ITEMS

A. For Information:


VP Young provided a slide presentation on the FY16 Second Quarter Financial Report as of December 31, 2015. Highlights included comparison of the prior format to the new format of net operating income that is based on the regents-approved budget for the current fiscal year that does not reflect any prior year carryover balances, and is closer to a budget-to-actual variance report format. It was reported that taken together these reports show a strong aggregated cash position, general fund, and tuition & fee special funds (TFSF) balance this fiscal year versus last year, and more revenues are anticipated this year because of tuition increases, which will increase in percentage to the overall budget. The two main funding sources for operations of the university are general funds and TFSF, and with half the year completed, the ending projection is at least static to the last fiscal year. The second quarter is the final quarter where administration can review the forecasts and analysis on financials to make meaningful adjustments on expenditures before the end of the fiscal year. As such, operations are expected to be no worse than the prior fiscal year, which had showed a small growth in overall reserves. Effectively, the second quarter numbers for this fiscal year confirm that the decline in overall reserves had stopped.

Questions and comments were raised regarding providing a quarterly report on the repairs & maintenance (R&M) backlog; clarification regarding the one-time reimbursement to the UH Cancer Center and composition of cash balances, including $5.6 million from the earnings on the original bonds that were issued for the Cancer Center.

It was explained that the Committee on Planning & Facilities receives quarterly updates on Capital Improvement Projects (CIP), which could be amended to include R&M and deferred maintenance (DM), which is expected to increase as no legislature funding was appropriated to address DM nor enough to keep up with current renewals. The one-time reimbursement was for expenditures made on construction until the bonds were issued. Remnant funds in the John A. Burns School of Medicine (JABSOM) account from interest accrued on the JABSOM bond proceeds for its construction before all of the proceeds could be expended currently equals about $5.6 million in a separate capital account, which can only be expended on JABSOM capital expenditures and not for operating expenses.

The committee requested that administration work on combining the most important things into one report, and looking at budget to actual in the report instead of projections.

2. UBS FY16 Second Quarter Investment Report on the Legacy Endowment Fund as of December 30, 2015
UBS representatives provided a slide presentation on FY16 Second Quarter Investment Report on the Legacy Endowment Fund as of December 30, 2015. Highlights included that the fourth quarter was good for equity markets, S&P was up 7% for the quarter and 1.3% year-to-date, the Dow was up 7.7% for the quarter and up 0.21% year-to-date. Internationally markets were up 4.75% for the quarter and down 0.39% for the year. Regarding emerging markets, China is down about 15% year-to-date. The fixed income market is down 57 basis points for the quarter and up only 55 basis points year-to-date. Overall it was a flat year. More declines in the economy are expected, however, as oil prices go down the correlation to the market is currently very high. Globally, the slowdown and market fluctuations in China are affecting global markets. Consumer spending is slowing down, the strong dollar has been affecting the manufacturing sector, which is making the GDP come down. There is still positive GDP growth for this quarter, coming in at 2.4% in 2015. The feds raised rates for the first time in December, signaling more positive signs in the economy. Nonfarm payrolls are positive, but low. Unemployment rate is down to 4.5%. Oil is expected to stabilize at some point going forward. Earnings are coming in positive and beating expectations, but not everyone has reported as of today.

Regarding portfolio performance on page 2, the current portfolio balance as of December 31, 2015 was $64,037,211.16, which equates to a quarterly return of 2.84% below the benchmark of 2.99% for the quarter, and down 2.32% for the period of June 30, 2015 to December 31, 2015 compared to the benchmark index which is down 2%; for the calendar year 2015 the portfolio is -0.58% compared to the benchmark at -0.17%; for inception-to-date the portfolio is 1.77% net of fees, and benchmark is at 2.53%.

Regent Matayoshi arrived at 1:15 p.m.

The portfolio is in compliance with all rules and has 61% equities and 39% fixed income. However, UBS is requesting exception to board policy requiring comparing a fund to the three year history to invest in a new EFT towards achieving 1% fossil fuel free investing in the portfolio; the portfolio is at 3% as of December 31, 2015.

The report also indicates the amount of individual securities in each fund, how the 3% exposure to energy is calculated, and expenses. The annualized net expense ratio is at 32 basis points, and the UBS annual fee of 20 basis points is added.

Regarding January performance, the markets have been volatile lately and the current balance as of January 31, 2016 is lower at $60,537,506, and includes large withdrawals.

Questions and comments were raised regarding whether every period performed below both benchmarks and why; the reason why the fund is performing below indices; how the expense ratio compares to similar funds; the rationale for withdrawals; where the $1.3 million shows up in the earlier financial statements; and including in the statements dollar amounts of fees charged.

UBS confirmed that all periods had performed below both benchmarks, but indicated the benchmarks include no fees, which means there are 52 basis points that need to be
achieved to exceed benchmark returns that perform and exceed their fees, but they are not currently doing that. Compared to similar funds, the 32 basis points expense ratio for UBS is very low because they use a lot of Exchange Traded Funds, which are low cost and well diversified. Endowments at other institutions use a lot of mutual funds that pay 3 to 5 times that in fees. VP Young explained the withdrawals were for scholarships, contributions for institutional aide, and a couple of other programs that are funded out of earnings from the investment portfolio. The $1.3 million in withdrawals come back to the university in the form of tuition monetized tuition waivers, and things like the president’s initiatives that are funded out of this could show up as pure expenditures. UBS agreed to include a line in the statements showing the dollar amounts of fees charged.

Regent Yuen arrived at 1:24 p.m.

The committee requested an annual summary on endowment expenditures and an evaluation on withdrawal amounts given. President Lassner agreed to check on the status of the annual summary, and noted that the intended withdrawals are reviewed every year, recommendation of the CFO to the president.

