COMMITTEE ON INVESTMENTS
INVESTMENT ADVISORY COMMITTEE
April 22, 2003

The Committee on Investments and the Investment Advisory Committee met jointly by teleconference on the above date at the Press Room, Morgan Center, Los Angeles campus; UCSF-Laurel Heights, 3333 California Street, San Francisco; and 1608 Rhode Island Avenue, NW, Washington, D.C.

Members present: Representing the Committee on Investments: Regents Lee, Ligot-Gordon, Montoya, Parsky, and Saban; Advisory member Binion

Representing the Investment Advisory Committee: Regents Hopkinson and Parsky, Senior Vice President Mullinix representing President Atkinson, Mr. John Hotchkis; Consultants Cambon, Keller, and Lehmann

In attendance: Associate Secretary Shaw, General Counsel Holst, Treasurer Russ, and Recording Secretary Nietfeld

The meeting convened at 1:35 p.m. with Committee on Investments and Investment Advisory Committee Chair Parsky presiding.

1. READING OF NOTICE OF MEETING

For the record, it was confirmed that notice was served in accordance with the Bylaws and Standing Orders for a Special Meeting of the Committee on Investments and the Investment Advisory Committee for the purpose of acting on Item 602A, Approval of Revisions to UCRP and GEP Asset Allocation Benchmarks, and Item 602B, Approval of Real Estate Investment Process and Guidelines.

2. APPROVAL OF MINUTES OF PREVIOUS MEETINGS

Upon motion duly made and seconded, the minutes of the meetings of October 29, 2002, January 7, 2003, and March 4, 2003 were approved, Regents Lee, Ligot-Gordon, Montoya, Parsky, and Saban voting “aye.”

3. INVESTMENT PERFORMANCE SUMMARY

Treasurer Russ reported performance results for the third fiscal quarter and the first calendar-year quarter, which ended on March 31, 2003. The University of California Retirement Plan (UCRP) and the General Endowment Pool (GEP) had slightly negative returns of 1.4

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1 Roll call vote required by State law for all meetings held by teleconference.
percent and 1.5 percent, matching the benchmark return for the GEP and outperforming the benchmark by 10 basis points for the UCRP. Because the U.S. equity portfolio which was previously managed internally by the Office of the Treasurer has been transferred to the index fund, the performance was equal to that of the benchmark. Treasury Inflation Protected Securities (TIPS) were the high performers for the portfolio, returning 11.8 percent for the fiscal year, thus demonstrating the benefits of diversified asset classes.

Treasurer Russ commented that the agenda materials mailed to the Committee members had included the 2003 Wilshire Report on State Retirement Systems: Funding Levels and Asset Allocation.

Mr. Steve Nesbitt discussed the role that his firm, Wilshire Associates, plays as a “generalist” consultant to The Regents on investment matters. Its primary responsibilities involve asset allocation, investment policies and objectives, the evaluation of both internal and external managers, and the calculation of the performance of the portfolios. He stressed that Wilshire works for The Regents and with the Treasurer in carrying out this role. Wilshire assists The Regents with four major asset pools: the UCRP, the GEP, the 403(b) funds, and those of the campus foundations. Mr. Nesbitt reviewed for the Committees the key investment actions that had been taken by The Regents over the past three years. In 2000, the Board adopted new asset allocation policies and investment guidelines. Secondly, The Regents approved a significant allocation to index funds in order to further diversify the equity portfolio, which had been concentrated in growth stocks. In 2002 The Regents established separate investment policies for the UCRP and the GEP, as the two funds have distinct objectives. Specialist consultants have been retained as independent checks on partnership investments. Finally, the Board has approved new allocations to TIPS and to absolute return portfolios.

