The Banking Committee of the Board of Regents met on Thursday, January 16, 2003, at the University of Iowa, Iowa City, Iowa.

Those present were:

Banking Committee members: Regents David Fisher (chair), Amir Arbisser, David Neil and Owen Newlin.

Others in attendance were:

Institutional representatives: Douglas True, Terry Johnson, Ann Madden Rice, Carol Senneff, Cynthia Bartels, Gregory Geoffroy, Ben Allen, Warren Madden, Mark Chidister, Brad Dye, Joan Thompson, Robert Koob, Tom Schellhardt, Gary Shontz, Jim Heuer, and Luann Woodward;

Barry Fick, Springsted, Inc.;

Ken Haynie and Ed Bittle, Ahlers law firm;

Mark Brubaker, Wilshire Associates;

Board Office: Pamela Elliott, Joan Racki, Deb Hendrickson, and Barb Briggle.

Regent Fisher called the meeting to order at 7:45 a.m.

APPROVE MINUTES OF THE NOVEMBER 2002 BANKING COMMITTEE MEETING.

MOTION: Regent Neil moved to approve the minutes of the November 14, 2002, Banking Committee meeting, as written. Regent Arbisser seconded the motion. MOTION CARRIED UNANIMOUSLY.

SALE AND AWARD OF $6,200,000 INDOOR MULTIPURPOSE USE AND TRAINING FACILITY REVENUE BONDS, SERIES ISU 2003.

Vice President Madden stated that bids would be received that morning and he anticipated a successful bond sale. Iowa State University officials have consulted with representatives of the two bond rating agencies (Moody’s and Standard & Poor’s) and the bonds have received the same ratings as other University bonds.
Mr. Fick stated that confirming ratings of AA3 had been received from Moody’s and Standard & Poor’s. The rating agency representatives commented on the University’s favorable student marketing position, strong levels of financial reserves and moderate debt level. He said this was an assignment of a new rating for a new self-liquidating enterprise at Iowa State University. Interest rates remain low and he anticipated a successful sale.

Regent Fisher asked if approximately $4 million in gifts would flow toward amortization of the bonds. Vice President Madden responded that the Foundation has pledge revenue streams that will cover the cost of this facility. They have cash on hand. Some of the pledges are multi-year pledges and so the debt service structure has been scheduled around the revenue streams. Although the back-up pledge is the student fees, the expectation is that this will be financed through the actual gift revenues on which they have commitments. He noted that construction bids had been taken for the project, and The Weitz Company was the low bidder. There is currently a competitive construction market. Construction would begin quickly and he hoped the project would be finished next year.

Regent Fisher asked for the use of the student fee revenue if it is not used for debt service. Vice President Madden responded that the fee is committed to the athletics program. If the revenues are needed to pay the debt service, the funds would be diverted from the Athletics Department for that use. The student fee revenue is a back-up pledge. He noted there was a high probability that the student athletics fee would increase next year.

Regent Fisher asked if the understanding of bond holders would be that the primary source of debt service payment is student fees. Mr. Bittle responded affirmatively. He stated that revenues from student fees and from gifts go into the sinking fund. Once the debt service coverage is met, the student fee revenue is returned to the Athletics Department.

Vice President Madden said the bond ratings are built around the student fees as a guarantee.

Regent Neil asked what the bond rating would have been if the student fees had not been pledged as a source of repayment. Mr. Fick responded that the bonds would likely have been rated at the A level, probably A1, which is one full step below the actual rating.

MOTION: Regent Arbisser moved to recommend that the Board adopt the following resolutions, subject to receipt of acceptable bids: (1) A Resolution
providing for the sale and award of $6,200,000 Indoor Multipurpose Use and Training Facility Revenue Bonds, Series I.S.U. 2003, and approving and authorizing the agreement of such sale and award. (2) A Resolution authorizing and providing for the issuance and securing the payment of $6,200,000 Indoor Multipurpose Use and Training Facility Revenue Bonds, Series I.S.U. 2003, to pay the costs of constructing and equipping an indoor multipurpose use and training facility including funding a debt service reserve fund and paying the costs of issuance of the Bonds. Regent Neil seconded the motion. MOTION CARRIED UNANIMOUSLY.

