MINUTES

BOARD OF REGENTS COMMITTEE ON BUDGET AND FINANCE MEETING

JUNE 4, 2020

Note: On January 30, 2020, the World Health Organization declared the outbreak of COVID-19 a public health emergency of international concern, subsequently declaring it a pandemic on March 11, 2020. On March 16, 2020, Governor David Y. Ige issued a supplementary proclamation that temporarily suspended Chapter 92, Hawaii Revised Statutes, relating to public meetings and records, "to the extent necessary to enable boards to conduct business in person or through remote technology without holding meetings open to the public."

I. CALL TO ORDER

Chair Eugene Bal called the meeting to order at 12:17 p.m. on Thursday, June 4, 2020. The meeting was conducted virtually with regents participating from various locations.

Committee members in attendance: Chair Eugene Bal; Vice-Chair Wayne Higaki; Regent Simeon Acoba; Regent Randy Moore; and Regent Alapaki Nahale-a.

Others in attendance: Board Chair Ben Kudo; Regent Kelli Acopan; Regent Michael McEnerney; Regent Jan Sullivan; Regent Michelle Tagorda; Regent Robert Westerman; Regent Ernest Wilson (ex officio committee members); President David Lassner; Vice President (VP) for Administration Jan Gouveia; VP for Legal Affairs/University General Counsel Carrie Okinaga; VP for Research and Innovation Vassilis Syrmos; VP for Budget and Finance/Chief Financial Officer Kalbert Young; UH Mānoa Provost Michael Bruno; UH Hilo Chancellor Bonnie Irwin; UH West Oʻahu Chancellor Maenette Benham; Executive Administrator and Secretary of the Board of Regents (Board Secretary) Kendra Oishi; and others as noted.

II. APPROVAL OF MINUTES

Regent Moore moved to approve the minutes of the March 5, 2020, meeting, seconded by Vice-Chair Higaki, and the motion carried, with all members present voting in the affirmative.

III. PUBLIC COMMENT PERIOD

Board Secretary Oishi announced that the Board Office did not receive any written testimony, and that one individual signed up to provide oral testimony but was not present.

IV. AGENDA ITEMS

A. Fiscal Year (FY) 2019-2020 Third Quarter Financial Report

VP Young provided the financial report for the third quarter of FY 2019-2020, briefly reviewing both budgeted and actual general fund revenues and expenditures, as well as revenues and expenditures for various special funds, for each of the four-year campuses, the community colleges, and the UH systemwide administration. He noted that although

actual revenues through the third quarter were $20.1 million, or 2.0 percent higher than projected, the year-over-year difference for all non-general fund types was minimal. Actual expenditures were $39.6 million or 4.8 percent lower than expected with the exception of the Research and Training Revolving Fund which had expenditures that were $2.0 million, or 6.0 percent, higher than anticipated. As these are third quarter figures for the current fiscal year, impacts from the ongoing COVID-19 pandemic have been minimal to date but impacts are expected to start being reflected in the fourth quarter financial report.

A historical perspective on third quarter revenue and expenditure trends over the last four years was also presented. VP Young noted that while revenue growth year-over-year has been positive, tuition revenue has continued to decline despite increases in tuition rates over that same period of time and can be attributed mainly to declining enrollment. Similarly, expenditures over the past four years have increased each year but have been tempered by increasing general fund appropriations. He noted, however, that the university is anticipating a decrease in general fund appropriations due to restrictions imposed by the Governor.

B. <u>Budget Impact Update Resulting from the COVID-19 Pandemic (COVID-19)</u>

A report on both the current, as well as potential, fiscal impacts of COVID-19 on the university was presented by VP Young. He stated that the COVID-19 pandemic will have significant fiscal impacts to the university's operations, particularly in light of an expected decline in revenues from all of the university's funding sources, including its two predominant revenue sources - the state general fund and Tuition and Fees Special Fund (TFSF). While the current fiscal impacts to the university have been minimal and deal mainly with COVID-19 response issues, the financial situation for both the university and the State is anticipated to worsen in FY 2021 and is projected to continue through at least FY 2022. It was emphasized that uncertainties still exist with numerous variables that could have an effect on the university's finances such as reductions in university general fund revenues; enrollment fluctuations; federal stimulus funding for higher education; the length and depth of the recession; and the length of duration of the COVID-19 pandemic.

