MINUTES

BOARD OF REGENTS COMMITTEE ON BUDGET AND FINANCE MEETING

MARCH 5, 2020

I. CALL TO ORDER

Chair Eugene Bal called the meeting to order at 9:04 a.m. on Thursday, March 5, 2020, at the University of Hawaiʻi at Mānoa, Information Technology Building, 1st Floor Conference Room 105A/B, 2520 Correa Road, Honolulu, Hawaiʻi 96822.

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 Jan Sullivan; Regent Michelle Tagorda; Regent Robert Westerman; Regent Ernest Wilson Jr. (ex officio committee members); President David Lassner; Vice President (VP) for Administration Jan Gouveia; VP for Community Colleges Erika Lacro; VP for Legal Affairs/University General Counsel Carrie Okinaga; VP for Academic Planning and Policy Donald Straney; VP for Research and Innovation Vassilis Syrmos; VP for Information Technology/Chief Information Officer Garret Yoshimi; VP for Budget and Finance/Chief Financial Officer Kalbert Young; UH Mānoa Provost Michael Bruno; UH Hilo (UHH) Chancellor Bonnie Irwin; UH West Oʻahu (UHWO) 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 November 7, 2019, meeting, seconded by Vice-Chair Higaki, and noting the excused absence of Regent Nahale-a, the motion carried, with all members present voting in the affirmative.

III. PUBLIC COMMENT PERIOD

Board Secretary Oishi announced that written testimony in support of the proposed health fee increase at UHH was received from:

- Gregory Zukeran
- Taliesin Sumner-Longboy
- Helen Tak
- Lovely Paz
- Joyce Norris-Taylor
- Allison Dupre

Late written testimony in support of the proposed health fee increase was received from:

- Zachary Cruison

Late written testimony regarding the Coronavirus (COVID-19) was received from:

- Dr. Jim Shon

Board Secretary Oishi also stated that no individuals signed up to provide oral testimony.

Regent Westerman arrived at 9:05 a.m.

IV. <u>AGENDA ITEMS</u>

A. <u>Fiscal Year (FY) 2019-2020 First and Second Quarter UBS Legacy Endownment Fund Investment Performance Reports</u>

Kyle Yoneshige and Lori Hamano from UBS provided a report on the Legacy Endowment Fund (Fund) for the first and second quarters of the fiscal year ending June 30, 2020. They reviewed both the asset allocation and investment performance of the Fund. Ms. Hamano stated that Fund consisted of cash assets, fixed-income assets, and equity assets. For the first quarter, Fund assets were allocated as follows – 2.25 percent cash, 39.61 percent fixed income; and 58.14 percent equities. Similarly, for the second quarter, Fund assets were allocated as follows - 1.19 percent cash; 38.08 percent fixed income; and 60.73 percent equities.

Regent Nahale-a arrived at 9:09 a.m.

Mr. Yoneshige highlighted the overall portfolio performance of the Fund as of September 30, 2019, noting that returns were up by 1.25 percent for the first quarter; 13.91 percent for the calendar year-to-date; 6.27 percent over the last 5 year period; and 5.95 percent since UBS began managing the Fund to the end of the first quarter. For the period ending December 31, 2019, which includes both the 1st and 2nd quarters of FY 2020, returns were up by 6.22 percent; 19.97 percent for the calendar year; 6.97 percent over the last 5 year period; and 6.63 percent since UBS began managing the Fund to the end of the second quarter. Mr. Yoneshige noted that equity markets were the primary driver of the strong performance of the Fund for the 2019 calendar year, particularly in the international growth equities market.

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 financial outlook of the Fund and the direction UBS was considering given the current market situation and market volatility. UBS expected market volatility since last year and planned for this instability by keeping the Fund’s allocation in equities at a minimum level to prevent risk exposure. Moving forward, UBS is anticipating increasing the allocation in equities when there is a sufficient lowering of prices in equity stocks and maintaining its focus on long-term investment strategies. It was noted that while the markets remain volatile, particularly due to fears about the economic impacts of COVID-19, it is important to maintain calm when making investment decisions. The financial impacts on the Fund will be reflected in the third quarter report. UBS will continue to closely monitor the financial markets and may adjust its investment strategies as more information becomes available.

