MEMORANDUM

To: Board of Regents

From: Board Office

Subject: Report of the Banking Committee

Date: February 9, 2004

Recommended Actions:

1. Approve the following:

   a. The selection of Grantham, Mayo, Van Otterloo & Co. (GMO) as the new international equity fund manager.

   b. The selection of Dodge and Cox as a new fixed income fund manager.

   c. The transfer of Invesco's domestic equity portfolio to Vanguard, the Board's current large capitalization index fund manager.

   d. An option as to whether an institution must split its fixed income portfolio, given its relative size and risk.

   e. BlackRock as a contingent fixed income manager, should the selection of a new fixed income manager be necessary within the next year. The utilization of this manager would be subject to further approvals.

2. Adopt the following resolutions, subject to receipt of acceptable bids:

   A Resolution providing for the sale and award of $3,875,000 Student Health System Revenue Bonds, Series U.N.I. 2004, and approving and authorizing the agreement of such sale and award.

   A Resolution establishing a self-liquidating and revenue-producing facility to be known as the "Student Health System" and authorizing and providing for the issuance and securing the payment of $3,875,000 Student Health System Revenue Bonds, Series U.N.I. 2004 to pay the costs of constructing, furnishing, and equipping an addition to the Student Health Center Building and improving, remodeling, and repairing the existing Student Health Center Building, including the debt service reserve fund, and paying costs of issuance.

   (ROLL CALL VOTE)

3. Adopt the following resolutions, subject to receipt of acceptable bids:

   A Resolution providing for the sale and award of $10,000,000 Field House Revenue Bonds, Series U.N.I. 2004, and approving and authorizing the agreement of such sale and award.

   A Resolution authorizing and providing for the issuance and securing the payment of $10,000,000 Field House Revenue Bonds, Series U.N.I. 2004, for the purpose of constructing, equipping, and furnishing an addition to the UNI-Dome Field House, and improving and remodeling the UNI-Dome Field House, funding a reserve fund and paying the costs of issuance.

   (ROLL CALL VOTE)

4. Adopt A Resolution authorizing the Executive Director to fix the date or dates for the sale of up to $25,000,000 Utility System Revenue Bonds (The State University of Iowa), Series S.U.I. 2004.

   (ROLL CALL VOTE)

5. Adopt A Resolution authorizing the redemption of outstanding Dormitory Revenue Bonds (Iowa State University of Science and Technology), Series 1964A, 1965A, 1966A, 1967A, and 1967G and directing publication of notice.

   (ROLL CALL VOTE)

6. Subject to Board approval of the purchase of radio station KIIC-FM, authorize Iowa State University to utilize master lease financing in an amount not to exceed $270,000.

<u>Executive Summary</u>:

Approvals

The Banking Committee materials have been furnished to all Board members. During its meeting on February 18, 2004, the Banking Committee is scheduled to consider approval of:

- The minutes from the December 2003 Banking Committee meeting
- Selection of fund managers
- Resolution for sale of UNI Student Health Center Revenue bonds
- Resolution for sale of UNI Field House Revenue bonds
- Preliminary resolution for sale of SUI Utility bonds
- Resolution for redemption of ISU Dormitory bonds
- Master lease purchase of radio station

Reports — The Banking Committee is scheduled to receive reports on:

- Investment and Cash Management
- Cost of Bond Issuance

Background and Analysis:

Minutes — The minutes of the December 2003 Banking Committee meeting are included with the Banking Committee materials.

Fund Managers — At its December 2003 meeting, the Board moved to sever the investment relationships with Alliance Bernstein and Invesco.

- Alliance Bernstein managed the Board's international equity component of the endowment portfolio valued at $24.1 million at the end of the calendar year.
- Invesco managed both a domestic equity portfolio of $109.1 million and a fixed income portfolio of $88.9 million as of December 31, 2003.

Selection Process — Institutional officials and Board Office staff worked with representatives from Wilshire Associates, the Board's investment advisor, to develop an expeditious process for replacing these fund managers.

Wilshire generated alternatives, including cost estimates, to transition the Board's identified endowment funds to new managers.

A fund manager selection group, consisting of some Banking Committee members and representatives of the universities, the Board Office, and Wilshire Associates, conducted interviews of the top three fund managers in each category.

Wilshire recommended the Board transition the domestic equity portfolio to Vanguard, its current domestic equity index fund manager. This action would maintain compliance with the Board investment policies. In several months, the portfolio would be evaluated, with an emphasis on the domestic equity component.

