The Regents of the University of California

INVESTMENTS COMMITTEE
March 16, 2023

The Investments Committee met on the above date at the UCSF-Mission Bay Conference Center, San Francisco campus and by teleconference meeting conducted in accordance with California Government Code §§ 11133.

Members present: Regents Anguiano, Cohen, Makarechian, Matosantos, Pouchot, Robinson, and Sherman; Ex officio members Drake and Leib; Advisory member Ellis; Chancellors Khosla and May; Advisors Lybarger and Zager; Staff Advisor Lakireddy

In attendance: Regents Chu, Hernandez, Pérez, Reilly, Sures, and Timmons, Regents-designate Raznick and Tesfai, Staff Advisor Mackness, Secretary and Chief of Staff Lyall, General Counsel Robinson, Provost Newman, Chief Investment Officer Bachher, Chief Compliance and Audit Officer Bustamante, Executive Vice President Byington, Executive Vice President and Chief Operating Officer Nava, Senior Vice President Colburn, Chancellors Block, Christ, Gillman, Larive, Wilcox, and Yang, and Recording Secretary Li

The meeting convened at 9:25 a.m. with Committee Chair Sherman presiding.

1. REVIEW OF PERFORMANCE FOR THE SECOND QUARTER OF FISCAL YEAR 2022–2023 OF UC PENSION, ENDOWMENT, BLUE AND GOLD POOL, WORKING CAPITAL, AND RETIREMENT SAVINGS

[Background material was provided to Regents in advance of the meeting, and a copy is on file in the Office of the Secretary and Chief of Staff.]

Chief Investment Officer (CIO) Bachher began the presentation by stating that the Office of the CIO tried to understand risks before considering an opportunity to earn returns.

Investment Officer Bradley Lyons presented a list of major events that occurred over the last three years. At the start of the COVID-19 pandemic, a rapid drop in the Standard and Poor’s (S&P) 500 led to a decline in hedge funds and zero percent interest rates. Federal stimulus then led to a rise in the S&P 500. Some 600 special purpose acquisition companies (SPACs) were issued in 2021, many initial public offerings (IPOs) were set, and much debt was issued due to low interest rates. Inflation then became more persistent, and the Federal Reserve (Fed) raised rates from zero to 4.5 percent. Since then, high-yield bonds and IPOs have dropped significantly, as have the prevalence of SPACS. It has become difficult to find debt to finance real estate, and supply chain issues, particularly with commodities and energy, have been exacerbated by geopolitical conflict. Mr. Lyons noted that each of these events would have been significant on its own, but all occurred in a span of several years.
Senior Managing Director Satish Ananthaswamy presented the risk rules that the Office of the CIO established when the Fed reduced interest rates to zero percent. The Office of the CIO reduced bond duration and the allocation to fixed income, increased the allocation to equities, sold real estate at high prices, increased passive management liquidity, and eliminated many credit bonds in the Short Term Investment Pool (STIP) portfolio, became selective in private assets, and prioritized U.S. investments.

Mr. Lyons reported that, as a result of these policy changes, investment assets have grown roughly $40 billion in the last three years. Mr. Bachher credited Committee Chair Sherman and Regent Makarechian for promoting a sense of calm during challenging times.

Regent Makarechian recalled that, several years ago, UC held more cash in the Total Return Investment Pool (TRIP) than in STIP because TRIP produced better returns, but the situation now seemed reversed. Referring to the written materials, Regent Makarechian asked where cash was being held and what the Office of the CIO planned to do with it in the near future. Mr. Bachher responded that, fiscal year to date, TRIP was returning three percent and STIP was returning 2.2 percent. Since August 2008, TRIP has earned 4.7 percent annualized returns while STIP has earned 1.5 percent. Currently, 50 percent of TRIP was allocated to bonds and 50 percent to stocks, and TRIP’s negative returns were a reflection of the stock market.

In response to Regent Makarechian’s question about STIP and cash, Managing Director David Schroeder stated that cash was invested in a money market fund in the STIP portfolio, and STIP was structured as a high-quality money fund that invests in short-term fixed income securities, commercial paper, U.S. Treasury securities, and certificates of deposit (CDs). Mr. Bachher opined that cash has been the best hedging strategy in the last several years. Currently, the University had $5.1 billion in cash. He considered most of UC’s fixed income portfolio as liquidity, and both fixed income and cash could be used to fund new investment opportunities.