Noting that certain sectors are anticipated to experience greater economic impacts due to COVID-19, Board Chair Kudo asked whether UBS was looking at shifting the Fund's holdings in these sectors to other sectors. Mr. Yoneshige replied that the energy sector is currently the worst performing sector which is fortunate for the Fund since the policy has been to divest from these types of investments. He noted that in the United States, the index approach to investing is used, but that UBS is attempting to make some shifts in the area of international equities and has been speaking to investment managers to ascertain more information on various sectors so as to pick areas in which fiscally prudent investments can be made.

Stating the UBS mentioned that it considers 60 percent to be the minimum amount of Fund assets that should be allocated to equities, Board Chair Kudo queried if there was a maximum amount to this allocation percentage. Mr. Yoneshige replied that currently, there is a 70 percent ceiling on the amount of assets of the Fund that can be allocated to equities.

Regent Moore requested that UBS provide explanations as to the determinations used to make its asset allocation decisions and the reasons behind the overall return being above or below their established benchmarks in future reports. Mr. Yoneshige stated that UBS will provide that in its next report.

Regent Acoba asked how meaningful asset allocation benchmarks were if these benchmarks were established by UBS and were at the same level as what currently exists in the Fund's portfolio. Mr. Yoneshige replied that the reason behind comparing the asset allocation of the Fund's portfolio to benchmarks established by UBS is to ensure that the Fund's portfolio is doing what it is supposed to be doing.

Regent Acoba inquired further as to whether the Fund outperformed its asset allocation model. Mr. Yoneshige replied in the affirmative.

Regent Acoba questioned if information provided by UBS indicating that the Fund was holding more investments in equities on December 31, 2019, than it did on September 30, 2019, was accurate. Mr. Yoneshige replied that this information was correct but that UBS did not invest more in equities. Rather, this increase in investment equities could be attributed more to price appreciation. Despite efforts by UBS to keep equities allocations low, including taking actions to sell equities owned by the Fund, the extraordinary performance of the equities market over the calendar year resulted in the continual increase of these numbers.

Regent Acoba asked about the total amount of fees paid for management of the Fund, expressed both in a percentage and an actual dollar amount. Mr. Yoneshige replied that the current management fee being charged, in the aggregate, is .49 percent which equates to approximately $375,000. Regent Acoba further inquired as to whether this was a reasonable amount. Mr. Yoneshige responded that for an endowment of this size, the management fee was inexpensive noting that for similarly sized endowments, the management fees, in the aggregate, is closer to .75 percent.

Regent Acoba solicited whether UBS or the individual Fund managers drive the direction of investments made by the Fund. Ms. Hamano replied that UBS drives the asset investment allocation decisions made with regards to the Fund. Mr. Yoneshige added that UBS is primarily looking at investments from a high level. While UBS decides how much assets are allocated to particular investments, it relies on the expertise of individual fund managers and does not instruct them on which stocks to buy. UBS also works to ensure that fund managers are doing what is expected of them.

Board Chair Kudo sought clarification on the values of the Fund provided by UBS asking if these values were as of September 30, 2019. Mr. Yoneshige stated that UBS was providing reports for both the first quarter of FY 2020, which ended on September 30, 2019, and the second quarter of FY 2020, which ended on December 31, 2019. Board Chair Kudo inquired further as to the total value of the Fund as of December 31, 2019. Mr. Yoneshige responded that the total value of the Fund on December 31, 2019, was $77,613,987.95 and that the total returns on portfolio performance for the 2019 calendar year was 19.97 percent. Board Chair Kudo asked if the total value of the portfolio was higher than $77.6 million as of March 5, 2020. Mr. Yoneshige replied that he did not have an exact figure but that the total current value of the portfolio is more than likely less than $77.6 million.

