

Contact: Patrice Sayre

NEW INVESTMENT OPTIONS, ASSET ALLOCATIONS, AND FUND MANAGER SELECTION

Action Requested: Consider recommending to the Board approval of the following:

- A diversified investment option with asset allocation guidelines to be incorporated into the Regent Investment Policy and the use of Vanguard Index Funds for the diversified investment option.
- The expansion of the real estate asset class to include other real assets to be incorporated into the Regent Investment Policy and an investment commitment to the Commonfund Capital Natural Resources Partners VIII, L.P., as part of the real asset class of investments.

Executive Summary: At the May meeting, the Board directed the Committee and university personnel to work with Wilshire Consulting to review the Regent asset allocation policy and provide any recommendations to the Committee. The Chair convened a meeting on July 9, 2008, with Board members, university personnel, and Board Office staff.

Wilshire Consulting, the Board's investment advisor, provided an extensive analysis of investment alternatives. Wilshire Consulting recommended changes to more broadly diversify investments that include:

- A new diversified investment option with specific asset mix targets and rebalancing ranges that can be implemented with low cost index fund vehicles. This investment option would provide the capability of increased return potential with effective management of overall risk.
- Use of Vanguard Index Funds for implementing this new option.
- An expansion of the real estate class exposure to include other real assets to generate a rate of return that exceeds the rate of inflation with increased diversification.
- Commitment to the Commonfund Capital Natural Resources Partners VIII, L.P.

Both proposed changes require modification to the existing Regent Investment Policy or acceptance of the proposed restructured Investment Policy as presented in Audit/Compliance and Investment Committee Item 5.

Background:

Diversified Investment Option

Rationale for Investment

The Diversified Investment Option presented offers potential for incremental return while being mindful of the funds' investment horizons and objectives. It maintains the safety of the principal, maintains the necessary liquidity to support longer term operational needs, and obtains a reasonable return for a prudent level of risk. Complimenting the diversified pool will be a liquidity pool needed to meet day to day and month to month university commitments.

This alternative investment provides increased return potential with a similar level of risk to the Merrill Lynch 1-3 Year Government/Corporate Index – the current benchmark for the externally managed operating funds. This option also provides a similar level of return potential but decreased risk as compared to the Lehman Aggregate – the current benchmark for the externally managed quasi-endowment.

Wilshire Consulting projects an increase in expected return of approximately 75 basis points compared to the current 100% fixed income operating pool externally managed and benchmarked to the Merrill Lynch 1-3 Year Government/Corporate Index. It also provides the greatest level of downside protection among the diversified asset mixes analyzed.

Historic and statistical analysis of cash flows and balances as well as other fund requirements would govern how each asset class is populated. The following represents the proposed asset allocation of the diversified investment option:

<u>Asset Class</u>	<u>Target</u>	<u>Rebalancing Range</u>	<u>Benchmark</u>
Cash	40%	+ / - 5%	T-Bill (91 day)
Core Fixed Income	30%	+ / - 4%	Lehman Aggregate
High Yield	5%	+ / - 2%	Lehman US Corp HY Index
TIPS	10%	+ / - 2%	Lehman US TIPS Index
U. S. Equities	8%	+ / - 2%	MSCI US Broad Mkt Index
Non-US Equities	2%	+ / - 1%	FTSE All-World ex US Index
REITS	5%	+ / - 2%	MSCI US REIT Index

Investment Policy Changes

- Changes to the existing policy 7.04 would include the following excerpts:

E. Operating Funds Investment Guidelines

1. Overview

For investment purposes, operating funds are defined as those general use and restricted funds not included in an institutions' endowment portfolio. Short-term operating funds shall consist of cash and liquid investments which are needed to meet underlying cash requirements of the institutions. Other operating funds are any remaining balances which have longer time horizons.

3. General Restrictions and Other Provisions

- a. Short-term operating funds shall not be invested in securities that at the time of purchase have effective maturities exceeding sixty-three months. (Iowa Code §12B.10.6.d.4) The effective maturity shall be defined as weighted average life.

F. Endowment Funds Investment Guidelines

1. Overview

Quasi-endowment funds are similar to endowment funds; however, there is no externally imposed restriction that the principal remain intact in perpetuity. (The different attributes of the quasi-endowment fund may lead to a different asset allocation than the endowment.) Therefore, individual quasi-endowment funds may be invested in either the endowment portfolio, a fixed income portfolio, a diversified investment option, or some combination thereof.

- If the restructured policy is adopted, the diversified option would be considered an option within the intermediate pool.

Investment Vehicles and Transition Plan

Wilshire Consulting uses extensive technology as well as both qualitative and quantitative measures to identify suitable managers and funds. Wilshire evaluated index fund managers and solicited fee quotes. Attached is a letter from Wilshire Consulting describing search and selection specifications for index managers, the evaluation process, and the basis for Wilshire's recommendation of the Vanguard Index funds.

The transition to the index funds would take place over a period of several months.

Expansion of Real Estate Asset Class in the Endowment Portfolio

Rationale for Modification

The endowment portfolio's target asset allocation mix should provide a diversified exposure to real estate, natural resources, and other real asset classes. The definition for real assets is evolving. Tangible assets have intrinsic value. Real assets capitalize unexpected inflation in their returns, which display a positive correlation to inflation. This positive correlation creates a unique pattern, which displays a low correlation to other asset classes, and therefore holds a potential diversification benefit to portfolios of traditional assets.

Investment Policy Changes

Replace the definition of real estate contained in the current Board policy:

Real Assets

The Board invests in real assets to generate a rate of return that exceeds the rate of inflation. Real assets offer diversification since they tend to perform better than traditional asset classes such as fixed income and equities during periods of high unexpected inflation. Most real assets are physical assets having intrinsic value and have potential to generate returns with some degree of correlation to inflation, thereby serving as an inflation hedge. Real assets may be publicly traded in securities or futures markets, or accessed through private markets. Types of real assets may include TIPS (Treasury Inflation Protected Securities), commodities, REITs (Real Estate Investment Trusts), equities (natural resource and infrastructure), private real estate, timberland, farmland, infrastructure, and oil and gas investments. Investments shall be in limited liability investment vehicles, such as limited partnerships, limited liability corporations, private REITs and other pooled investment vehicles including fund of funds. Investment shall be primarily equity oriented, but may also include debt instruments secured by real estate with equity like returns. Real asset investments shall be diversified by type and by geographic location, when applicable.

Investment Vehicles and Transition Plan

Wilshire Consulting has identified an additional investment opportunity for the real asset component of the Regent endowment portfolios – Commonfund Capital Natural Resources Partners VIII, L.P., which is one of a variety of investment partnerships of the Commonfund. Attached is a letter from Wilshire Consulting recommending the investment vehicle.

The Commonfund is a New York Membership corporation dedicated to a broad cross section of the nonprofit world, including higher education, public and private foundations, hospitals and health care providers. The Commonfund was founded in 1971 through a grant from the Ford Foundation and currently manages approximately \$40 billion in assets for more than 1,800 nonprofit clients (2007). Its mission is to enhance the financial resources of nonprofit institutions and to help them improve investment management practices.

The commitment of funds would happen immediately upon approval. Funding of the commitment will be continuous.