Mr. Nesbitt turned to the performance of pension plans in general and to that of the UCRP in particular, noting first that over the past twenty years pension plans have tended to have double-digit returns, leading to reduced employee contributions and increased benefit payments. He added, however, that over the past five years this performance had fallen short of the average actuarial rate of 8 percent, causing significant concern within both the public and the private sectors. He noted that the performance of the UCRP tends to mirror industry standards. Mr. Nesbitt displayed a graph which illustrated the fact that the UCRP is one of the best-funded public pension plans in the country, with a healthy ratio of assets to liabilities.

4. INVESTMENT RISK REPORTING

Mr. Jesse Phillips, Director of Investment Risk Management, presented the report on investment risk in The Regents’ portfolios based upon a series of slides which had been mailed to the Committees in advance of the meeting. He recalled that he had provided an introduction to investment risk to the Investment Advisory Committee at its August 2002
meeting, at which time he had explained that risk is the chance of loss accepted by an investor in order to earn a return. Risk management imposes guidelines and controls on the investment process to maintain the probability of loss within acceptable limits. Risk management does not require the elimination of risk but rather balances risk and expected return. Mr. Phillips explained that the purpose of measuring risk is to ensure that its sources are identified, understood, and quantified. The assumption of risk should be intentional and be consistent with investment objectives. The most widely accepted measures of asset risk focus on the volatility of returns, typically around benchmark or target returns. He emphasized that standard deviation is only one measure of volatility; alternative measures focus on worst-case losses as well as on the probability and magnitude of losses. In assessing risk, two types of volatility measures are used: historical, based on actual returns, and forecast, based on current holdings. Forecast risk models are being used in connection with fixed-income management and will be implemented more broadly in the second half of 2003. Mr. Phillips continued that systematic risk represents the behavior patterns that are common to groups of securities, which is helpful to the investor in making investment decisions. In diversified portfolios, these common factors tend to dominate risks from individual securities. The measurement of risk requires the analysis of multiple factors; for example, in choosing a security a manager might look first at the country and then at the sector. Mr. Phillips gave an overview of the principle risk factors for the fixed income and absolute return portfolios.

Mr. Phillips presented some highlights from the Investment Risk Report for the First Quarter 2003, which begins with a section on asset allocation and capital markets. The total risk for the UCRP is largely related to the allocation between equities and bonds, with a persistent underweight in total equity due to the under-allocation to private equity. While the policy weight under the asset allocation plan for private equity is 5 percent, to date only 2 percent has been achieved within the UCRP and 3 percent within the GEP. The forecast risk and return, using Wilshire’s capital market assumptions, is close to the constrained efficient frontier. The forecast return, however, is less than the 7.5 percent actuarially required return. This gap in performance should be made up through a careful allocation to active management and to less efficient asset classes. Mr. Phillips continued that the UCRP total fund exhibited total risk and risk-adjusted returns similar to those of the benchmark.

In response to a comment by Regent Parsky, Mr. Phillips stressed that the choice of the benchmark is one of the most important decisions made by The Regents. The benchmark sets the tone for the risk tolerance of the entire portfolio.

In response to a question from Mr. Hotchkis, Treasurer Russ reported that, since the adoption of the asset allocation plan, the risk for both portfolios had been reduced through an increase in the number of equities held and through diversified investments. In addition, the risk in the fixed income portfolio has been lowered through the reduction in duration of the bonds held. Regent Parsky commented that the Treasurer is in the process of selecting managers for the U.S. equity portfolio, which is at present invested in the index fund. Treasurer Russ
added that recruitment is under way for the internal staff who will manage the outside managers.

Continuing with his presentation, Mr. Phillips referred to a graph which demonstrated how the total risk in the U.S. equity portfolio had been reduced since 2000. Similar results were found for the fixed income portfolio. This reduction in risk was the result of steps that were taken by the Office of the Treasurer, as outlined by Treasurer Russ above. Mr. Phillips stressed that the intention is to balance risk and return by taking specific actions within a portfolio.