Recommended Selection — The group recommends the following fund manager selections:

- Grantham, Mayo, Van Otterloo & Co. (GMO) as the new international equity fund manager.
- Dodge and Cox as a new fixed income fund manager.

In addition, the group concluded that splitting a relatively small fixed income component of the endowment portfolio between two managers may be inefficient and costly. Therefore, the group recommends that Board investment policies provide institutions with an option on whether the fixed income portfolio, given its relative size and risk, must be split between two fixed income managers.

- BlackRock, based on their interview, would be considered a contingent fixed income manager, should a new fixed income manager be needed within the next year. This would eliminate the necessity for another in-depth selection process over a relatively short time frame.

- Domestic equities currently with Invesco should be transitioned to Vanguard, the Board's current large cap index portfolio fund manager.

The transition of all of these funds to the new managers would take place as soon as practical after Board approval.

Investment and Cash Management Reports

The Regent institutions maintain two investment portfolios — operating and endowment/Quasi-endowment. Both portfolios include restricted and unrestricted funds.

As of December 31, 2003, the market value of the Regent combined operating and endowment portfolios total $1.3 billion.

- Operating portfolios total $885.9 million
- Endowment/quasi-endowment portfolios total $405.7 million

The universities internally managed operating portfolios were a mix of underperformance and outperformance compared to industry standards.

The two external fund managers for the operating portfolios, BlackRock and Wellington, underperformed and outperformed industry standards, respectively.

Wilshire Associates, the Board's investment advisor, prepares the summary report on the endowment/quasi-endowment portfolio.

The University of Iowa (excluding the quasi-endowment) and Iowa State University endowment portfolios totaled $191.6 million and $120.4 million, respectively, as of December 31, 2003.

The combined investment managers' returns for the quarter were 8.8% for SUI and 9.2% for ISU, while the blended asset allocation benchmark posted returns of 9.1%.

The SUI quasi-endowment totaled $93.8 million and returned 0.7% for the quarter ended December 31, 2003, which outperformed the benchmark of 0.3%.

Wilshire reported that, for the quarter, Alliance Bernstein, Invesco (stocks), and Reams outperformed their benchmarks; Invesco (bonds) were similar to the benchmark; and LSV Asset Management, Seneca, and Vanguard underperformed their benchmarks.

Sale of Revenue Bonds (UNI)

The Board is requested to adopt two resolutions related to the sale and award and issuance of up to $3,875,000 Student Health System Revenue Bonds, Series U.N.I. 2004.

At its January 2004 meeting, the Board authorized the Executive Director to fix the date(s) for the sale of the bonds, which would be sold to construct a two-story addition to the Student Health Center; renovate the existing office and clinic space; and provide infrastructure, fire safety, accessibility and other code upgrades.

The Board approved the schematic design, and project description and total budget ($3,500,000) for the project at its November 2003 meeting.

Principal on the bonds would be repaid over a period of 20 years, with debt service of approximately $290,000 annually to be paid from net rents, profits, and income received from the Student Health System, including the income derived from previously approved student fees.

- In November 2002, the Board approved a new $26 per academic year per student Health Facility mandatory fee (effective with the 2003-2004 academic year) to provide funds for the debt service payments for expansion and renovation of the UNI Student Health Center.

Interest on the bonds would be exempt from federal and state taxes (double tax-exempt) for individuals who are Iowa residents and purchase the bonds.

Sale of Revenue Bonds (UNI)

The Board is requested to adopt two resolutions related to the sale and award and issuance of $10,000,000 Field House Revenue Bonds, Series U.N.I. 2004.

At its January 2004 meeting, the Board authorized the Executive Director to fix the date(s) for the sale of the bonds, which would be sold to provide partial financing for construction of the Arena, which would provide a 6,100 seat multipurpose venue to host athletic events, including men’s and women’s basketball games, volleyball matches, wrestling meets, and other special events.

Principal on the bonds would be repaid over a period of 20 years from pledged gifts and net rents, profits and income received from the Event Complex (UNI-Dome and the new Arena). Revenue from the Intercollegiate Athletics student fee could also be used should this source be needed.

Debt service payments would be slightly less than pledged gifts through FY 2008; after that time the debt service payments would be approximately $600,000 per year.

Interest on the bonds would be exempt from federal and state taxes (double tax-exempt) for individuals who are Iowa residents and purchase the bonds.

Preliminary Resolution (SUI)

The Board is requested to adopt a resolution authorizing the Executive Director to fix the date or dates for the sale of up to $25,000,000 Utility System Revenue Bonds, Series S.U.I. 2004.

