MINUTES

BOARD OF REGENTS COMMITTEE ON BUDGET AND FINANCE MEETING

MARCH 3, 2022

Note: On January 26, 2022, Governor David Y. Ige issued a proclamation related to the COVID-19 emergency that temporarily suspended Section 92-3.7, Hawaiʻi Revised Statutes (HRS), “only to the extent necessary to suspend the requirement to have at least one meeting location that is open to the public”.

I. CALL TO ORDER

Chair Robert Westerman called the meeting to order at 9:30 a.m. on Thursday, March 3, 2022. The meeting was conducted virtually with regents participating from various locations.

Committee members in attendance: Chair Robert Westerman; Vice-Chair Wayne Higaki; Regent Benjamin Kudo; Regent Alapaki Nahale-a; and Regent Diane Paloma.

Others in attendance: Board Chair Randy Moore; Regent Simeon Acoba; Regent Eugene Bal; Regent William Haning; Regent Ernest Wilson (ex officio committee members); President David Lassner; Vice President (VP) for Community Colleges Erika Lacro; VP for Legal Affairs/University General Counsel Carrie Okinaga; 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 (UHM) 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

Chair Westerman stated that the minutes of the November 4, 2021, committee meeting had been distributed and inquired as to whether committee members had any recommended corrections. Hearing none, the minutes were approved.

III. PUBLIC COMMENT PERIOD

Board Secretary Oishi announced that the Board Office did not receive any written testimony, and that no individuals signed up to provide oral testimony.

IV. AGENDA ITEMS

A. Associated Students of the University of Hawaiʻi (ASUH) Stadium Stock Fund Investment Performance, through December 31, 2021

Regent Nahale-a arrived at 9:33 a.m.

VP Young explained that Regents Policy (RP) 8.207 requires that a semi-annual report on the investment performance of the ASUH Stadium Stock Fund (Stadium Stock Fund) portfolio be provided to the committee. He introduced Mr. Peter Backus, ASUH Investment Advisor from Graystone Consulting/Morgan Stanley; Ms. Alyssa Renteria, ASUH Vice President; Mr. Blake Saari, ASUH Treasurer; and Ms. Bonnyjean Manini, Director of the Office of Student Life and Development at UHM, who would be providing the report.

Mr. Saari provided an overview and history of the Stadium Stock Fund noting that, in 1976, its initial corpus of $839,258.77 was generated from the liquidation of 1,481 shares of Honolulu Stadium, Ltd. that were held in the name of ASUH. Since that time, ASUH has invested the principal and interest of the Stadium Stock Fund to generate additional revenues which has resulted in attaining a portfolio that is presently valued at $11,480,386.05. He also reviewed the Stadium Stock Fund portfolio's asset allocations stating that it currently consists of 0.4 percent cash, 24.8 percent fixed-income, and 74.8 percent equities, and highlighted the portfolio's performance over the past three years.

Mr. Backus reviewed his functions as the ASUH Investment Advisor explaining that he serves as a non-discretionary investment consultant and provides quarterly reports, compliance reviews, and investment recommendations to ASUH through its Investment and Long-Range Planning Committee (ILRP). He summarized the events that impacted the stock market in 2021 as well as the actions being taken by Morgan Stanley to prepare its clients for anticipated market volatility due to increasing commodity prices and interest rates, multi-decade high inflation, and current events occurring in Europe. He also described the process used by ASUH to approve and implement Stadium Stock Fund portfolio changes, including the role of the investment advisor in this process, and noted recent changes made to the portfolio.

It was noted by Mr. Saari that ASUH's budget is comprised of annual student fees and Stadium Stock Fund dividends. ASUH believes that they consider (the investment policy) managing the portfolio to generate five percent return of the Stadium Stock Fund's portfolio. Mr. Saari stated that, even though annual student fees have remained relatively flat since fiscal year (FY) 2018, the Stadium Stock Fund portfolio experienced a strong performance in 2021, which translated to an overall ASUH budget of $692,811. While a portion of the budget is used to fund operational expenses, Ms. Renteria stressed that ASUH strives to use these monies to benefit the majority of the student population at UHM and provided examples of various programs, services, scholarships, awards, and student support activities funded by ASUH.