Regent Parsky asked about the role that Mr. Phillips plays within the Office of the Treasurer. Mr. Phillips explained that initially he had developed a database in order to provide some historical perspectives on the portfolio. The intention is to bring risk management into the portfolio management process, whether internal or external, and to understand what returns may be expected as a result of taking certain risks.

Mr. Hotchkis stated his understanding that external managers would be chosen who fit the risk profile. Treasurer Russ explained that the intention will be to choose a wide range of managers with diversified investment strategies. Regent Parsky added that the role of the risk manager would be to ensure that the risk for the overall portfolio does not deviate substantially from that of the benchmark.

Consultant Lehmann pointed out that the asset allocation across outside managers is intended to serve the function of producing an overall portfolio with attributes that follow the asset allocation guidelines. The managers will also be held responsible for their performance in relation to the relevant benchmarks. Mr. Phillips added that one advantage to using risk-management techniques is to enable the Office of the Treasurer to choose managers who provide the correct risk profile for the portfolio.

Mr. Phillips concluded his presentation with some comments pertaining to the fixed income portfolio, noting that the adoption of the asset allocation plan had significantly reduced risk. The fixed income manager has produced positive risk-adjusted return. In response to a question from Mr. Hotchkis, Mr. Phillips explained that the bond market consists of three major sectors: government, corporate, and mortgages, with a separate manager who is responsible for each core sector. Each manager has the responsibility to outperform that sector’s benchmark.

5. APPROVAL OF REVISIONS TO UCRP AND GEP ASSET ALLOCATION BENCHMARKS
The Treasurer recommended, with the concurrence of Wilshire Associates, that the University of California Retirement Plan (UCRP) and General Endowment Pool (GEP) target benchmarks be revised as follows:

Changes from current policy shown by highlighting

**UCRP Recommended Asset Allocation**

<table>
<thead>
<tr>
<th>Recommended</th>
<th>Target Allocation</th>
<th>Minimum</th>
<th>Maximum</th>
<th>Current Policy</th>
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<td>5%</td>
<td>9%</td>
<td>7%</td>
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<tr>
<td>Fixed Income</td>
<td>28%</td>
<td>23%</td>
<td>35%</td>
<td>30%</td>
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<tr>
<td>TIPS</td>
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<td>3%</td>
<td>7%</td>
<td>5%</td>
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<tr>
<td>Private Equity</td>
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<td>7%</td>
<td>0%</td>
</tr>
<tr>
<td>Real Estate</td>
<td>5%</td>
<td>0%</td>
<td>7%</td>
<td>0%</td>
</tr>
</tbody>
</table>

Treasurer Russ recalled that at the January meeting of the Committees, Regent Parsky had suggested that the Office of the Treasurer might wish to formulate some new strategies to improve investment performance while reducing risk in the balanced portfolios. At the March meeting, representatives from CalPERS presented their perspectives on investing in real estate.

Mr. Gary DeWeese, Director of Real Estate Investments, recalled that at the March meeting he had presented real estate investment strategies for consideration. Adding real estate to the portfolios would be expected to provide the following benefits: long-term total risk and return that is between U.S. equities and bonds, competitive risk-adjusted returns, diversification benefits given low cross-correlation with other asset classes, protection against unanticipated inflation, and a higher proportion of the total return coming from

**GEP Recommended Asset Allocation**

<table>
<thead>
<tr>
<th>Recommended</th>
<th>Target Allocation</th>
<th>Minimum</th>
<th>Maximum</th>
<th>Current Policy</th>
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<td>Non-U.S. Equity</td>
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<td>8%</td>
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<td>10%</td>
</tr>
<tr>
<td>Fixed Income</td>
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<td>23%</td>
<td>35%</td>
<td>30%</td>
</tr>
<tr>
<td>Private Equity</td>
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<td>5%</td>
<td>12%</td>
<td>10%</td>
</tr>
<tr>
<td>Absolute Return</td>
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<td>0%</td>
<td>6%</td>
<td>5%</td>
</tr>
<tr>
<td>Real Estate</td>
<td>5%</td>
<td>0%</td>
<td>7%</td>
<td>0%</td>
</tr>
<tr>
<td>100%</td>
<td>100%</td>
<td>100%</td>
<td>100%</td>
<td>100%</td>
</tr>
</tbody>
</table>
current return rather than equities. Accordingly, the Treasurer recommends that real estate be included in the University’s balanced portfolios.

