MINUTES

BOARD OF REGENTS COMMITTEE ON BUDGET AND FINANCE MEETING

JANUARY 11, 2018

I. CALL TO ORDER

Committee Chair Wayne Higaki called the meeting to order at 12:03 p.m. on Thursday, January 11, 2018, at the University of Hawaiʻi at Mānoa, Information Technology Building, 1st Floor Conference Room 105A/B, 2420 Correa Road, Honolulu, Hawaiʻi 96822.

Committee members in attendance: Committee Chair Wayne Higaki; Committee Vice Chair Benjamin Kudo; Regent Michael McEnerney; Regent Douglas Shinsato; Regent Michelle Tagorda.

Committee members excused: Regent Simeon Acoba; Regent Norma Doctor Sparks.

Others in attendance: Board Chair Jan Sullivan; Board Vice Chair Randy Moore; Regent Eugene Bal; Regent Lee Putnam; Regent Stanford Yuen (ex officio committee members); President/Interim UH-Mānoa (UHM) Chancellor David Lassner; Vice President for Legal Affairs/University General Counsel Carrie Okinaga; Vice President for Academic Planning & Policy Donald Straney; Vice President for Research & Innovation Vassilis Syrmos; Vice President for Information Technology/Chief Information Officer Garret Yoshimi; Vice President for Budget & Finance/Chief Financial Officer Kalbert Young; Interim UH-Hilo (UHH) Chancellor Marcia Sakai; UH-West Oʻahu (UHWO) Chancellor Maenette Benham; UHM Vice Chancellor for Research/Interim Vice Chancellor for Academic Affairs Michael Bruno; Executive Administrator and Secretary to the Board of Regents Kendra Oishi; and others as noted.

II. APPROVAL OF MINUTES OF THE NOVEMBER 1, 2017 MEETING

Regent Tagorda moved to approve the minutes of the November 1, 2017 meeting, seconded by Committee Vice Chair Kudo, and the motion carried unanimously.

III. PUBLIC COMMENT PERIOD

Executive Administrator and Secretary to the Board, Kendra Oishi announced that the Board Office received no written testimony, and no individuals had signed up to give oral testimony.

IV. AGENDA ITEMS

A. For Information

1. FY18 Q1 UBS Legacy Endowment Fund Investment Performance Report

UBS representatives provided a brief update on the economy and markets; reviewed investment performance and compliance; and shared next steps. Temporary cost-effective changes in the portfolio since last the last report include: reducing the investment in the SPDR S&P 500 Fossil Fuel Free ETF and moving funds to the

Vanguard S&P 500 ETF due to liquidity concerns and concentration risks, and eliminating the Oppenheimer Senior Floating Rate Fund due to it being a high asset class risk and high energy exposure, and diversifying it into fixed income index funds. As of September 30, 2017, the portfolio is up 2.76%, which is slightly below the benchmarks, but in line with similar portfolios. The quarterly compliance review of the high level endowment fund and underlying individual investments showed no material changes in ownership, investment management team, or pending litigation. All equity funds are in compliance with the board's investment policy, and all fixed income funds are in compliance except for the iShares MBS fund and Schwab Short Term US Treasuries fund, which were added to the portfolio as part of the Oppenheimer Fund replacement. Given the interest rate environment, the endowment's objectives, and risk profile of these two funds, UBS considers these to be appropriate holdings for the endowment at this time. Regarding the overall asset composition, there was a nominal cash position, fixed income was 39%, and equities were 61%, and the portfolio is in compliance with the overall benchmarks. The weighted energy position of 2.4% is slightly higher than before and the total expense of the endowment is slightly down at 0.43%, due to the reduction of the SPDR S&P 500 fund and elimination of the Oppenheimer Fund.

Discussions held regarding portfolio weights not being shown for earlier periods of time; and whether UBS will be able to make a recommendation whether the asset allocation policy is sufficient and what would be the recommendation going forward in this market.

UBS explained that because of the nature of owning individual mutual/index funds, they can only show the portfolio weights as of September 30, 2017, but could do a composite on high-level asset allocation. UBS indicated they would find out if their system could do a calculation showing how the investment percentages have changed over time and whether they are relatively consistent with assets or specific investments over the entire portfolio history. The move to individual mutual/index funds UBS should be able to provide more granular reporting going forward. Once the UBS institutional consulting services agreement contract is finalized, UBS will implement the recommendations presented at the September committee meeting to improve performance, become more effective in achieving the fossil fuel mandate, and provide greater clarity & transparency over compliance reporting. As part of its services, UBS will also analyze the investment policy statement, provide ongoing board education & discussions of the statement and its relevance to the endowment goals, and make recommendations on asset allocation.