Regent Makarechian asked how the TRIP allocation compared with the STIP allocation. Mr. Bachher replied that there was currently $12.8 billion in TRIP and $7.4 billion in STIP, and that he would encourage campuses to examine their days’ cash on hand. He believed that TRIP, which had a three- to five-year time horizon, was still a favorable investment option, as was the Blue and Gold Pool, the University’s best performing investment asset. Eighty percent of the Blue and Gold Pool was invested in stocks and 20 percent in bonds.

Regent Makarechian asked about co-investments, which were earning negative returns, and about the credit that venture capitalists and hedge funds were holding in their portfolios. Mr. Bachher stated that UC has invested in hedge funds for 20 years, but they were not very effective. Over the next few years, the Office of the CIO planned to move the money invested in hedge funds to private credit. In his view, negative one-year returns were not too concerning and he invited Director Matthew Webster to speak about co-investments.

Mr. Webster stated that, in the years prior to the pandemic, the Office of the CIO had little interaction with the companies it invested in and could not react well in a crisis. Now, the
Office of the CIO was building a portfolio of high-quality businesses and deeply understood the markets they served, their business model, and the strengths of their management teams. This approach has created new opportunities. In response to Regent Makarechian’s question about co-investments earning negative returns, Mr. Webster stated that the Office of the CIO had been incubating assets in the private markets. In 2021, there was an opportunity to seek liquidity through the public markets, but some assets declined in value in 2022. The Office of the CIO was looking to incubate early-stage companies from the private market to the public market.

In response to Regent Makarechian’s question about venture capital, Mr. Bachher responded that the Office of the CIO wished to focus more time on innovation from the University and, in the last eight years, has invested $8 million to $9 million in UC-related companies.

In response to comments made by Regent Makarechian, Mr. Bachher stated that investments that the University has made in the last 50 years have contributed to 30-year annualized returns of 20 percent in private equity.

Committee Chair Sherman asked about the safety of the University’s cash assets in light of recent news about the banking sector. Mr. Bachher replied that STIP, which functions as a bank for UC, was comprised of government and government agency securities with a duration of one year or less. In 2020, the Office of the CIO eliminated credit risk from the portfolio to avoid what happened to Silicon Valley Bank, which had collapsed following a run on deposits. Mr. Bachher stated that the Office of the CIO invested conservatively and that he wished to mark to market in STIP and the UC Retirement Savings Plan.

Advisor Zager asked how short the Office of the CIO would keep duration if it was marking to market. He foresaw the need to keep a cushion in STIP. Mr. Bachher responded that this was a new decision and that he would sort through details such as accounting.

Mr. Zager asked if Mr. Bachher anticipated that STIP would be more competitive in the next three months. Mr. Bachher replied in the affirmative. Mr. Schroeder added that the STIP portfolio was valued daily and that the average duration in the portfolio was about one-third of the year. Last month, the securities portfolio had generated a monthly income of 4.5 to five percent, a reflection of money market rates. Mr. Zager asked why the Office of the CIO was still holding on to this investment instead of paying it out. Mr. Schroeder replied that STIP also held notes made to the UC Retirement Plan (UCRP). Notes were reset last year at a low interest rate, which was bringing down the portfolio’s monthly income.

Regent Leib asked about the advantages of co-investing. Mr. Webster responded that the Office of the CIO was able to select assets, have access to market reports and quality of earnings, and meet management. This deeper understanding of the asset was beneficial from a risk standpoint. These assets were being offered on a no-fee, no-carrier basis. The Office of the CIO could curate a portfolio of fewer companies to drive returns. Mr. Bachher
added that most co-investment opportunities come about when a fund seeks help from investors due to concentration limits.

Regent Sures asked if the companies in which UC has invested through private equity and venture capital were subject to exposure by the collapse of Silicon Valley Bank. Mr. Bachher replied that the UC had $4 million in exposure. Regent Sures asked if these funds were covered by the bank. Mr. Bachher responded in the affirmative.

Regent Chu asked if the Office of the CIO’s approach to co-investment changed its operations. Mr. Bachher responded in the affirmative. Of the $14 billion in private equity, $3 billion was in co-investment. When deciding to buy into a fund, one was allocating capital; when deciding to buy into a company, one was investing. The Office of the CIO has found a way to invest that is profitable for the institution.