Mr. Saari and Ms. Renteria also provided overviews of the processes used by ASUH to approve general legislation, as well as its budget; reviewed some of the activities funded by ASUH during the COVID-19 pandemic; and offered insights into the impacts of past market volatility on ASUH operations.

Mr. Backus remarked that RP 8.207 currently allows for a range of between 40 and 80 percent of the Stadium Stock Fund's portfolio assets to be weighted towards equities but noted that the allocation range was incorrectly cited in the presentation provided by ASUH during the meeting. He apologized for the error and emphasized that the

Stadium Stock Fund portfolio is well within established minimum and maximum allocation parameters and compliant with all investment policies of the board. [Note: corrected materials were subsequently provided.]

Chair Westerman asked whether all adjustments made to the Stadium Stock Fund portfolio require ASUH approval. Mr. Backus replied in the affirmative reiterating that he serves as a non-discretionary investment consultant to ASUH.

Referencing the recent volatility of the stock market, Chair Westerman asked if ASUH was preparing for any reductions in its budget should there be a decrease in investment returns and working with its investment advisor on this issue. Mr. Saari replied that ASUH generally receives data on portfolio performance in June or July of a particular year and uses this data to plan and develop its budget for the coming fiscal year. He also stated that, historically, downturns in the stock market have only affected excess amounts of funds available for use by ASUH.

Board Chair Moore expressed his concerns with the apparent inconsistency between the cited annual distribution withdrawals of five percent from the Stadium Stock Fund, which he believed was unsustainable, and the maximum annual distribution rate of 4.25 percent based upon a rolling 20-quarter average value of the Fund specified in RP 8.207. Director Manini replied that the ASUH Board's reading of RP 8.207 is that the policy only requires that the Stadium Stock Fund portfolio generate an annual distribution of up to 4.25 percent of a rolling 20-quarter average value of the Fund and provides the ASUH Board with the discretion to determine the amount of the annual distribution. While ASUH budgets for a distribution of five percent each year, she stated that it has not expended more than three percent annually over the last two decades. Board Chair Moore recommended that the ASUH Board obtain clarification from VP Young on this matter. Chair Westerman concurred with Board Chair Moore adding that the board wants to ensure that the Stadium Stock Fund remains solvent during times of extreme economic difficulty.

Board Chair Moore suggested that future Stadium Stock Fund performance reports include the gross fees charged by the Stadium Stock Fund's investment managers, the amount of these gross fees as a percent of the total investment fees charged, and an accounting of the Stadium Stock Fund's performance relative to its established benchmarks.

B. <u>FY 2021-2022 Second Quarter UBS Legacy Endowment Fund (Endowment Fund) Investment Performance Report</u>

Kyle Yoneshige and Lori Hamano from UBS provided a report on the Endowment Fund for the second quarter of FY 2022, reviewing both asset allocation and investment performance. Ms. Hamano stated that, overall, the asset allocation of the Endowment Fund consisted of 4.32 percent cash, 24.55 percent fixed-income, and 71.13 percent equities, and provided a detailed breakdown of each asset class. She also stated that asset performance continues to be impacted by COVID-19 federal stimulus funding, increased government spending, and high inflation. Given the heightened value of equities and the lack of normal market corrections, Ms. Hamano explained that $3 million in cash was raised at the end of the 2021 calendar year as part of a strategic maneuver in conjunction with the recognition that liquid assets would be needed for the near term.

Mr. Yoneshige stated that as of December 31, 2021, the value of the Endowment Fund stood at just over $97.6 million. He reviewed the Endowment Fund portfolio's overall performance highlighting that returns net of an annual 0.5 percent investment management fee were up by 4.09 percent for the second quarter of the fiscal year; 2.46 percent for the first two quarters of the fiscal year; 11.28 percent over the last five-year period; and 8.56 percent since UBS began managing the Fund to the end of the second quarter of this fiscal year. While the Endowment Fund portfolio's performance remains in line with long-term expectations, it lagged in meeting established quarter-to-date benchmarks during the fourth quarter of the 2021 calendar year due to a lackluster performance in the international equities markets. Internal compliance reviews also confirmed that the Endowment Fund was compliant with fossil fuel divestiture mandates and all investment policies. Additionally, no material changes or weaknesses have been identified with respect to the management of the Endowment Fund.