SALE AND AWARD OF $9,210,000 DORMITORY REVENUE BONDS, SERIES UNI 2003.

Vice President Schellhardt stated that University of Northern Iowa officials were ready to proceed with the bond sale. He said staff had worked with the bond rating agencies. Moody’s rated the bonds as A2, and Standard & Poor’s rated the bonds as A-. The purpose of the proceeds is to renovate the Towers dining area similar to what was done with the Redeker dining area.

Mr. Fick stated that very strong positive comments were received from both rating agencies (Moody’s and Standard & Poor’s).

MOTION: Regent Neil moved to recommend that the Board adopt the following resolutions, subject to receipt of acceptable bids: (1) A Resolution providing for the sale and award of $9,210,000 Dormitory Revenue Bonds, Series U.N.I. 2003, and approving and authorizing the agreement of such sale and award. (2) A Resolution authorizing and providing for the issuance and securing the payment of $9,210,000 Dormitory Revenue Bonds, Series U.N.I. 2003, for the purpose of paying the cost of remodeling, improving, constructing and equipping residence halls and related facilities, located on the campus of the University of Northern Iowa, including funding a debt service reserve fund and paying the costs of
issuance of the Bonds. Regent Arbisser seconded the motion. MOTION CARRIED UNANIMOUSLY.

PRELIMINARY RESOLUTION FOR THE SALE OF UP TO $6,200,000 UTILITY SYSTEM REVENUE REFUNDING BONDS, SERIES SUI 2003.

Vice President True stated that this was an economic refunding for the University of Iowa. There was no “new” money being created by the sale.

Mr. Fick said the bond sale would be conducted for interest rate savings. It should be a straight-forward transaction because interest rates remain low. The only caveat he mentioned was a possible war with Iraq, and he did not anticipate that such an event would have a long-lasting effect on the bond market.

Regent Fisher noted the bonds issued in 1993 were at a net interest rate of 4.73 percent. He asked if the rate received for the refunding bonds would have to be around 4 percent to be financially feasible. Mr. Fick responded affirmatively. He said there is not a significant amount of debt in the remaining years of the bonds. Very low interest rates are available for bonds with one- to two-year maturities.

Regent Arbisser asked if the monies that are saved will be returned to the University’s general fund. Vice President True responded that the savings will be returned to the enterprise, which reduces the costs for the entire University.

Mr. Bittle said the bond sale would take place during the Board’s February conference call.

MOTION: Regent Neil moved to recommend that the Board adopt A Resolution authorizing the Executive Director to fix the date or dates for the sale of up to $6,200,000 Utility System Revenue Refunding Bonds (The State University of Iowa), Series S.U.I. 2003. Regent Arbisser seconded the motion. MOTION CARRIED UNANIMOUSLY.
PRELIMINARY RESOLUTION FOR THE SALE OF UP TO $22,000,000 DORMITORY REVENUE BONDS, SERIES ISU 2003.

Vice President Madden stated that the bond proceeds would finance the second suite building as part of the Union Drive redevelopment at Iowa State University. The first suite building was occupied this past fall. The Suite Building 1 has 320 beds and those have been very popular. The bond sale is scheduled for March 2003.

Regent Fisher asked for the housing environment in Ames between college dormitories and private apartments, particularly with the influx of new apartments.

Vice President Madden responded that there is adequate housing overall. The University’s Residence Department recently received an updated market study from an outside marketing group. The study indicates the occupancy rate at the University continues to be very good. The private sector’s occupancy rate is 97 percent to 98 percent which, in Ames, is viewed to be okay. The marketing data indicate that students continue to desire more privacy and more square footage, both of which the residence system master plan is addressing. University officials will bring to the Board a recommendation to tear down Westgate, Knapp and Storms residence halls. In March, University officials hope to provide the Board with an update of the University’s residence system master plan, originally presented five years ago.