Regent Chu asked how attractive UC was for co-investment opportunities. Mr. Bachher stated that the Office of the CIO tried to be decisive, responsive, and available, which made it a good partner.

Mr. Bachher asked Mr. Webster about the annualized returns that co-investments earned since inception. Mr. Webster replied that co-investments earned more than 20 percent. Mr. Bachher remarked that this was better than the returns earned from funds.

Regent Robinson asked how much of the University’s investment portfolio is susceptible to the assumptions about a three percent inflation rate. The collapse of Silicon Valley Bank demonstrated that rising interest rates could have unintended consequences. He believed that a shorter duration was better as interest rates continue to rise. Mr. Bachher shared his view that the Fed could be experimenting with interest rates and was fixated on a two percent inflation rate. Mr. Schroeder noted that the pandemic, fiscal and monetary stimulus, and geopolitical conflict disrupted a longtime inflation rate of two percent to a high of nine percent. Inflation has since declined to an overall rate of six percent and a core rate of 5.5 percent. Those who projected a three percent inflation rate were predicting that shelter would decline to four or five percent.

Regent Robinson asked how the Office of the CIO factors inflation into its investment decisions. Mr. Schroeder replied that he worked to protect fixed income assets by keeping duration short. Managing Director Ronnie Swinkels added that U.S. companies were passing inflation on to customers to keep high profit margins. This was partially why the S&P 500 has performed so well despite geopolitical risk, along with fiscal and monetary stimulus. Mr. Bachher stated that it was difficult to understand how unemployment could be low in this environment. He believed that capital was artificially inflating private equity. In an inflationary environment, real estate and real assets with infrastructure could be good assets, as were private companies with pricing power.
2. **UC INVESTMENTS REAL ESTATE STRATEGY**

[Background material was provided to Regents in advance of the meeting, and a copy is on file in the Office of the Secretary and Chief of Staff.]

Chief Investment Officer (CIO) Bachher shared his plan to make $2 billion, drawn from the pension and endowment, available to invest in real estate assets near UC campuses. In the last eight years, the Office of the CIO has invested in eight assets that accounted for $1.2 billion of gross asset value. These investments were meant to make a return on investment for the pension and the endowment. Mr. Bachher presented properties near UC Santa Cruz, UC Berkeley, UC Santa Barbara, UC San Diego, and the Office of the President. In January 2020, the Office of the CIO sold at a profit property near Stanford University that it had purchased several years prior. In his experience, owning property around a university seemed profitable. In partnering with the UC campuses to develop a business plan, the Office of the CIO learned that there was a great need for real estate to be built near the campuses. Mr. Bachher acknowledged that there has been confusion about these investments and clarified that the Office of the CIO had a fiduciary responsibility to make a return on investment. By making real estate investments directly instead of relying on a third-party investment partner, the Office of the CIO could save hundreds of millions of dollars in fees. He likened this to the UC Retirement Savings Program, in which savings were passed on to clients. In Mr. Bachher’s view, this was the right thing to do from an economic and social perspective.

Regent Pérez asked about the return on investment and the value such an investment would add to a campus or the surrounding community. UC has received criticism for its investment in Blackstone, which was seen as exacerbating housing affordability issues. Regent Pérez remarked that those who have suggested diverting that money to wages did not understand the impact that would have on pension participants and the employer. Mr. Bachher replied that a campus could negotiate better terms for a capital project with funding from the Office of the CIO than if the campus entered into a public-private partnership. If the Office of the CIO was a partner in a transaction, the University would be better able to dictate governance terms, operation, and management. A third-party developer could decide to build something different or delay a project. Typically, in a real estate transaction, one entered into a ground lease in exchange for a third party supplying the bulk of the capital. By investing UC’s own assets, it could obtain better economic terms and share profits negotiated by the third party and the campus. With regard to community benefit, Mr. Bachher cited the example of the Hilltop apartments in Santa Cruz. The Office of the CIO bought the property in 2021 and decided not to increase rent this year. Regent Pérez recalled that a minimum rent increase had been part of a public-private partnership agreement at UC Berkeley. He remarked that rent at Hilltop would have been raised if it was part of a public-private partnership. Mr. Bachher stated that real estate was a fee-rich business, and the Office of the CIO could be more customer-centric without those same fees. Mr. Bachher underscored that there was both a housing affordability crisis and a pension crisis, and it was the job of the Office of the CIO to select assets that were accretive to future generations and retirees. The Office of the CIO chose Blackstone in
order to earn 11.25 percent in returns over six years for the pension and the endowment. In his view, Blackstone was a responsible landlord that was working to address issues in the properties it has bought. He believed Blackstone was a good investment.

