A meeting of the Investment Subcommittee of the Board of Trustees of the University of Vermont State and Agricultural College was held on Monday, June 25, 2007 at 9:00 a.m., in Vice President J. Michael Gower’s office, 350B Waterman Building.

MEMBERS PRESENT: Chair Robert Cioffi*, Vice Chair John Snow, Susan Hudson-Wilson*, Jeffrey Davis*, and Jeanette White*.

MEMBERS ABSENT: Ian Boyce

PERSONS ALSO PARTICIPATING: Vice President for Finance and Administration J. Michael Gower, Associate Vice President for Finance and University Controller Bonnie Cauthon, and LaRoy Brantley* and Daniel Guttell*, Cambridge Associates.

Chair Robert Cioffi called the meeting to order at 9:00 a.m.

*participating via teleconference

**Real Estate Manager Search**

Chair Cioffi thanked Ms. Hudson-Wilson for the thorough review provided to the Subcommittee. Ms. Hudson-Wilson discussed briefly the key points of each manager, referring to the memo and the spreadsheet compiled from her research. The basic goal of the research was to fill out the inflation hedge allocation to the 10% target; which currently is at 6.5% with Wellington investment at $20 million. The original breakout for the inflation hedging strategy was to have 60% diversified real assets 40% real estate. The allowable range for inflation hedging investment is set at 8-15%.

The open end commingled fund managers researched were all selected based on: maturity, liquidity, transparency, and fee structure. Ms Hudson-Wilson noted that real estate investment is not a perfect hedge nor is the currently invested in Wellington (Diversified Inflation Hedges) product. She noted that the closest thing to a perfect inflation hedge is TIPS but that the return yielded by this asset class is only the rate of inflation. The major change in real estate as a hedge that has occurred, concerns the retail sector and the change from a lease with rent payment set as a percentage of sales. Today, retail leases no longer contain this payment structure; which has directly resulted in the retail sector, once known as the best hedge, becoming the worst hedge. The “super hedge” sector is currently offices due the replacement costs associated with land, labor, and materials. The following managers’ funds were evaluated on their inflation hedging capability relating to: diversification, correlation to inflation, risk management, fee structure, operation management, property type allocations, and asset composition:

**Blackrock Granite**

This fund is open to investment from endowments. This manager had the following characteristics: low on big assets, low on CBD assets, okay fee structure, and standard redemption. Two things that concerned Ms. Hudson-Wilson were the change in management and the fund’s position as the most risk for achievement of market return. Ms. Hudson-Wilson rejected investment in this fund.
Heitman

The original players in this firm are gone; which Ms. Hudson-Wilson observed to be a “good” thing. She noted that the fund was just started in January 2007 and the low fee reflected the effort to create and grow the fund. Due to the newness of the fund there was no data available for testing results. Ms. Hudson-Wilson rejected investment in this fund.

ING Clarion Lion Fund

This firm is known well since they were a former client of Ms. Hudson-Wilson. The fund’s good performance is indicated by its position to the left of the risk/reward graph. The fund size is $9.9 billion. The mixed result inflation hedging evaluation is due to the good allocation in large assets, but low in CBD. The fee structure is good at 125 bps; along with a separate 10 bps fee charged for cash management, which was observed to be a good idea. Ms. Hudson reported that the analysis supported acceptance of this fund and indicated that it would be useful for inflation hedging strategy.

Invesco

The fund is open to investment by endowment. Ms. Hudson-Wilson recommended rejection of this fund because of the overall total returns and low percentage of large assets.

Morgan Stanley Prime Fund

The background on this fund is that it was taken over from Equitable and has taken positive actions, including replacing the portfolio manager. She noted that Mark Albertson, the new portfolio manager, was excellent. This manager was described as a “machine” in terms of putting to use capital. It is a big fund that has had “monster inflows”. The following categories were rated good: size of fund, portfolio manager, % of large assets, urban concentration, risk/reward position.

Prudential PRISA 1

The major issue with this fund relates to it being a separate account of an Insurance Company; in which endowments are not supposed to be investors. PRISA has declined to convert it to a REIT, investable by endowments, but the manager has a special contract, available for endowments, to avoid this issue. However, legal issues make this an unattractive option, given lack of other compelling features.

Russell Open End Fund of Funds

Ms. Hudson-Wilson believes this fund of funds is a great, interesting idea. The factors that negate investing are: includes some of the funds that analysis indicates should be rejected and the fee is high since it includes the portfolio management fees, and the inflation hedge performance is not strong. In addition, this firm was very uneven with responses to data requests and the data provided was old. Ms. Hudson-Wilson rejected investment in this fund.

Final Summary

Ms. Hudson-Wilson recapped that the analysis indicated that the biggest contributor would be ING Clarions’ Lion fund, with Morgan Stanley’s PRIME next. There was discussion on whether manager proliferation would be a problem. Ms. Hudson-Wilson explained in response that the risk mitigants were: the two firms recommended for allocation were all very deep, well managed with
long term viability and the investment vehicle was not fancy but “simple real estate.” Mr. Brantley added that for inflation hedging as long as the underlying investments don’t overlap excessively that manager proliferation should not be considered a problem.

A motion was made, seconded and passed to allocate an initial investment of $6.5 million each by October 1st to the following open end commingled core funds: Morgan Stanley Prime Fund and ING Clarion Lion Fund.

Ms. Hudson-Wilson will supply Morgan Stanley and ING Clarion Lion with Bonnie Cauthon’s contact information to begin the paperwork processing. It was agreed upon by the Subcommittee, the appropriate time for deciding the source for funding the new investment into open end commingled funds would be at the July meeting when the Subcommittee will be reviewing the broad asset allocation targets.

Mr. Brantley noted that, since Cambridge Associates’ real estate research team does not actively cover open end commingled fund managers, this would be an area that the Subcommittee would depend heavily upon Ms. Hudson-Wilson’s clearly established, long-term relationships with the specific managers chosen for hire in order to glean detailed performance-related information (as Cambridge does for all other parts of the portfolio).

Mr. Snow discussed his vision and the role of the Subcommittee: to look at asset allocation over the medium term (3 years), to make adjustments using an informed view over the long term, and to make one consistent judgment regarding inflation expectations for both the investment and debt portfolio. He noted that all of our managers should have a view on inflation. It was proposed by Ms. Hudson-Wilson and agreed upon by the rest of the Subcommittee that a written one-page summary or conference call from the investment managers once a year that discloses the manager’s outlook (using a 3-year time horizon) would benefit the Subcommittee.

For the July meeting, Cambridge Associates will send out a request to all the managers for a single power point slide summarizing their firm’s view on inflation. Ms. Hudson-Wilson noted that this information is important to the University since it pays out in real terms. Ms. Hudson-Wilson will provide information from Bill Gross using Pimco’s website. Mr. Gower will request from Prager, Sealy & Co., LLC, CITI, UBS and Commonfund.

**Adjournment**

There being no further business, the meeting was adjourned at 10:10 a.m.

Respectfully submitted,

Robert Cioffi, Chair