VP Young provided a brief overview of the State's economic outlook and touched on some of the impacts this may have on the university. Tax revenue growth remains flat through April, 2020, and expectations are that combined tax revenue growth will be negative for this fiscal year and severely negative for FY 2021. It has been projected that this will result in at least a $1.0 to $1.5 billion budget shortfall for the State which will have major economic consequences for the university. He noted that the university receives approximately $510 million annually in general funds and that it has been developing scenarios to address general fund allocation reductions of between 10 percent and 25 percent, which equate to between $50 million and $127 million, based upon inquiries from both the Legislature and the Executive Branch. He remarked that the Governor and Legislature are also considering furloughs and reductions in pay between 20 and 40 percent to help address budget shortfalls.

While the recently passed State budget has no dollar amount reduction to the university's general fund appropriations for this fiscal year, VP Young stated that the grim economic forecast recently reported by the Council on Revenues will require the

Legislature to make additional adjustments and reductions to the State budget when it reconvenes in mid-June. He also noted that Legislature eliminated all vacant full-time equivalent (FTE) position counts from the university's budget. In total, nearly 758 FTE counts were reduced, which is equivalent to more than 11 percent of all general-funded FTEs available to UH. Although these positions were vacant, these reductions will inhibit UH's ability to hire and recruit personnel which may have an impact on services to students and the community.

The university has also been required to quickly adapt its operations to rapidly respond to the impacts of COVID-19, which has been difficult given the fluidity of the situation. Response efforts have already been undertaken by the university to ensure, among other things, the maintenance of the health and safety of students, faculty, and staff, and the continuation of the educational mission of the university. While these efforts are ongoing, the university has also begun planning for the reopening of campuses in the fall and VP Young highlighted a number of the university's planned response efforts including modifying classroom, student housing, and office layouts to adhere to physical distancing guidelines; establishing remote work capabilities; increasing sanitation and janitorial efforts; and preparing for flexible delivery of educational instruction in either an on-campus or online basis, or a mixture of both. All of these response efforts entail new expenditures that were unplanned and unanticipated a few months ago.

VP Young reiterated that the two primary sources of university revenues are the State general fund, which is dependent on general excise tax (GET) revenues, and TFSF, which is dependent on enrollment. Together, these funding sources account for more than 66 percent of the university's annual operating budget. Similar to its significant impact on GET revenues, COVID-19 is also anticipated to have a measurable effect on enrollment, and concomitantly TFSF revenues. While the possibility exists that enrollment will increase as a result of the economic downturn, this will not necessarily translate to an increase in revenue. It is expected that more students will choose to remain home due to COVID-19 and attend local universities which will result in considerable changes to the number of non-resident students attending any particular campus. Since non-resident students pay higher tuition, large decreases in non-resident students may cause tuition revenues to decline even if enrollment increases.

Given all the factors and uncertainties that could impact university revenues, the university developed a number of revenue reduction scenarios. VP Young noted that these scenarios were developed using the following criteria – general fund revenue reductions of 10%, 16%, and 25% and TFSF revenue reductions of 5% and 15%. The scenarios were also based on the assumption that no other changes to budget expenditures or revenue contributions would occur. VP Young proceeded to review each of the scenarios, including estimated revenue losses and speed of depletion of campus reserves, for the three four year campuses, the community colleges, and system-wide administration.

VP Young also provided a brief overview of higher education funding contained in the Coronavirus Aid, Relief, and Economic Security Act, or CARES Act, as well as their potential uses, and noted that CARES Act funds received by the university may be sufficient to cover COVID-related operational expenses through FY 2021.

Regent Acoba asked how much CARES funding has not been used to date, if there was a lapse date by which the funds had to be encumbered, and whether this funding could be used for general campus operations. Regent Acoba noted that Tranches 2 and 3 of the CARES Act funding were broad enough for use by the university rather than distribution directly to students and combined amounted to $33 million. VP Young stated that he did not currently have the figures on the amount of CARES funding that remains unused as this funding only recently became available but noted that CARES funding must be encumbered by December 31, 2020. President Lassner added that CARES funding has several restrictions on its use, including requirements for funds to be used to address direct impacts of COVID-19 and COVID-19 response efforts. The administration has been meeting to determine university costs related to addressing the direct impacts of COVID-19 with a focused priority on using the funds for costs related to the health and welfare of students, faculty, and staff. While it may be possible to use certain CARES funds to offset costs for general campus operations, the administration does not anticipate any CARES funds being available for this purpose once moneys are expended for its COVID-19 response efforts.