The Treasurer further recommends that the new benchmark targets provide for the real estate allocation to be funded from a 3 percent reduction in the target allocations for U.S. stocks and a 2 percent reduction for fixed income. While the minimum targets for U.S. stocks and fixed income have been reduced to accommodate the new real estate allocation, the maximum targets have not been changed because it will take some period of time before the real estate allocation is actually completed. In the meantime, the Treasurer may need to maintain the existing maximum targets. The proposed minimum and existing maximum target ranges for U.S. stocks and fixed income will provide the necessary flexibility to fund real estate investments in proportions deemed advisable.

Mr. DeWeese summarized some other key points which he had presented at the March meeting, recalling that surveys of pension funds, endowments, and foundations of peer institutions had found that peers who invest in real estate typically target 5 to 9 percent of assets in real estate, either public or private. Real estate represents a meaningful percentage of the investment universe, and most investors consider holdings in real estate at some point. Overall, the addition of real estate can improve portfolio return and lower risk under various investment scenarios. He continued that real estate had shown favorable historical returns compared to other asset classes. The data support the view that investing in a blend of public and private real estate will produce a total risk and return somewhere between that of a U.S. equity and a U.S. bond. Real estate exhibits low correlation with stock and bond indices, primarily as a result of conditions in the real estate market.

Mr. DeWeese outlined the role of public and private real estate investment strategies. He described the benefits of a public strategy as follows:

- Liquidity and real-time pricing
- Benefits from public market oversight and transparency
- Low transaction costs
- Instant diversification
- Ease of buy and sell decisions
- A good alignment of investor and management interests.

The private strategy offers the following advantages:

- The opportunity to take advantage of private market inefficiencies
- The opportunity to purchase assets that are not publicly available
- Lower correlations with stocks and bonds than public real estate
- A better alignment of interests, provided the sponsor has invested a significant portion of net worth in the partnership
- Investors can have some influence over management’s major decisions.
Private real estate investments may be in the form of either direct ownership of assets or indirect ownership through limited liability investment vehicles, the latter of which is preferred. There are three strategies for investment in private real estate: core, value-added, and opportunistic.

Mr. Nesbitt commented that when Wilshire Associates had performed its initial review of The Regents’ investment strategies, it had considered recommending that real estate be included in the asset allocation plan. From a staffing point of view, however, Wilshire could not give real estate a high priority at that time. Since the asset allocation plan was adopted in 2000, major steps have been taken to diversify the portfolios; real estate represents a significant asset class in this diversification. Wilshire concurs with the Treasurer’s recommendation.

Mr. DeWeese presented graphs which illustrated the fact that the addition of real estate could improve the risk-adjusted return for both the UCRP and the GEP, moving them closer to the efficient frontier.

The Treasurer is recommending that The Regents adopt a dual public and private strategy in order to reduce risk within the overall real estate portfolio. This strategy provides an opportunity to tilt the overall real estate exposure toward public or private strategy depending on relative valuations in the public or private markets. The intention will be for the investments to have a target of 40 percent in public real estate and 60 percent in private real estate, with the underweighting to public due in part to the fact that a small percentage of total portfolio assets will be invested in public real estate as publicly traded real estate investment trusts (REITs) represent about 1.6 percent of the Russell 3000 index. The overweighting to the private sector may be justified by the potential superior return-risk profile. Within private real estate, there will be a further suballocation of 40 percent to core properties and 60 percent to value and opportunistic, as REITs typically own core-type assets.