3. Update on University of Hawai‘i at Mānoa Budget Allocation Model

Chancellor Bley-Vroman explained how the report updated the significant progress on the model shared at the November presentation, with handouts of a simplified version of the materials distributed to regents.

Dr. William Chismar, Dean of the UHM Outreach College, worked extensively on problems of implementing the budget plan over the last few months and reviewed the handout that contained an overview, highlighting the revised UHM Budget Allocation Model, and examples of impact on revenues; allocation of tuition & fees; how the new model promotes improved fiscal management; the mission support for the first year; and the annual review process.

Questions and comments were raised regarding how the allocation method utilizes metrics, adequacy of consultation and collaboration with faculty stakeholders, integration of a strategic planning process, allocation method of mission support among departments, incentivizing increases in course and program fees, peer comparisons, and allocations including enrollment management, student services, and student support.

It was explained how general funds are deposited into a central pool, the budget process determines unit mission support comprised of tuition and general funds as determined by the UHM budget office, in consultation with the deans who ask for mission support rather than general funds. The UHM budget office tracks the proper management of general funds to ensure allocation of general funds are maximized to pay for permanent positions, which ensure all general funds are spent by the end of the year.

Administration had consulted with various groups including four faculty members, including representatives from UHMFS, regarding the model. Formal meetings with the UHMFS CAB will begin immediately as the proposed model is relatively firm and ready to engage in meaningful consultation. It was noted that the proposal and the CAB approach
are not fundamentally incompatible, as both are correctly concerned about proper
assignment of mission support, and it is hoped that faculty and its committees will be
involved in those mission support decisions.

In concept, it is expected that the largest portion of expenditures will be for
infrastructure, facilities, electricity, and support services (library, student services, KŌKUA
program). Mission support for the units will initially be done through an annual budget
review process with a committee the chancellor deems appropriate, individuals propose
mission support allocation needs, and the committee as a group decide on those
requests. More structure on the process will include metrics and evaluation based on
metrics in the form of a dashboard rather than formulaic, and include subsidies of
undergraduate education for special programs, extension offices, certain infrastructure
costs or other service activities the schools and colleges provide the state.

Regarding concern over fees, procedures are in place to prevent the arbitrary
assignment of fees to generate money, and instead the new model includes new
incentives for additional revenue through metrics such as increased enrollment, better
graduation rates, and larger number of majors.

Peers who have adopted a similar budget allocation model successfully include
Indiana University and University of Washington, and actual data is pending as a whole
new information system had to be created for gathering the data and involved a new
culture change.

Board Chair Moored arrived at 2:12 p.m.

The item will be put on another committee or board agenda and questions submitted
to Committee Chair Sullivan, Secretary Quinn and Board Chair Moore in preparation for
the next meeting.

B. For Action:

1. Recommendation for Approval of Amendments to RP 8.204 Budget Policy

Committee Chair Sullivan recounted the history of improvements recommended by a
consultant engaged by the board in 2013 relating to board operating procedures and
practices that affect the budget policy, and how proposed board policy revisions reflect
new current practices of utilizing actual versus budgeted expenditures, enhancing the
financial reporting the board reviewed, with more regular and thorough financial review
and improving accountability and financial oversight through periodic financial reporting
mechanisms including reported comparing budgeted expenditures against actual. The
practice of adopting an operating budget and 6-year CIP plan, and the later part of the
policy in particular pertains to the legislative budget process that is under review and may
change in the future.

The committee noted the inconsistent use of the term “biennium budget policy” and it
was agreed that any reference to biennium in this section be deleted.
The committee thanked Committee Chair Sullivan for working on this and President Lassner for supporting this long overdue effort, which is a major improvement over what the board used to have and absolutely necessary.

Regent Putnam moved to recommend board approval of amendments to RP 8.204 Budget policy, with the additional revisions, seconded by Committee Vice Chair Mizuno, and the motion carried unanimously.

2. Approval of Exception to RP 8.207 Investment Policy to Allow Fossil Fuel Free Investment for SPDR S&P 500 Fossil Fuel Free ETF (SPYX)

UBS representatives requested the committee recommend board approval of the Exception to RP 8.207 Investment Policy to Allow Fossil Fuel Free Investment for SPDR S&P 500 Fossil Fuel Free ETF (SPYX). Highlights included how this exception was related to reducing the portfolio to 1% investment in fossil fuels as part of the university’s divestment efforts. It was recognized such products were extremely limited. The SPDR S&P 500 Fossil Fuel Free ETF is an S&P 500 fund without any fossil fuel companies, is new to the market, and recommended as it is a passive investment strategy, and low cost at 20 basis points compared to a mutual fund that is currently in the portfolio at 95 basis points. Board policy requires three years of history, which is not possible given this is a brand new product. It was noted that this type of product was anticipated to materialize, as the fund specifically excludes owners of fossil fuel reserves, which is a narrower definition than the term energy, as there are entities in the energy business that have nothing to do with fossil fuel investment. The exception would apply to only this fund.

Regent Matayoshi moved to recommend board approval of the exception to RP 8.207 Investment Policy to allow fossil free investment for SPDR SS&P 500 Fossil Fuel Free ETF (SPYX), seconded by Committee Vice Chair Mizuno, and the motion carried unanimously.

V. ADJOURNMENT

There being no further business, Regent Matayoshi moved to adjourn, and Board Chair Moore seconded, and with unanimous approval, the meeting was adjourned at 2:27 p.m.

Respectfully Submitted,

/S/

Cynthia Quinn
Executive Administrator and
Secretary of the Board of Regents