Regent Acoba continued, asking if the administration anticipated any additional federal funding similar to CARES monies being provided in the future. President Lassner replied that the university is hopeful that additional federal assistance will be forthcoming noting that a bill is currently before the United States Congress that would provide substantial allocations for public higher education. However, it is uncertain as to what, if any, federal assistance will be provided in the future and the university must plan accordingly.

Given all the fiscal uncertainties being faced by the university, Regent Moore inquired as to when the university will make a determination on proceeding with its fiscal planning to address the impacts of COVID-19. VP Young replied that, under normal circumstances, the Legislature would have already adjourned, a State budget would have been passed, and the university would have already begun developing a fiscal spending plan. However, to date, the components used to develop this spending plan are not in place. Although the Legislature recently passed a budget bill that included no reductions to the university's general fund appropriations for this fiscal year, it is certain that additional adjustments and reductions to the State budget will be required in light of recent economic forecasts. He stated that, without knowing the actual amount of general funds the university will receive or what the actual reduction in funding will be, it becomes very difficult to establish an accurate spending plan. Greater uncertainty also exists regarding enrollment and its associated tuition and fees revenues than in years past and may not be available for a few more weeks. As such, the administration developed the revenue reduction scenarios that were reviewed earlier which provided a broad array of possible fiscal impacts to the university.

Regent Moore appreciated VP Young's response but noted that if the university waited for absolute certainty in the fiscal unknowns, which may not occur until the start of the fall semester, it may be too late to address any issues that may arise. VP Young replied that the State budget will be completed between June 15 and June 30 at which time the university will have a better understanding of where it stands with regard to general fund revenue reductions. At that point, the university will move ahead with a fiscal spending plan, including taking actions regarding reductions in operational expenditures, despite not having all the necessary information on enrollment and tuition. Regent Moore opined

that, even after obtaining the information regarding general fund revenue reductions, the university still must maintain flexibility and the ability to quickly respond to a very dynamic situation given all of the other uncertainties noted by the administration.

Regent Acoba questioned whether the university has taken into consideration the possible occurrence of a second wave of COVID-19. President Lassner responded in the affirmative. The administration's expectation is that, should a second wave of COVID-19 occur, the university would be required to revert back to the way it is currently operating with classes being conducted in an entirely online capacity and employees working remotely.

Board Chair Kudo commented that the board established policies requiring the creation of reserve funds that would allow the various campuses to maintain operations for a two-month period. Currently, there is slightly over $130 million contained in these various reserve funds. He stated that if the COVID-19 situation extends into 2022 or longer and given the worst case scenario provided by the administration, the university will need large sums of money to simply maintain current operations even with the availability of these reserve funds. VP Young stated that when the administration developed the various scenarios, it was believed that a 25 percent reduction in general fund revenues and a 15 percent reduction in TFSF revenues was an extreme, worst case scenario. However, after economic events have unfolded over the last two months, these scenarios appear to be fairly accurate and may actually worsen the longer the situation progresses. President Lassner added that the scenarios developed by the administration also assumed constant expenditures which may not be accurate, particularly with the provision of solely online courses. While there is no denying that the university will have to take action to address its fiscal situation, the university will have a better idea of the magnitude of these actions as the State's economic numbers become more refined.

Regent Sullivan remarked that it is essential that a sense of urgency exist when addressing the COVID-19 situation even though there are numerous uncertainties and the university cannot precisely predict its effects. If the university waits for the situation to become clear before developing a plan of action, the university's future may be decided for it by outside forces in a way that may not be the most beneficial to the university. COVID-19 is a real threat to the existence of higher education and the university needs to begin planning now on how it will drastically cut expenses to improve the survivability of the institution.

Regent Wilson stated that he believed that the university should be using this opportunity to continue, in earnest, efforts that have already been undertaken regarding the streamlining of its academic programs. The university needs to make determinations as to the necessity of the programs it is currently providing, the potential of merging programs, and the possibility of eliminating programs. Some of these decisions could help the university address some of the fiscal difficulty it will be facing in the near future.

Regent Nahale-a expressed his concerns with the long-term financial outlook of the university and asked whether the administration was anticipating the Legislature reducing the university's general fund appropriations beyond the next two years. VP Young responded that current State economic forecasts are anticipating declining revenues for the near future but stated that they also expect revenue growth to begin in FY 2022.