Mr. DeWeese presented examples of how the private strategy would be implemented. Such investments could include the following:

- Limited partnership with other like-minded limited partners where the partnership invests in office buildings
- Limited partnership interest where the general partner is a public REIT that invests in industrial properties
- Common stock in a Limited Liability Corporation (LLC) that would own retail properties
- Common stock in a private REIT that is formed to own apartment buildings
- The purchase, in the secondary market, of an existing investor’s limited partnership interest in a partnership.
The private strategy does not involve the purchase of 100 percent (or less) of assets directly in the name of The Regents or entering into separate accounts where assets are purchased by sponsors on behalf of The Regents.

Regent Hopkinson expressed her support for the proposal but questioned the timing, given the high pricing in the current real estate market. Treasurer Russ assured Regent Hopkinson that the Treasurer’s Office would move cautiously in implementing the real estate investment strategy. Regent Parsky pointed out that approval by The Regents of such a strategy need not necessarily mean immediate implementation.

Mr. Hotchkis also supported the proposal, with the understanding that timing issues would be addressed by Treasurer Russ. Consultant Lehmann concurred that the portfolio would benefit from further diversification, but he cautioned against market timing.

Regent Lee raised the issue of real estate that is donated to the campus foundations. Treasurer Russ confirmed that gifts of real estate are sold, and the funds are placed in the endowment in accordance with the wishes of the donor.

Upon motion duly made and seconded, the Committee approved the Treasurer’s recommendation and voted to present it to the Board, Regents Lee, Ligot-Gordon, Montoya, Parsky, and Saban voting “aye.”

6. APPROVAL OF REAL ESTATE INVESTMENT PROCESS AND GUIDELINES

The Treasurer recommended that The Regents approve the proposed real estate investment decision process (Attachment 1) and investment guidelines (Attachment 2).

Mr. DeWeese reported that Russell Real Estate Advisors, Inc., a subsidiary of the Frank Russell Company, had been retained as a real estate consultant conditioned on approval of The Regents’ adoption of the real estate investment strategy. The consultant’s role is to assist the Office of the Treasurer in selecting sponsors of private real estate investments and approving investments in this area, as well as assisting in the selection of external public real estate managers. Russell was chosen following a screening process and interviews with three firms. Wilshire Associates and Russell support the recommended investment process and guidelines.

Mr. DeWeese presented a summary of the real estate investment process and guidelines, as outlined in Attachments 1 and 2.

2 Roll call vote required by State law for all meetings held by teleconference.

3 See the minutes of the May 15, 2003 meeting of The Regents of the University of California for the revised Attachment 2 which was approved by The Regents.
Upon motion duly made and seconded, the Committee approved the Treasurer’s recommendation and voted to present it to the Board, Regents Lee, Ligot-Gordon, Montoya, Parsky, and Saban voting “aye.”

(At this point Regent Saban left the meeting.)

In response to a question from Consultant Keller, Treasurer Russ believed that it would be possible for the campus foundations to participate in the real estate investment process at some time in the future. He reported on the contributions made to the private equity program by a number of the campus foundations.

In response to comments by Committee members, Mr. Nesbitt explained that the performance of the publicly traded real estate program would be measured against the Wilshire REIT index, while the private portfolio will be measured against the NCREIF index, which is the industry-standard, broadly diversified portfolio of private real estate investments.

Regents Hopkinson and Parsky commented that the goal of a 5 percent real rate of return might be seen by the Regents as too low. Mr. Nesbitt explained that the expectation would be a return of 7.5 percent, less 2.5 percent inflation. This is fairly consistent with the asset allocation assumptions for real estate. The absolute return for equities is 8 percent.