B. <u>FY 2019-2020 Second Quarter Financial Report</u>

VP Young provided the financial report for the second 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 second quarter were $35.2 million, or 3.8 percent higher than projected, the year-over-year difference for all non-general fund types was minimal. He also noted that actual expenditures were $16.2 million, or 3 percent lower than projected, but some of this could be attributed to timing issues in fund transfers. VP Young stated that university finances appear to be satisfactory through the second quarter of FY 2019 - 2020 and fiscally sound for the first eight months of this fiscal year and that the administration will continue to monitor the fiscal situation of the university.

A historical perspective on second 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.

Given the likelihood of the local economy facing a downturn due to COVID-19, Regent Moore asked whether there have been discussions by the state about restricting funds for the balance of the year. VP Young replied that he was not aware of any directions given by the Department of Budget and Finance regarding budget restrictions. He pointed out that UH has already received its general fund allocation for the current fiscal year and that the university is well-positioned to get through this fiscal year. However, the Council on Revenues (COR) is scheduled to meet later this month and it is anticipated that COR will lower its tax revenue forecast because of the economic impacts of COVID-19. This could significantly impact the budget currently being crafted for the next fiscal year by the State Legislature and result in the reduction of future appropriations for the university.

Regent Acoba opined that having $35 million in excess revenues above what was projected appears to be positive news and asked if this was the case. VP Young replied that, yes, actual revenues through the second quarter were $35.2 million higher than projected. However, he cautioned that this figure is in the aggregate across multiple funds and that the majority of this money will be expended by the end of the fiscal year. There should not be an expectation that the university will end the year with a $35 million positive balance. Regent Acoba asked where these excess revenues are deposited. VP Young responded that most of the balances will likely end up in the Tuition and Fees Special Fund (TFSF) or a number of other special funds but reiterated that while historical performances over the past fiscal years have resulted in positive balances being realized, these balances have been nowhere near $35 million.

Regent Acoba asked for clarification on when the planned tuition increases will end and whether a lack of increased revenues due to the absence of a tuition increase is being anticipated. VP Young responded that the university is in the last year of planned tuition increases and that it is highly likely that tuition revenues, sans a tuition increase, will be decreasing given recent enrollment trends. However, he noted that enrollment and tuition revenues are not perfectly correlative and that a number of factors can affect tuition revenue amounts including the numbers of credits being taken; types of programs being entered into; increases in graduate students; and the numbers of residents versus non-residents entering the UH system. As such, it is possible to witness increases in tuition revenues even while experiencing declining enrollment.

Regent Acoba noted that each campus of the UH system has reserve balance requirements and asked whether each campus was at its maximum reserve balance amount. VP Young responded that every campus, without exception, is within the Regent Policy (RP) and Executive Policy (EP) range for required reserve balances which is 5% in the RP and 16% in the EP.

Board Chair Kudo stated that it was his understanding that utility costs were the second highest costs experienced by the university behind personnel costs. VP Young stated that he believed that statement to be correct. Noting that there were significant variances in UHWO and community college utility costs as indicated in the second quarter financial report, Chair Kudo inquired how UHM and UHH were faring with utility costs. VP Young replied that UHH utility expenditures were about $800,000 below the administration’s forecast and that UHM utility expenditures were approximately $1.5 million above the administration’s forecast. Board Chair Kudo asked what the reasons were for the increased utility costs at UHM and whether this was due in part to utility rate increases. VP Young responded that he was not certain why UHM experienced a utility cost increase. Sandy French, Interim Vice Chancellor for Administration, Finance, and Operations at UHM, clarified that the utility expenditure numbers given by VP Young were with regard to funds distributed from the TFSF which is the largest contributor toward utility costs. She noted that, although utility rates have increased slightly, when all sources of funding for utility costs are taken into account, the variance in projected costs verses actual utility expenditures is fairly minimal.

Regent Acopan arrived at 10:02 a.m.