Regent Arbisser asked if some more modest student residence facilities will be maintained. Vice President Madden responded that some of the original structures will be retained. Wallace and Wilson residence halls will substantially stay as they are and will be offered at the lower rates. The goal is to offer an array of choice.

President Geoffroy stated that at least one-half of the residence halls will be untouched by renovations for the next 10 years. There will still be plenty of the “good ‘ol” rooms.

Vice President Madden said the marketing study indicates that the demand is for upscale more than for downscale facilities.

Regent Arbisser asked if the marketing study was of current students. Vice President Madden responded affirmatively. He said the study did not include students who are not enrolled at the University.

Regent Neil stated that at the time the Board of Regents was presented with the Union Drive project, University officials indicated they anticipated residence system increases of approximately 5 percent. He asked for the current expectation of increases.
Vice President Madden responded that University officials continue to review the rates. It is hoped that rates will continue to be in the range projected. He said the driving force, though, is the salaries component. University officials are not in control of some of the pay rates. If salaries continue to increase at high rates, those salaries will have to be built into the cost structure because the residence system is self-supporting.

Regent Neil asked what pay increases were anticipated at the time University officials indicated that residence system increases would be approximately 5 percent. Vice President Madden responded that two-thirds of the salary structure of the Residence Department is merit system salaries, which are governed by the state’s collective bargaining contract. University officials are looking at ways to minimize the impact of merit system salaries, perhaps by increased use of student employees.

Regent Arbisser referred to the older dormitory facilities for which there is no debt service, and asked what proportion of the residence system fee for those older facilities is devoted to salaries. Vice President Madden responded that the residence system is run as an enterprise. He said 20 percent to 25 percent of the residence system revenues are for debt service and financial obligations. There will be approximately $140 million in debt in the system.

Regent Fisher said he had read that a private investor is building 120 units near the Iowa State University campus. Vice President Madden stated that, in the last several years, 400 to 500 units per year have been added in Ames, although that number has dropped in the last couple of years. The major growth is in senior citizen housing units and not in the student rental market. He said students are migrating into some of the older apartment complexes. He noted that the Ames community is becoming more aggressive in maintaining occupancy standards, which will change some of the community dynamics. The enforcement of occupancy standards will effect where students elect to live. The advantage of University housing is its proximity to campus and the availability of high-speed internet access in every room.

Mr. Fick stated that representatives of both rating agencies are aware that this bond sale is forthcoming. He did not anticipate adverse reaction on the ratings.

**MOTION:** Regent Newlin moved to recommend that the Board adopt A Resolution authorizing the Executive Director to fix the date or dates for the sale of up to $22,000,000 Dormitory Revenue Bonds, Series I.S.U. 2003. Regent Arbisser seconded the motion. **MOTION CARRIED UNANIMOUSLY.**
COSTS OF BOND ISSUANCE.

Associate Director Racki stated that this month’s report included issuance costs for the September 2002 sale of University of Iowa Facilities Corporation Bonds for the Roy J. and Lucille A. Carver Biomedical Research Building Project and the October 2002 sale of University of Northern Iowa Dormitory Revenue Refunding Bonds. She referred Banking Committee members to the location in the meeting materials of the cost data.

Regent Fisher stated that the tables on the overall cost of bonding were very readable.

ACTION: Regent Fisher stated the Banking Committee, by general consent, received the report on the issuance costs related to the September 2002 sale of University of Iowa Facilities Corporation Bonds for the Roy J. and Lucille A. Carver Biomedical Research Building Project and the October 2002 sale of University of Northern Iowa Dormitory Revenue Refunding Bonds.

QUARTERLY INVESTMENT AND CASH MANAGEMENT REPORT.

Director Elliott stated that the information presented was as of September 30, since there was not a December Banking Committee meeting. She said the returns for the operating portfolios, which totaled $896 million, were in line with benchmarks for institutional investments. As of September 30, 2002, total Regent combined operating and endowment portfolios were over $1.2 billion.