However, the administration is taking the position that any reduction in general fund allocations to the university will be extensively prolonged if not permanent and perpetual.

C. FY 2019-2020 Third Quarter UBS Legacy Endowment Fund Investment Performance Report

Kyle Yoneshige and Lori Hamano from UBS provided a report on the Legacy Endowment Fund (Fund) for the third quarter of the fiscal year ending June 30, 2020, reviewing both the asset allocation and investment performance of the Fund. It was noted that the markets have experienced an unprecedented level of volatility over the past few months as a result of the COVID-19 pandemic. Ms. Hamano stated that the Fund consisted of cash assets, fixed-income assets, and equity assets. For the third quarter, Fund assets were allocated as follows: 1.45 percent cash, 34.76 percent fixed-income, and 63.79 percent equities. Ms. Hamano stated that since March, UBS has had discussions with the administration and moved an additional $7 million of the Fund into equities which resulted in substantial benefits to the Fund during these tumultuous times.

Mr. Yoneshige highlighted the overall portfolio performance of the Fund as of March 31, 2020, noting that returns were down by 11.22 percent for the third quarter and 5.7 percent for the current fiscal year. He reported that the financial performance of the Fund for the third quarter and current fiscal year did better than the Fund's established benchmarks for those time periods in light of the COVID-19 pandemic and attributed much of this to the Fund's fixed-income portfolio which was up 4 percent for the third quarter and 6.43 percent for the current fiscal year.

Stating that the Fund had a strong performance for the 2019 calendar year primarily due to the equity markets, Mr. Yoneshige commented that, at the last committee meeting, UBS mentioned that it considered 60 percent to be the minimum amount of Fund assets that should be allocated to equities and that it was anticipating increasing the allocation in equities when there was a sufficient lowering of prices in equity stocks. As noted earlier, UBS has accomplished this, increasing the allocation in equities by $7 million, or roughly 10 percent of the Fund's portfolio, near the end of March when equity stocks were experiencing some of their lowest prices. He reported that, with the changes to asset allocations of the Fund to include this increase in equity assets, the Fund has nearly recouped all of its losses for the 2020 calendar year with the portfolio being down only 1.22 percent as of May 31, 2020, and up 4.93 percent for the current fiscal year-to-date.

Overall, the asset allocation and financial performance of the Fund is on par with the Fund's benchmarks. Internal compliance reviews conducted by UBS also confirmed that the Fund was compliant with its fossil fuel divestiture mandates, that there were no material changes or weaknesses in the management of the Fund, and that the Fund was in compliance with all investment policies.

Mr. Yoneshige and Ms. Hamano briefed the committee on the financial outlook of the Fund and the direction UBS was considering given the current market situation and market volatility. UBS continues to advocate for the keeping the Fund's allocation in equities at a minimum level of 60 percent to prevent risk exposure. It is anticipated that the markets will remain volatile for the foreseeable future, particularly due to fears about the economic impacts of COVID-19, trade issues with China, and the upcoming elections

in the United States, and that it is important to maintain calm when making investment decisions. UBS will continue to closely monitor the financial markets and adjust its investment strategies as more information becomes available with the ultimate goal of maintaining long-term investment strategies.

Regent Acopan left at 2:00 p.m.

Regent Acoba asked what UBS had planned for 2021 with some opinions being stated that the United States may be headed to a depression. Mr. Yoneshige replied that UBS is forecasting that the markets will experience high volatility of perhaps a year or more. While UBS has increased the amount of equities in the Fund's portfolio, approximately one-third of the portfolio consists of bonds, which are paying less. Thus, it makes sense to maintain a higher level of equities and lessen the amount of bonds owned, at least for the near-term. Regent Acoba inquired further as to when UBS would decide to sell given this type of economic climate. Ms. Hamano responded that if the markets witnessed a significant rally of 10 percent or more, UBS may consider selling as a prudent course of action.

D. Committee Annual Review

Chair Bal referred members to the committee annual review matrix provided in the materials packet.

V. ADJOURNMENT

There being no further business, Vice-Chair Higaki moved to adjourn, seconded by Regent Moore, and with all members present voting in the affirmative, the meeting was adjourned at 2:03 p.m.

Respectfully Submitted,

/S/

Kendra Oishi
Executive Administrator and Secretary
of the Board of Regents