Regent Parsky commented that, in the private equity area, the performance objective is the Russell 3000 + 3 percent. In addition, attention is paid to relative performance in vintage years as compared with The Regents’ peers. He stressed that the guidelines should be amended to reflect more clearly the expected performance of the real estate investment strategy. Mr. Nesbitt emphasized that, rather than stating an expected real rate of return, the guidelines should define the two benchmarks.

Regent Hopkinson suggested that the intention to limit any investment in an individual security to 5 percent of the equity market capitalization was too restrictive. She also believed that the intention that no investment with a single manager could represent more than 25 percent of the public real estate portfolio was extremely high. Treasurer Russ agreed to review these issues and propose, with the concurrence of Wilshire Associates, any amendments to the guidelines which would then be presented to The Regents for approval.

Mr. DeWeese responded that the 5 percent represents the maximum amount of the outstanding common shares permissible to be owned by The Regents. He confirmed for Regent Hopkinson that when the U.S. equity portfolio was managed internally, a 5 percent limit was also in place. Any greater holding in a single stock triggers a reporting

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4 Roll call vote required by State law for all meetings held by teleconference.
requirement to the Securities and Exchange Commission of the intention to take over the company.

Regent Hopkinson observed that the guidelines for private real estate propose up to ten percent investment in a category that includes such property types as hotels, golf courses, and agricultural property. Mr. DeWeese explained that such an investment could result from investing in a partnership that has a golf course as one of its assets. While she questioned the value of investing in these types of properties, she agreed that if they represented less than ten percent of an entity in which The Regents was investing, such a strategy would be acceptable. Treasurer Russ agreed to amend the guidelines to reflect Regent Hopkinson’s views.

Regent Hopkinson also believed that the guideline allowing up to 20 percent of private real estate investment outside of the United States was too high.

Regent Parsky noted the important role played by the guidelines in the implementation of the real estate investment strategy. He suggested that some refinement to the guidelines would be needed prior to presenting them to the Board. He suggested that the members of the Committee on Investments and the Investment Advisory Committee review the guidelines and provide him and the Treasurer with any additional comments and suggestions.

The Committees went into Closed Session at 3:50 p.m.

The meeting adjourned at 4:25 p.m.

Attest:

Associate Secretary
REAL ESTATE INVESTMENT DECISION PROCESS

The following is a description of the investment decision process that would be followed with respect to both public and private real estate investments. The Director, Real Estate Investments, in the Office of the Treasurer would be responsible for Office of the Treasurer’s management of the real estate program. The Director would develop and recommend policy, develop internal operational procedures, meet with prospective sponsors and managers, screen investment opportunities, prepare investment reports, independently conduct due diligence, participate in the negotiation of the investment vehicle agreements, monitor performance of the investments, and evaluate and recommend action concerning the sponsors and managers.

A. Public Real Estate Investments

The public strategy would be accomplished through an externally managed program where managers are investing in publicly traded real estate securities, mostly Real Estate Investment Trusts (REITs). The manager selection and due diligence process will be led by the Director, Real Estate Investments. External management would involve hiring approximately five managers. The manager selection criteria will primarily focus on managers who have the following:

- an experienced management team;
- a clear and sustainable strategy that is consistent with the guidelines;
- a track record of superior performance (minimum three years) and relatively low volatility with little or no leverage used in the strategy;
- established risk management procedures and controls;
- excellent client service and operations, including research; and
- capable trading operations.

In addition, a real estate consultant will be engaged in the selection process and must approve the external managers, in a manner similar to the case with The Regents’ absolute return strategy. Individual investment guidelines will be established for each manager. There will be on-going monitoring of the managers as public real estate securities are traded actively and portfolio characteristics change continuously. This monitoring will include frequent performance reviews, manager meetings, and internal risk management assessments at the manager level and for the overall public real estate investment program.