2. University of Hawaiʻi Revenue Bond Post-Issuance Compliance Update

The committee received a presentation on the UH revenue bond post-issuance compliance report through FY16 showing compliance requirements, revenue procedures for management contracts and sponsored research agreements, private use analysis results, the process to determine private use, and what the university should expect moving forward in order to have better governance on minimizing private activity use and compliance. All bond issues are in compliance regarding the private activity use threshold, and private activity use has been trending down for a number of issues. UH has been proactively restructuring existing bonds from tax-exempt to taxable, which allows for greater private activity use. The same philosophy is being applied to any new bonds issued in anticipation of the potentially increased desire for private activity use (e.g., real property monetization) at the university. Administration will continue to monitor private activity use percentages annually, and consider the effects of newly placed in service bond-financing projects will have on private activity use percentages; and working with the UH Foundation on organizing and structuring private contributions intended to fund research so private activity use calculations are not triggered.

Discussions held regarding whether private activity use should be closer to the 10% threshold instead of being so conservative; confirming the 10% private activity use threshold was calculated using square footage; the entities that govern the university's tax exempt status; implications/penalties for non-compliance on private activity use; and the difficulty in getting restrictions on the Cancer Center bonds removed.

VP Young explained that he advises that as much as possible any private activity use should be minimized, and would not want to intentionally maximize at the 10% threshold. Going forward, UH will be looking at more monetizing approaches and strategies, and how to redevelop and up-utilize existing facilities, many of which have outstanding bonds on them, while making sure UH can restructure wherever possible to be better prepared to maximize private use and not run afoul of tax-exempt compliance requirements. The Internal Revenue Service governs the university's tax exempt status, the Securities & Exchange Commission Compliance requires UH ensure it does not violate the covenants for bonds, and UH periodically reports to investors and federal municipal agencies attesting UH is in compliance; for those reasons, UH does not want to get too close to breaching a threshold and inadvertently compel an audit of private activity usage. If UH violates the private use, tax-exempt provisions then investors will be penalized, which could result in legal action against UH. The Cancer Center bonds are taxable, Build America Bonds (BABs), which were part of the federal stimulus American Recovery & Reinvestment Act (ARRA). These BABs have the same limitations on private activity use as tax exempt bonds because UH gets a rebate from the federal government of interest paid on the bonds, which would be forfeited if the bonds were converted. UH looked into restructuring those bonds during the 2015 and 2017 bond transactions, but the covenant limitations in the bond structure made it permissible but uneconomical to do so. Interest rates were another factor that needed to be considered. Administration is looking at the 2020 call date for the bonds, but has underwriters looking at the economics of the market to determine an opportune time to refinance a portion of these bonds to taxable bonds.

Chair Sullivan thanked administration for their efforts and noted that there was no bond compliance review occurring a few years ago, and this is an important issue for the long-term benefit of the university. When a tax-exempt bond issuance is done, the board represents and warrants that the university will comply with the bond covenants, including private activity use. The board has come a long way on establishing procedures for fiscal integrity and sometimes the cost of money can be taken for granted. The cost of debt is an important expense for the university and if the university is going to do its own bond issues instead of relying on the state, then the university will need to continue refining financial practices to maintain a good rating and achieve lower debt for the university.

3. FY18 UH Revenue Bond Transaction Recap

VP Young provided a slide presentation recapping the FY18 UH Revenue Bond transaction that included refinancing and issuance of new bonds, as well as transaction highlights, a financing summary, and debt service savings. Due to new federal tax regulations, the university needed this transaction to close before December 31, 2017, and had to get the financial statements approved and publicly issued quickly and timely. UH was the first state agency to submit its audited financials over to the state. The ratings for these bonds and all outstanding bonds were reaffirmed by Moody's at Aa2 (stable outlook), and Fitch Rating at AA (stable outlook). The total transaction amount was $110,795,000: $106,805,000 to refund existing UH revenue bonds for debt-service savings and $3,990,000 in new UH Revenue bonds for $4,500,000 in capital proceeds. Due to the tax reform bill, it was a difficult transaction to price and close because of increased competition among the many bond issuers flooding the market to beat the deadline of December 31, 2017. When looking back at the date, the day UH priced was the single best day of that week.

The committee expressed appreciation for the tremendous effort administration put into getting this bond issuance done.

4. FY19 University of Hawaiʻi Supplemental Budget Update

VP Young provided a slide presentation the FY19 UH Supplemental Budget Update that included the Governor's budget request, the state fiscal situation, differences between the board's and Governor's operating & CIP budgets, budget briefings, and next steps.

V. <u>ADJOURNMENT</u>

There being no further business, Committee Vice Chair Kudo moved to adjourn, and Regent Shinsato seconded, and with unanimous approval, the meeting was adjourned at 1:20 p.m.

Respectfully Submitted,

/S/

Kendra Oishi
Executive Administrator and Secretary
to the Board of Regents