Proceeds from the sale of the bonds would be used to fund the Upgrade of the Health Sciences Campus - Purified Water System project and a portion of the cost of the West Campus Chilled Water Plant Development/Expansion project.

The calendar year 2004 bond issuance schedule approved by the Board in November 2003 included a University of Iowa Utility System Revenue Bond sale for the projects in March 2004.

Principal on the bonds would be repaid over a period of 20 years, with debt service of approximately $1,850,000 annually to be paid from utility system charges and the proceeds of any utility system student fees which the Board may establish in the future.

The University's Utility System is a self-supporting operation.

Interest on the bonds would be exempt from federal and state taxes (double tax-exempt) for individuals who are Iowa residents and purchase the bonds.

Call of ISU Dormitory Bonds

The Board is requested to adopt a resolution authorizing the redemption of outstanding Dormitory Revenue Bonds I.S.U. Series 1964A, Series 1965A, Series 1966A, Series 1967A, and Series 1967G, and directing publication of the notice of redemption.

The outstanding principal of these bond series, as of February 1, 2004, is $5,210,000; interest (coupon) rates on the bonds range from 3.0% to 4.3%.

These bonds mature from July 1, 2004 to July 1, 2008 and can only be called on an interest payment date.

Through establishment of an escrow agreement with Wells Fargo Bank, authorization for which is included in the resolution, and a deposit of funds into an escrow account with the Bank, the bonds would be defeased, effectively removing them from the listing of outstanding debt of the residence system. All outstanding bonds of the bond series listed above would be called on July 1, 2004.

The escrow account would be funded through FY 2004 funds budgeted for debt service and voluntary reserve funds. After the call date, the reserve fund can be reduced since the maximum annual debt service for the Residence System is being reduced. The reserve funds no longer needed can then be deposited into the voluntary reserve fund.

Establishment of the escrow account no later than May 31, 2004, and the early retirement of the referenced outstanding bonds will ensure that the critical bond coverage ratio of 135% (net revenues compared to debt service payment), stipulated in the bond covenants, is met.

Cost of Bond Issuance

The Banking Committee has requested reports identifying the costs associated with each bond issuance. The report provided to the Banking Committee in October 2003 included issuance costs for the July 2003 bond sales.

This month's report includes the estimated and actual issuance costs for the five bond sales from September through November 2003.

Bond Issue	Estimated Costs	Actual Costs
September 2003 - $25,000,000 Dormitory Revenue Bonds, Series SUI 2003	$ 79,700.00	$ 82,815.65
October 2003 - $7,790,000 Academic Building Revenue Refunding Bonds, Series ISU 2003	$ 47,000.00	$ 34,088.40
October 2003 - $6,750,000 Regulated Materials Facility Revenue Bonds, Series ISU 2003	$ 59,600.00	$ 38,654.59
November 2003 - $14,060,000 Telecommunication Facilities Revenue Bonds, Series SUI 2003	$ 75,300.00	$ 57,667.15
November 2003 - $13,280,000 Utility System Rev. Bonds, Series ISU 2003	$ 78,500.00	$ 48,115.04

Master Lease Purchase of Radio Station (ISU)

Details of the proposed acquisition of KIIC-FM are outlined in G.D. 5b.

Iowa State University requests Board approval to purchase the radio station, to submit a letter of intent and an asset purchase agreement to the seller, and to submit the necessary paperwork to Federal Communications Commission (FCC) regarding the license transfer.

Also requested for Board approval is authorization for Iowa State University to begin discussions with Public Radio Capital, whose mission is to broaden the reach of public radio and who acts as an intermediary in buying stations on behalf of public radio, for the purchase of the physical plant and a lease arrangement that enables WOI to operate the station.

Subject to Board approval of the purchase as outlined in G.D. 5b, the Board is requested to authorize utilization of master lease financing in an amount not to exceed $270,000 to assist in financing the acquisition of the license until grants and community support are obtained.

The University proposes to finance the project for no more than a five-year period, with the final interest rate set per the master lease agreement at the time the borrowing commitment is executed.

- The estimated interest rate is approximately 3.46 percent for a five-year term, which would result in semi-annual payments of approximately $29,800.
- Funding for the semi-annual payments would be from the WOI Radio Group at Iowa State University which has sufficient assets to cover the cost of the lease payments if the grants and gifts financing does not materialize.

Jean A. Friedrich

Jean A. Friedrich

Approved: Gregory S. Nichols

Gregory S. Nichols

jaf\H:\BF\2004\04febdoc\febgd11.doc