B. Private Real Estate

The private real estate investments would be undertaken through investing in limited liability investment vehicles, such as limited partnerships, LLCs, private REITs and other pooled investment funds. Experienced real estate professionals, who are responsible for management of the assets, sponsor these vehicles. When fully implemented, the private strategy will likely consist of about 20 to 30 separate investments being sponsored by 10 to15 separate sponsors.
The sponsor selection and due diligence process will be led by the Director, Real Estate Investments. The sponsor and investment selection criteria will primarily focus on the same issues as in the selection of managers for the public strategy with two exceptions. First, the track record of the sponsors will be examined in the context of the fact that many employ higher levels of leverage in executing their strategy, especially with regard to value and opportunistic investment strategies. Second, instead of examining trading capabilities, the focus will be on acquisition, disposition, and asset management capabilities, including an assessment of the quality of assets acquired historically and an ability to add value to the investments. In addition, a real estate consultant will be engaged in the selection process and must approve the sponsors and proposed investments, in a manner similar to the case with The Regents’ private equity strategy. There will be on-going monitoring to assure that the sponsors are adhering to their stated investment objectives, that performance is meeting expectations, and that the guidelines are being met.
REAL ESTATE INVESTMENT GUIDELINES

The purpose of the real estate investment guidelines is to define investment objectives, philosophy, specific guidelines for making investments, and the benchmarks to measure performance.

Overall Real Estate Investment Program Objectives

The overall objective would seek to maximize long-term total return (measured as outperforming the benchmark index identified below and achieving a minimum 5 percent annual real rate of return) while maintaining appropriate risk and preserving capital. The real estate portfolio should also provide diversification benefits to the overall portfolio by offering returns that have low correlation to the returns of other asset classes and are internally diversified through the dual public and private strategy.

A. Public Real Estate Investments

Investment Philosophy - Public
The general philosophy that would direct the public investments would be as follows:

(1) Invest primarily for the long term, but recognize that there are opportunities to add value through disciplined trading and short strategies.
(2) Focus on larger, more liquid securities.
(3) Identify companies that produce sustainable cash flow (i.e., quality assets in good locations with leases that produce the cash flow that will enable dividends to grow, on average, at least at the rate of inflation), achieve profitable growth (return on capital above cost of capital), and exhibit evidence of acting in shareholders’ interests.
(4) Invest in companies with reasonable absolute and relative valuation, with a primary element of valuation being stock price compared to net asset (private market) value per share.

Performance Benchmarks - Public
The proposed benchmark for measuring performance would be the Wilshire REIT Index.

Investment Guidelines - Public
The general investment guidelines for public real estate investments would be as follows:

(1) At least 90 percent of the portfolio must be in the benchmark index, with no more than 10 percent of the portfolio being securities of publicly traded companies incorporated outside the U.S. in G-10 countries excluding the U.S. (United Kingdom, Germany, France, Belgium, the Netherlands, Italy, Sweden, Canada, and Japan).
(2) No property type may exceed two times that property type’s weight in the benchmark index.
(3) The weighting of any individual security cannot exceed more than three times its weight in the benchmark index.
(4) The Regents’ investments in any given security may not exceed 5 percent of the equity capitalization of that security at the end of any quarter.
(5) No investment with any single manager can represent more than 25 percent of the public real estate portfolio.
(6) No investment with any single manager may exceed 25 percent of that manager’s total assets under management.

Specific guidelines will be adopted for each manager based on individual strategies.

B. Private Real Estate Investments

**Investment Philosophy - Private**
The general philosophy that would direct the private equity investments would include the following:

(1) Invest for the long term, although select sponsors with a demonstrated sell discipline. The average term of investments is not likely to exceed seven to ten years.
(2) Select the best sponsors and emphasize alignment of interests. The preference is for sponsors who can create value rather than asset accumulators whose compensation is more closely tied to asset management fees. There must be fair and equitable sharing of rewards and risks with the sponsor and good governance structures.
(3) The investment agreements shall provide for appropriate governance mechanisms, such as advisory committees, sponsor removal rights under certain circumstances, etc.