Board Chair Kudo asked if there was a correlation between the student population at a campus and utility costs. VP Young stated that under the facility use model, a correlation between utility costs and the number of students/users would be expected, but the correlation may be small. VP Gouveia added that an analysis of the correlation between utility costs and student population at a campus has not been done but that it was a fairly straightforward analysis that could be conducted.

Noting that utility costs continue to rise at a number of university campuses, Board Chair Kudo questioned whether conservation measures that have been discussed by the sustainability office have been implemented. VP Gouveia replied that some smaller projects that address electrical consumption on university campuses have been implemented and that efforts to increase electrical generation continue throughout the university system. She also noted that a green revolving fund has been created into which any utility cost savings experienced by a university campus will be placed for reinvestment in energy conservation and generation projects. Work is also currently underway to develop a long-term energy management plan that is anticipated to be presented to the board in the administration's annual sustainability report.

Board Chair Kudo asked about the use of smart meters in the management of electrical demand and consumption, particularly at UHM. VP Gouveia responded that about 80 percent of the buildings on the main campus have had smart meters installed but that they have not been installed at some of the ancillary sites for various reasons.

Regent Moore noted that utilities also include sewer and water and that costs for those utilities were also increasing. VP Gouveia replied that while the costs for those utilities were increasing, it was not increasing at an alarming rate. Regent Moore suggested that it might be useful, going forward, to look at trends for the number of kilowatt hours of electricity generated and used by the university, the university's electric bill, the number of gallons of water used by the university, the university's water bill, and the correlation between student population and utility consumption on a per student basis. VP Gouveia responded that this is already done and is included in the annual sustainability report. She also stated that research is responsible for a larger portion of energy consumption than can be attributed to students.

C. Recommend Board Approval of Revisions to Regents Policy (RP) 8.207, Investments; and Repeal of RP 8.211, Resolution on Use of New Income, Principal, and Investment of ASUH-Mānoa Stadium Stock Fund dated January 18, 1979, and RP 8.212, Guidelines on Use of Income from the University of Hawaiʻi Mānoa Stadium Stock Fund, Proceeds from the Sale of the Kaimuki Observatory Lot and from the Rental of University Property

Board Secretary Oishi provided an overview of past discussions concerning revisions to RP 8.207, and the repeal of RPs 8.211 and 8.212, stating that recommendations for revising and repealing the noted RPs were the result of work conducted by a board permitted interaction group on investments (Investments Task Group) established in 2019 which was chaired by Regent Moore. She noted that the revisions to RP 8.207 also included additional recommendations made by Accuity, LLP, at the last meeting of the Committee on Independent Audit.

Regent Tagorda arrived at 10:13 a.m.

Regent Moore explained that the purpose of the Investments Task Group was to review and make recommendations to the board regarding RPs related to investments. He noted that the Investments Task Group met four times between July and September of 2019, and reviewed a number of issues regarding board investment policies including the appropriate role of regents with regard to investments; asset allocation ranges; whether the board and Associated Students of the University of Hawaii should create a perpetual inflation-protected revenue stream of income that can be invested and used for the purposes for which the funds were established; and whether the three separate policies could be condensed into a single, more succinct policy. The Investments Task Group made several recommendations that were approved by the Committee on Budget and Finance, as well as the full board, and sent them to the administration for placement in appropriate policy form. Regent Moore highlighted the additional change made to RP 8.201 per Accuity's recommendation. He noted that the change concerned the 15 percent limit placed on investment managers with regard to equity investments which was problematic because of recent trends in the investment market that have seen large investment increases in only a few sectors and at times have caused investments made by the university to be in violation of RP 8.207. To address this concern, RP 8.207 was further revised to replace the 15 percent limitation with the requirement that investments in individual equities comprise no more than 4 percent of the total market value of the stock portfolio. The result of these discussions and work is contained in the regent policy that is presently before the committee.

Regent Sullivan arrived at 10:16 a.m.

Discussions occurred between committee members regarding the changes to RP 8.207, with Regent Acoba suggesting a number of additional substantive and non-substantive amendments to the revised RP 8.207.