Regent Pérez stated that he was less trusting and sought more certainty. He stated his understanding that a percentage of the Office of the CIO’s fund targeted governmentally controlled affordability in housing. Mr. Bachher responded in the affirmative. Six percent of housing investments was in California, over 90 percent of which was affordable housing. In his view, the key to affordable housing was building more housing.

Advisor Lybarger stated that about 70 percent of American Federation of State, County and Municipal Employees (AFSCME) Local 3299 members could not afford housing near the campus where they worked, and some union members and students were sleeping in their cars. Ms. Lybarger was perplexed that the University would seek more State funding for student housing while investing $7.5 billion in Blackstone, a company that relied on raising rent. The Office of the CIO’s limited liability company would invest in market rate housing, which a majority of workers and students could not afford. Ms. Lybarger underscored how inflation and low housing supply has led to an imbalance between wages and affordability. She stated that the University could make investment choices that alleviate its workers’ and students’ cost burdens. A coalition of over 40 organizations across the country were calling for divestment from Blackstone. Research has shown that investments in affordable housing offer stable and consistent returns and a good hedge in an inflationary environment, which would meet UC’s moral obligation to the communities it serves. Ms. Lybarger called for freezing annual rent and stopping no-fault evictions from UC housing, divesting from firms that support limiting tenant protections, and developing affordable housing. Calls to divest from Blackstone would only gain momentum, and the Regents could choose to be on the right side of history as they have done in the past, divesting from tobacco, fossil fuels, and South Africa during Apartheid. Mr. Bachher stated that he was available to engage in conversation and expressed appreciation for the solutions Ms. Lybarger suggested. The Office of the CIO bought housing in Santa Cruz to address housing insecurity among UC Santa Cruz students but also had to earn returns for the pension. Ms. Lybarger remarked that an investment should not hurt its beneficiaries.

Committee Chair Sherman stated his understanding that the Office of the CIO would not be opposed to investing in Section 8 housing as long as it made economic sense. Mr. Bachher responded in the affirmative. There was an expectation that an investment must grow at a certain rate based on the capital or source of capital being used.

Regent Pérez agreed that the University must be concerned about whether its investment decision was creating a disproportionately negative impact. UC also had an absolute responsibility to produce a return in the pension. He expressed concern about participants of the Defined Contribution Plan seeking to retire when the market collapses. He stated that the Office of the CIO managed the investments for the Defined Benefit Plan and had an obligation to protect the interests of the participants. By obtaining returns, UC would not have to increase its contribution to the pension, which would undermine wages and services, or ask employees for an increase in contribution, which would undercut an
increase in wages. He wished to hold Mr. Bachher to his commitment to seeking returns and co-benefits to stakeholders and the University.

Regent Park asked how returns were calculated for real estate investments, noting that revenue could come from rental income or the sale of real estate. Mr. Bachher responded that there would be no difference in the real estate assets being considered and used co-investment as an analogy. The Office of the CIO’s co-investments could earn five percent more than investments made through a fund manager because of money saved on fees.

Regent Park asked if returns are regarded as year-over-year earnings or the revenue generated when UC disposes of an asset. Mr. Bachher replied that the cost of capital could be the same regardless of whether UC invested through a third party, but the difference was in fees. Cost of capital varied; investing in a development project was riskier than investing in an existing building. He could not promise that investing in real estate this way would result in a discounted cost of capital. The same economic terms would apply, and the Office of the CIO would determine other benefits, such as fee savings. The pension set the definition of the cost of capital. Mr. Bachher stated that projects built by a university were more expensive because of the cost structure. Costs had an effect on returns. Savings meant the Office of the CIO could decide not to raise rents in a given year.

Regent Park noted that there would be pressure to keep rents at or below market rate and asked what factors and principles would be taken into account when setting rent. Mr. Bachher emphasized that these investments would be complicated, and UC’s investment partners might ask why it was opting for lower returns. The Office of the CIO’s real estate investments have earned returns for UC, and Mr. Bachher believed this effort could be expanded.