Mr. Yoneshige and Ms. Hamano briefed the committee on the financial outlook of the Fund and the direction UBS was considering given the current economic and market situation. Market volatility, which has been on the rise and is expected to intensify for the near term, continues to weigh on the Endowment Fund portfolio's performance. Inflation, which is experiencing a multi-decade high and currently stands at 7.12 percent, is expected to remain relatively high throughout 2022 and possibly continue into 2023. As a result, the Federal Reserve has begun increasing interest rates with additional increases being projected throughout the 2022 calendar year. The hike in inflation and increasing interest rates have also impacted the bond markets which are experiencing declining yields or reduced returns. Equities, particularly United States large cap equities, were buoyed by federal spending and stimulus funding and continue to perform well despite their high valuation. Given these factors, UBS believes that equities offer the best opportunity for returns-on-investment and continues to advocate for maintaining the Fund's equity allocation at current levels. While UBS expects muted returns in the future as compared to the last several years, it will continue to monitor the financial markets, focusing on long-term returns that consider inflation and market volatility, and adjust its investment strategy accordingly.

A brief overview of market performance over the past 42 years was also provided with Mr. Yoneshige explaining that, although the stock market historically has witnessed positive rates-of-return three out of every four years, it has also experienced, on average, intra-year declines of 14 percent. Thus, any market decline that is less than 14 percent, including the 7.7 percent decline currently occurring in 2022, is considered to be a normal market correction.

Chair Westerman inquired as to whether the $3 million in cash raised at the end of the 2021 calendar year was sufficient and asked about the intended use of these funds. Mr. Yoneshige replied that discussions were held with the administration on the appropriate amount of money to raise given the cash requirements for calendar year 2022 and market conditions and $3 million was deemed to be a fitting and prudent amount. He also noted that the cash asset allocation at the end of calendar year 2021 stood at 4.3 percent, which is slightly less than half of the 10 percent ceiling on cash assets owned established under RP 8.207. The money raised will continue to provide cash for the university to meet its cash requirements for the 2022 calendar year but can also be deployed to repurchase equities should the market begin to experience a pullback of 15 percent or more.

Referencing the Endowment Fund's long-term investment focus and stating his belief that current market volatility and increased inflation are temporary situations, Regent Kudo asked if investing in equities with good dividend return rates would have been a more judicious approach then raising cash assets. Mr. Yoneshige responded that taking into consideration the historic high costs of equities globally, as well as the forces impacting global markets, UBS believed that raising cash was the most prudent approach to employ. He also stated that dividend-oriented equities, such as utilities, experienced very low rates-of-return and were unattractive purchases. Chair Kudo questioned if investing in non-utility dividend-oriented equities with elevated rates-of-return and high appreciation potential could be an option. Mr. Yoneshige replied that UBS has avoided purchasing higher dividend-yielding equities due, in part, to their adverse reaction to rising interest rates and the lower yields experienced during these periods. Ms. Hamano added that UBS believed this was an opportune time to generate cash given the high valuation of equities but noted the potential for use of this cash to purchase higher dividend-yielding equities should interest rates stabilize and the markets begin to experience more normalized corrections.

Referencing the $3 million in money raised at the end of calendar year 2021, Regent Acoba requested clarification of the purpose for raising these funds. Regent Acoba also asked if his understanding was correct that UBS intended to reinvest these funds in equities should the market experience a decline of more than 14 percent. Ms. Hamano replied that equities were sold as part of a tactical maneuver given the high valuation of equities at the end of the 2021 calendar year as well as to raise cash for endowment payouts for the 2022 calendar. She also reiterated that these monies can be reinvested in equities should there be a decrease in the cost of equities due to a market decline of more than 14 percent.

Regent Acoba asked if payouts from the Endowment Fund only amounted to $3 million a year. VP Young replied that the amount of monies drawn down from the Endowment Fund has historically been about $2.5 million per year or less. The $3 million figure was settled on after discussions with UBS determined that the benefits of raising this amount would be two-fold by providing enough liquid assets to cover endowment payouts as well as fund purchases of equities should the market soften.