Mr. Brubaker distributed a “flash report” of performance for the 2002 year-end. He stated that 2002 represented the third consecutive negative year in the stock market. This was the first time since 1939-1941 that there have been three consecutive negative years in the market. Standard & Poor’s was down 22.1 percent for the year. All sectors of the market had negative returns for the year. He said the market was skittish in 2002. There were numerous false starts and optimism, particularly with regard to technology and telecom sectors. The MSCI EAFE index was down 15.9 percent for the year. The top-performing asset class last year was fixed assets.

President Newlin asked for Standard & Poor’s year-end rates for 2001 and 2000. Mr. Brubaker referred him to the location in the hand-out of the annualized returns for Standard & Poor’s, which were -14.6 percent per year over the most-recent three-year period. He noted that there have been negative returns in the U.S. stock market going back five years. In 2002, the stock market responded to corporate governance and accounting scandals as well as the terrorist attacks in the U.S. There is currently
uncertainty about the war in Iraq. He said that, in looking at historical periods where the country has been on the brink of war, the markets reacted as they have now but, once war begins, the markets respond positively.

Returning to his presentation on the year-end flash report of performance, Mr. Brubaker noted that results for the Board’s new manager, LSV Asset Management, had been provided (5.5 percent for the quarter). He said Invesco had a pretty good quarter but, for the year, was 0.4 percent behind its benchmark. Invesco’s three-year results have been quite good but, he said, its long-term numbers were disappointing. Wilshire Associates is practicing due diligence with regard to Invesco. Organizational developments have taken place at Invesco. He next stated that Seneca Capital Management had a rough two years although its longer-term numbers were quite good. He said Seneca’s performance will be quite volatile by the nature of its investment style. He met with Seneca representatives the previous week and confirmed that the company is still doing for the Board what it was hired to do. With regard to LSV Asset Management, he said its performance was 0.1 percent ahead of its index for the quarter. Alliance Bernstein’s performance was up 10.1 percent for the quarter. For the year, Alliance Bernstein is more than 10 percent ahead of its index. He pointed out that the international composite outperformed the domestic composite over the past three years. Mr. Brubaker next addressed the performance of fixed income managers Invesco and Reams Asset Management. He said the returns for Invesco were up 8.6 percent while the index was up 10.2 percent. Reams was up 1.7 percent while its index was up 1.6 percent. He stated that the reason for both firms’ underperformance was bad credit selection.

Regent Fisher asked if the two fixed income managers had WorldCom bonds. Mr. Brubaker said he believed that Invesco had some WorldCom bonds. He then said that if one were to look at the fixed income managers relative to their peers, their results were not that bad. Many fixed income managers got into a trap where WorldCom and Tyco were easy to trade.

Mr. Brubaker next discussed total endowment results for the University of Iowa and the Iowa State University portfolios. He noted that market performance for 2003 had begun on a fairly good note. The markets were up.

President Newlin complimented Mr. Brubaker on the development of the bar chart of each manager’s performance within the portfolios. He asked that the type of manager be included after the name of each manager. President Newlin next pointed out that, after 14 years with Invesco, the return on its portfolios was approximately 9 percent since inception.
Mr. Brubaker stated that Wilshire representatives have reminded the Banking Committee members that the years of +20 percent-type returns would not last.

Vice President True asked for the composition of the Wilshire 5000 index which is used for the broader market index. Mr. Brubaker responded that the Wilshire 5000 (which actually contains 7,200 issues) is designed to comprise the entire U.S. equity market. He said the Standard & Poor’s 500 makes up 75 percent of the Wilshire 5000. The remaining 25 percent would be in mid cap, small cap, and micro cap stocks. The Wilshire 5000 is designed to be a proxy on the total market.

President Newlin asked how the returns for Iowa’s Regent universities compare to the returns of their peers. Mr. Brubaker responded that, for the year, Iowa’s Regent universities were probably around the median relative to their peers. With regard to longer-term numbers, he said Iowa was well in the top one-third to the top quartile. He offered to incorporate the peer information into future reports.