**Performance Benchmark - Private**
The proposed benchmark for measuring performance would be the National Council of Real Estate Investment Fiduciaries Index (NCREIF Index). This index reflects the returns from unleveraged investments in investment-grade, non-agricultural, income-producing properties that have been acquired on behalf of tax-exempt institutions and held in a fiduciary environment. The benchmark is composed of an income return, an appreciation return, and a total return and is calculated on a quarterly basis, lagged one quarter.

**Investment Guidelines - Private**
The general investment guidelines for the private equity component of the program would be as follows:

(1) Investments shall be in limited liability investment vehicles (“LLIVs”) such as limited partnerships, limited liability corporations, private REITs, and other pooled investment funds.
(2) Investments shall be primarily equity oriented but may also include debt instruments secured by real estate with equity-like returns.

(3) A property type in the portfolio shall be within the following ranges:
   o Office: 0 to 50 percent
   o Industrial, retail and multi-residential: 0 to 35 percent each
   o Other (hotel, single family residential, healthcare, and specialty such as golf courses, agricultural): 0 to 10 percent

Investments in timber, mineral, and oil and gas assets would be subject to future approval by the Committee on Investments.

(4) Investments in the U.S. shall be diversified by geographic location with no one region (West, Midwest, East, or South) exceeding 50 percent of the private real estate portfolio.

(5) Investments outside the U.S. may not represent more than 20 percent of the private real estate portfolio and must be diversified by type and geographic location.

(6) Target sub-allocations and ranges are (a) 40 percent “core” strategies within a range of 25 to 75 percent and (b) 60 percent “value” and “opportunistic” strategies combined within a range of 25 to 75 percent. Definitions are shown below. The higher allocation to “value” and “opportunistic” strategies is based on the premise that “core” real estate has return and risk characteristics that are similar to public real estate and thus should be under-weighted in the private real estate strategy.

(7) The Regents’ investment in any one investment shall not exceed 50 percent of the total capital being raised for that investment.

(8) No more than 25 percent of the private real estate portfolio may be invested with one sponsor or group of related sponsors.

(9) The Regents’ outstanding investment(s) with any given sponsor or related sponsors may not exceed 25 percent of that sponsor’s or related sponsors’ total equity under management.

(10) In order to properly align the interest of the investor and the sponsor, the sponsor of a “value” or “opportunistic” investments will be required to make a meaningful co-investment.

(11) Leverage at the portfolio level shall not exceed 50 percent of the appraised value of the assets. All leverage shall be non-recourse to The Regents.

Note: compliance with some of these guidelines will not be met until a sufficient number of investments have been made. The Office the Treasurer will keep the Committee on Investments and the Investment Advisory Committee periodically informed as to the status of its compliance with these guidelines and as requested.

Definitions

Core Strategy
This strategy involves investing in investment-grade, income-producing properties (apartments, office, retail, and industrial/R&D) in good condition with stabilized occupancies near or above the market occupancy levels (usually 80 percent and above), leased primarily to credit-worthy tenants and located in major geographic markets with
above-average economic growth and some constraints on future development activity. Stable income and value that can grow modestly are emphasized.

**Value Strategy**
This strategy involves investing in functional, high-quality assets with good long-term potential that have lost value due to property-specific circumstances (high vacancy, significant lease expirations, below-market rents). These assets typically generate about half of their income from in-place leases, the other half being dependent on new leasing and property re-positioning efforts. The properties have typically been under-managed and may also include redevelopment of common areas. These properties can usually be purchased at a discount to replacement cost. The emphasis is on growth in income and value.

**Opportunistic Strategy**
This strategy involves investing in properties that have good long-term potential but are currently generating income from less than half the space being income-producing, or require major asset re-positioning involving more than half the leases, or require high levels of financial re-structuring, or even changes in use. These kinds of assets might also include major re-development or new building development, usually accompanied by major pre-leasing commitments. The emphasis is on growth in value.