Regent Acoba followed-up on Board Chair Moore's questions regarding fees charged by the Stadium Stock Fund's investment managers as well as the reasoning for performance metrics falling below established benchmarks expressing his belief that these questions remained unanswered. Board Chair Moore stated that his intention was to have these figures and explanations presented in future Stadium Stock Fund performance reports. Regent Acoba acknowledged Board Chair Moore's response but nevertheless requested a response to these questions. Mr. Backus replied that a gross fee of .38 percent is charged for managing the Stadium Stock Fund's portfolio based upon Morgan Stanley's standard fee of .25 percent for its consulting services and an estimated investment management fee of .13 percent because of the large amount of index funds used. He also stated that the Stadium Stock Fund's performance was more or less in-line with established benchmarks but fell short during the fourth quarter of the 2021 calendar year primarily due to the underperformance of some of the small- and mid-cap assets contained within the Stadium Stock Fund's portfolio. Mr. Backus stressed that this data was preliminary and that a more detailed analysis of these issues would be provided in the next Stadium Stock Fund performance report.

C. <u>FY 2021-2022 Second Quarter Financial Report</u>

VP Young provided the financial report for the second quarter of FY 2021-2022 stating that, with 50 percent of the fiscal year complete, actual revenues and expenditures appear to indicate that the university will continue to experience positive fiscal conditions for the remainder of the fiscal year. Nevertheless, the administration will continue monitoring pre-pandemic comparisons to better gauge the overall financial and fiscal progress of the university.

Data on both general fund (GF) and various special fund revenues and expenditures was presented for each of the major units of the university. Although total revenues were approximately $140.8 million higher than the same period last fiscal year, he explained that this was attributable to a change in the GF distribution methodology used by the State Department of Budget and Finance (B&F) which led to the university already receiving its entire FY 2021-2022 GF allocation as opposed to FY 2020-2021 when funds were released on a quarterly basis. Tuition and fees revenues were $6.4 million higher than the same period last year which was primarily due to the notable increase in enrollment at UHM. The uptick in on-campus activity also boosted revenues generated for other special and revolving funds, though it was noted that they remained below pre-pandemic levels. While overall expenditures were $23.5 million lower than the same period last fiscal year, greater on-campus activity is also expected to result in higher expenses. In an effort to mute large increases in expenditures, the administration is anticipating that cost mitigation and other cash preservation strategies implemented during the pandemic will be maintained for the remainder of the fiscal year.

Regent Paloma questioned the reasoning behind the release of GF on a quarterly as opposed to an annual basis. VP Young replied that this determination, which is a decision made by the Governor in conjunction with the Director of B&F, is generally based upon the forecasted generation of tax revenues for the fiscal year and, as such, can differ from year-to-year.

Regent Acoba asked if his understanding that the university received an infusion of approximately $241 million in federal stimulus monies was correct. VP Young replied that, while the figure cited was correct, it is not indicative of direct federal funding actually received by the university. He emphasized that, although some funding was provided for operational expenses directly related to the COVID-19 pandemic, a large portion of these funds were given directly to students in the form of financial aid.

Regent Acoba requested that a more detailed breakdown of federal stimulus monies received, as well as their uses, be provided to regents. VP Young replied that under federal reporting requirements, the university is obligated to prepare and publicly post compliance reports that contain detailed information on the receipt and expenditure of federal stimulus funds. He noted that these reports are periodically presented to the committee, with the last report being presented in October 2021, and are available on the university's government relations website. Regent Acoba asked if the entirety of federal stimulus funds received by the university have been expended as of January 2022. VP Young responded in the negative.

Regent Acoba inquired as to whether all of the major units of the university are compliant with funding reserve requirements contained in the RPs. VP Young responded that all university campuses, with the exception of UHM, are at or above established funding reserve requirements when considering the Tuition and Fees Special Fund, which is the primary funding reserve for campuses, and that UHM is very close to achieving this level. However, he noted that total funding reserve levels may still remain lower than the 16 percent established in the RPs.

Regent Acoba questioned whether federal stimulus monies were reflected in this financial report. VP Young replied that federal stimulus monies received by the university were not reflected in this report.

D. Discussion on Future Distribution of Legacy Endowment Funds

Due to time constraints, this agenda item was deferred.

V. ADJOURNMENT

There being no further business, Chair Westerman adjourned the meeting at 10:52 a.m.

Respectfully Submitted,

/S/

Kendra Oishi
Executive Administrator and Secretary
of the Board of Regents