President Newlin asked about the performance of the university foundations for 2002. Vice President True responded that, for the University of Iowa, the Foundation performed better (by 2-3 percent) than the University for calendar year 2002. Three years ago, the University outperformed the Foundation by 3-4 percent.

Vice President Madden stated that Iowa State University had performed a little better than its Foundation. He noted that the Foundation is restructuring its portfolio.

Vice President True offered the following information to Mr. Brubaker, and suggested that similar comparison data could be integrated into the peer comparison data that will be provided in future Wilshire reports. He said endowment return results of both the University Foundation and the University are reported as an aggregate. The University’s returns are also compared within the Big 10, recent data for which has been received by the University. The University of Iowa’s aggregate return (for the University and the Foundation) ranks third from the top and has been in that same relative position for the last five years. He said this was especially useful in comparing endowment returns on a national basis because some universities do not have a separate foundation. Therefore, those universities report their endowment returns as a total for the university. Other universities, like Iowa State University and the University of Iowa, have two separate organizations with separate endowments.

President Newlin pointed out that reporting endowment returns in the manner described by Vice President True would provide a more “apples-to-apples” comparison.

Vice President Madden offered to share the data from NACUBO’s benchmark study which was completed in late fall for the last fiscal year.
ACTION: Regent Fisher stated the Banking Committee received the investment and cash management reports for the quarter ended September 30, 2002, by general consent.

At this point in the meeting, Regent Fisher reported that President Newlin, Executive Director Nichols, Director Elliott and he had met with Iowa’s new State Auditor, David Vaudt, a few weeks previous to this meeting. The next step is for Vice Presidents True, Madden and Schellhardt to meet with Mr. Vaudt for further dialogue. Regent Fisher stated that Mr. Vaudt seems very interested in consumer relations and customer satisfaction. He believes there will be a fresh start for the Board of Regents with the State Auditor’s Office.

Vice President True asked if the universities’ internal auditors and business officers may proceed to make the arrangements to meet with Mr. Vaudt. Director Elliott responded that Mr. Vaudt welcomed a meeting with university personnel. Plans were to hold the meeting in February.

REVENUE BOND AND NOTE FUND AUDIT REPORTS – IOWA STATE UNIVERSITY.

Director Elliott said the revenue bond and note fund audit reports of Iowa State University for the year ended June 30, 2002, indicated that the financial statements of each were presented fairly in all material respects. No findings were reported regarding financial or compliance issues.

Vice President Madden said University officials were pleased with the audit results. The State Auditor was selected, through a bidding process, to perform the audits. He noted that the State Auditor’s office appeared to have experienced staffing and workload challenges in completing some of these audit reports.

ACTION: Regent Fisher stated the Banking Committee, by general consent, received the following Iowa State University Revenue Bond and Note Fund Audit Reports for the fiscal year ended June 30, 2002: 1) Academic Building, 2) Dormitory and Dining Services, 3) Hilton Coliseum, 4) Ice Arena Facility (note), 5) Parking System, 6) Recreational Facility, 7) Student Health Facility, 8) Telecommunications Facilities, and 9) Utility System.
INTERNAL AUDIT REPORTS – UNIVERSITY OF IOWA.

Director Elliott referred to the status of internal audit follow-up reports. She said all of the expected completion dates were within the next couple of months.

Director Senneff stated that, in October, the University of Iowa hired two new auditors to fill vacant positions. Both individuals have their MBAs and one has a CPA. Both auditors plan to take the Certified Internal Auditor (CIA) exam in May.

Regent Fisher asked for the number of internal auditors at the University of Iowa. Director Senneff responded that there are seven auditors located at Seashore Hall. She spends one-half of her time at University Hospitals. There are two additional auditors at the Hospitals as well as one vacant auditor position at the Hospitals.