Regent Park asked how much the additional $2 billion would add to the Office of the CIO’s real estate investment strategy. Mr. Bachher explained that the Office of the CIO would be adding $2 billion to the $1.2 billion already invested around UC campuses. He planned to make available $1 billion of equity and $1 billion of debt.

Regent Park asked how the occupants of these investment properties would be determined. Mr. Bachher replied that a property manager would determine the occupants. However, as the owner, the Office of the CIO could provide guidance to property managers regarding the types of occupants it wished to prioritize.

Regent Park asked if the Office of the CIO had a particular real estate investment strategy at or around UC Merced. Mr. Bachher replied that he planned to visit the campus and speak to Chancellor Muñoz. The Office of the CIO was available to meet with campuses.

Regent-designate Tesfai remarked that UC would continue to face backlash over its investment in Blackstone. He and Regent Blas Pedral wished to discuss with the Office of the CIO its strategies for student housing. He underscored the need to ensure affordability for students and residents in the community and suggested campus or nonprofit management of the properties. Regent-designate Tesfai asked if the Office of the CIO had
a preference in the type of real estate investment. Mr. Bachher offered to speak to him after
the meeting. It was difficult to set a blanket rule for every situation; these investments
needed to be examined on a case-by-case basis. He reiterated the Office of the CIO’s
obligation to the pension, endowment, and working capital.

Regent Hernandez shared his belief that UC could bypass go-betweens like Blackstone and
earn similar returns while offering housing to students with below-market rental rates. The
University should target acquisitions around campuses instead of elsewhere in the nation.
Mr. Bachher offered to speak to Regent Hernandez after the meeting.

3. UPDATE ON DIVERSITY, EQUITY, AND INCLUSION AT UC INVESTMENTS

[Background material was provided to Regents in advance of the meeting, and a copy is on
file in the Office of the Secretary and Chief of Staff.]

Chief Investment Officer (CIO) Bachher stated that the Office of the CIO would provide a
more detailed presentation of this item at an upcoming meeting.

Chief Operating Officer Arthur Guimaraes provided an update on the Office of the CIO’s
fourth annual diversified returns report. In 2021–22, 40 percent of UC’s actively managed
assets was managed by 44 diverse firms. These were firms that were more than 25 percent
diverse-owned. The Office of the CIO defined “diverse” as including individuals who were
female, Black, Latino(a), Asian, Pacific Islander, Native American, veteran, LGBTQ+,
gender-nonconforming, and disabled. The number of Latino(a) majority-owned investment
partners increased 120 percent, and assets managed by diverse-owned firms grew by
$2.6 billion. The number of majority diverse-owned partners increased as well. In 2021–
22, the Office of the CIO committed about $500 million in six new diverse-owned partners.
Over the past four years, the number of Black and Latino(a) staff at the Office of the CIO
has increased ten percent, but more needed to be done to improve gender balance. The UC
Investments Academy aimed to enroll 10,000 students by 2027.

Mark Harris, faculty member in the Department of Economics and Business Management
at UC Merced, emphasized the need to improve the pipeline into the financial sector and
shared that he was only one of two African American managing directors at Bear Stearns.
In response to the low numbers of students who were women and people of color in the
department, he sponsored the Investment Club at UCM, which began with 12 students and
now had 120 students. He credited Mr. Bachher and the Office of the CIO for connecting
with all the campuses through the UC Investments Academy. Mr. Harris’ greatest
challenge was determining how undocumented students could participate in internships
and other Wall Street access points. He asked President Drake and the Regents for their
assistance. The second greatest challenge was instilling in students confidence and a sense
of belonging in this field, especially female students.

Investment Director Craig Huie shared the experiences of Tiler Fears, a UC Merced
student-athlete, who reached out to the Office of the CIO for guidance developing a career
strategy. The UC Investments Academy helped him write a resume and cover letter and
create a networking strategy. The Academy also advised him to seek help from the campus career center. Mr. Fears was later offered an internship at Mercer. The Academy was working to expand enrollment in order to meet high demand from the campuses.

Regent Park praised the progress that the Office of the CIO has made in its diversity efforts.

The meeting adjourned at 11:15 a.m.

Attest:

Secretary and Chief of Staff