Chair Bal noted that the majority of the suggested amendments made by Regent Acoba appeared to address issues related largely to probation and termination issues regarding the investment policy. He suggested that the administration recast RP 8.207, in light of the suggested amendments.

Brief discussions ensued as to how the administration could best address the suggested amendments when recrafting RP 8.207, particularly with regard to termination issues involved in the investment policy.

Regent Moore moved to recommend board approval of the revisions to RP 8.207, with the additional amendments suggested by Regent Acoba, and repeal of RP 8.211 and 8.212, seconded by Vice-Chair Higaki, and the motion carried with all members present voting in the affirmative.

D. <u>Request for Health Fee Increase at UHH</u>

UHH Chancellor Irwin explained that UHH was requesting to increase the student health fee from the current $7.00 per semester to $30.00 per semester through at least FY 2023-2024, and noted that all of the testimony received by the committee from students was in support of the fee increase. She introduced Farrah-Marie Gomes, UHH Vice Chancellor for Student Affairs, who would be providing more information on the proposed fee increase.

Ms. Gomes provided a brief overview of UHH's request to increase the student health fee, noting that this fee has not changed since it was established in 2003. She stated that the purpose of the proposed increase is to support the rising costs of comprehensive medical care services for UHH students, specifically allowing for expansion and enhancement of medical services through additional staff and better equipment and technology. The increased fee will also allow for better alignment of actual costs experienced by UHH Student Medical Services to provide medical services that help to ensure that students meet all necessary medical requirements to remain enrolled at UHH and actively pursue their academic goals. The additional staff and services to be provided with this proposed fee increase will also help to ensure compliance with the Health Insurance Portability and Accountability Act of 1996 and the Family Educational Rights and Privacy Act and reduce liability to the institution.

Regent Moore moved to recommend approval of the student health fee increase, seconded by Regent Nahale-a, and the motion carried with all members present voting in the affirmative.

E. <u>Multi-Year Financial Forecast for FYs 2019-2025</u>

Chair Bal asked what the repercussions would be if discussions on this issue were delayed until the next meeting. VP Young replied that this is the last component of the Integrated Academic and Facilities Plan (IAFP) which is subject to the discretion of the board and therefore a delay of discussions should not cause any repercussions.

President Lassner explained that while this is the last component plan of the IAFP, it also was the most difficult to formulate. The multi-year enrollment plan, which the administration briefed the board on in November 2019, provided enrollment trajectories and numbers which were used to forecast revenues associated with enrollment. This revenue forecast was then used to integrate revenue and expenditure projections into a six-year financial forecast. He stated this was the first time the administration has attempted to develop a financial plan on a six-year basis and noted that the intent of the administration was to provide the board with a six-year rolling financial plan. This methodology is similar to the six-year capital improvement project rolling plan that is currently in place and used by the administration.

Taking into account the importance of this issue, Vice-Chair Higaki suggested that the presentation and discussions on the multi-year financial forecast take place at the next committee meeting or a special committee meeting.

Stating that it was deserving of the full board to be involved in these discussions, Regent Sullivan suggested that this presentation be placed on the agenda for the next board meeting.

With the concurrence of committee members and Board Chair Kudo, Chair Bal stated that the presentation of the multi-year financial forecast for FYs 2019-2025 will be placed on the board agenda for the next board meeting and discussions will take place at that time.

F. Committee Bylaws and RP Alignment

Chair Bal stated that he would defer this agenda item until a future date due to time constraints.

G. Future Status of Budget and Finance Committee

Chair Bal noted that the board self-imposed this action on all its standing committees to address the question of whether each standing committee should be maintained or abolished in light of the statutory reduction in the number of regents. He opined that the Budget and Finance Committee plays an important role regarding oversight of fiscal matters related to the university and therefore should be maintained. Discussions among committee members on the future status of the committee were then opened. There being no comments or discussion, Chair Bal stated that a recommendation to maintain the Committee on Budget and Finance will be made to the board.

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 10:43 a.m.

Respectfully Submitted,

/S/

Kendra Oishi
Executive Administrator and Secretary
of the Board of Regents