Director Senneff presented an overview of the University of Iowa’s internal audit reports presented this month. She noted that it had been a while since she had met with the Banking Committee members; therefore, there were several audits to be presented. She stated that, over a three-year period, the University Internal Audit Office audits 14 areas of NCAA compliance. With regard to the NCAA compliance audit presented this month, she said the objective of the audit was to determine whether the institution maintains proper documentation in compliance with NCAA and Big Ten regulations and with recruiting regulations. The auditors made several recommendations for better record keeping. Another audit report presented this month related to hazardous materials management, the primary focus of which was on policies and procedures. The auditors recommended development of a written policy to complement existing procedures defining the University’s expectations for managing hazardous materials and chemicals on campus. A draft policy has been developed that links many of the existing procedures. She noted that the EPA had recently cited a number of East Coast universities for inadequate policies on hazardous materials.

Regent Neil asked if the outstanding Hospitals audits were pretty much completed. Director Senneff responded that there was one outstanding audit related to the Hospitals’ business office; otherwise, the long list of Hospitals audits was pretty much completed.

ACTION: Regent Fisher stated the Banking Committee, by general consent, 1) Received the following internal audit reports from the University of Iowa: Hazardous Material Management – Chemicals; Human Subjects Office; NCAA Compliance – Recruiting; NCAA Student-Athlete Vehicles; NCAA Playing and Practice Seasons; UI President’s
Residence Inventory; University Hygienic Laboratory – Des Moines Locations; and, UIHC Capitalized Assets. 2) Received the report on the Status of the Internal Audit Follow-up reports, including three follow-up reports from the University of Iowa; two from University Operations and one from Hospital Operations.

OTHER BUSINESS.

Vice President True stated that informal conversations had taken place about development of a process whereby more of the operating funds would be moved from institutional management to professional external management, as is currently done with BlackRock. He said there appeared to be consensus among institutional officials that there is a desire to move in this direction. One matter to be decided is whether to further invest with BlackRock or to hire a second manager. The next step would be a process with the Banking Committee, the Board Office and Wilshire Associates to interview alternative managers as well as BlackRock and decide whether or not to place the additional funds with BlackRock or with another manager. He said that, if the Banking Committee agrees to more professional external management of operating funds, an interview process would need to be conducted. The interview process would be similar to the one utilized less than a year ago when additional managers were selected. University officials would like to move as quickly as possible to place more of the operating funds into professional management and to move away from past practices of internal investing.

President Newlin pointed out that placing the funds with an additional external manager would provide a form of diversification.

Vice President True stated that university officials would work with the Board Office and then return to the Banking Committee with a recommendation.

Vice President Madden said the recommendation would likely result in the proposal for an interview process to take place in Des Moines.

Regent Arbisser asked if there were university personnel who are currently engaged in managing the operating funds and, if so, whether privatizing that activity would result in a decrease in FTEs. Vice President True responded that University of Iowa officials would redeploy personnel because there are plenty of other tasks to be accomplished. The recommendation to seek external management of operating funds is an effort to become more efficient and to privatize an activity that can be done better by
professional external managers. He noted that there will always be some investing
done by University personnel for purposes of liquidity and for bond reserves.

Regent Fisher asked for an approximate amount of additional funds to be transferred to
external management. Vice President True responded that there could be three times
as much as is currently managed by BlackRock ($154 million) although the level of
funds may not start out that large. The amount of funds managed by an external firm
could be virtually everything except the restricted portfolio.

Vice President Madden pointed out that BlackRock's performance is very good. Hiring
an additional manager would provide additional diversification. However, the
universities would pay additional fees, so there is a trade off.

Mr. Brubaker stated that, over the next 30 days, the various trade offs would be
quantified. He pointed out that, for each incremental dollar given to BlackRock, the
charge would be approximately 18 basis points. There would not be additional
transaction costs. With utilization of a second manager, transaction costs with the
custodian bank will effectively double. The amount of fees would increase to around 25
basis points.

It was agreed that the institutions and Board Office would begin a process for evaluating
options for moving more of the operating portfolios to professional external fund
managers.
ADJOURNMENT.

The meeting of the Regents Banking Committee adjourned at 8:50 a.m. on January 16, 2003.

Pamela M. Elliott  
Director, Business and Finance

Gregory S. Nichols  
Executive Director