

Public University Fund Investment Policy Changes

BACKGROUND

The six participating universities in the Public University Fund (Fund), including Oregon Tech (University), have requested a change in the Fund's investment strategy to divest from current fossil fuel related securities and restrict future investment of assets into fossil fuel related securities, specifically, the Carbon Underground's 200 global oil, gas and coal companies (C.U. 200). The current investment policy does not restrict investment into C.U. 200 companies.

To address the participant's request, Oregon State University (OSU), in its role as the Designated University, collaborated with the Oregon State Treasury (State Treasury), OSU's investment advisor, PFM and the University Shared Services staff to design a portfolio strategy to incorporate the fossil fuel restrictions, while maintaining a low-cost, total return strategy similar to the present Fund's investment strategy.

Because the Oregon Intermediate-Term Pool and Long-Term Pool policies do not restrict investment into the C.U. 200, a new separately managed account will be established by the State Treasury to fulfill the fossil fuel free mandate. The State Treasury will transfer the Fund's proportional share of securities, meeting the investment policy guidelines, held in the Intermediate-Term Pool and the Long-Term Pool into the new separately managed account. Cash will be received for any securities held which appear on the current C.U. 200 list and reinvested into securities from approved sectors. The investment strategy for the new account will blend the strategies from the Intermediate-Term Pool and the Long-Term Pool into one Core investment account which incorporates the fossil fuel free security restriction. The maturity target for the underlying securities is between three to seven years, heavily weighted towards the three to five year maturities.

The liquidity allocation will remain invested in the Oregon Short-Term Fund. The State Treasury is the primary cash investment option for multiple State agencies banking with State Treasury, which precludes any request to restrict fossil fuel investments from this specific fund. While the State Treasury investment policy does not restrict investment into fossil fuel related securities, the State Treasury fixed income investment team has indicated there are no plans to purchase new securities from the energy or coal sector. The State Treasury currently holds a 1.1 percent allocation to securities from the C.U. 200 list and are scheduled to mature over the next 18 months. The present expectation is for the Oregon Short-Term Fund's fossil fuel security allocation to decline to zero by March 2018.

The recommended Fund investment strategy is designed to reduce total fossil fuel exposure from 1.7 percent to 0.4 percent, resulting in a 75 percent reduction upon creation. The strategy includes anticipated future divestment from the remaining fossil fuel securities over the following 18 months, lowers annual investment fees by 13 percent, and is estimated to return a net income yield of 1.6 percent, comparable to the present investment strategy.

Summary	Market Value	Est. Annual Income	Est. Yield	Annual Mgmt Fees	Invest. Mgmt. Fee Rate	Est. Net Income	Est. Net Income Yield	Fossil Fuel Market Value	Fossil Fuel Alloc.
PUF Portfolio (Avg Balance)	\$ 515,900,000	\$ 7,984,900	1.57%	\$ 140,084	0.027%	\$ 7,633,816	1.50%	\$ 8,817,600	1.71%
Recommended Portfolio (Avg Balance)	\$ 515,900,000	\$ 7,984,900	1.57%	\$ 121,728	0.024%	\$ 7,652,172	1.50%	\$ 2,171,400	0.42%

Estimates based upon data available in May 2016

The State Treasury and the Oregon Investment Council, recommend the following changes to the Fund's investment policy. The changes reflect the requested investment restrictions, portfolio changes to incorporate the investment restrictions, modifications to active management parameters to reduce variances to the benchmark and formatting revisions to streamline the policy.

RECOMMENDED CHANGES

- Portfolio rule changes to incorporate the fossil fuel restriction:
 - *Portfolio Rule 3* - The Portfolio Allocation and Risk Profile table has been modified to reflect the new fossil fuel free portfolio. The new portfolio combines elements of the current Intermediate-Term and Long-Term portfolio strategies into one managed account. The target weighted average maturity for the underlying securities is 3-7 years;
 - *Portfolio Rule 4* – The Oregon Intermediate-Term Pool and the Long-Term Pool are eliminated as permitted holdings;
 - *Portfolio Rule 8* – An additional rule has been added to restrict investment of fossil fuel related securities as defined by the C.U. 200 list. The compliance monitor list of restricted issuers will be updated each calendar year-end based upon constituent changes to the C.U. 200 list. Any existing holdings from issuers that appear on the C.U. 200 list subsequent to purchase will be held until maturity;
 - *Portfolio Rule 10* – A custom benchmark to measure the performance of the new portfolio strategy is defined as: Bloomberg Barclays U.S. Aggregate 3 to 5-year index (75%) and Bloomberg Barclays U.S. Aggregate 5 to 7-year index (25%).

- Portfolio rule changes to modify active management parameters:
 - *Portfolio Rule 7* –The average modified duration variance of the new fossil fuel free portfolio compared to the custom benchmark is set at +/- 10 percent. The current policy average modified duration variance is +/- 20 percent;
 - *Portfolio Rule 10* – The performance expectations are modified to performing “in-line” with the stated custom benchmark from the current “outperform” the stated benchmark.

NEXT STEPS

The recommended policy changes have been communicated to all Fund participants and it is anticipated that all participants will seek their Board's approval for investment in the new strategy prior to the end of January 2016. Implementation of the new investment strategy is anticipated the first calendar quarter of 2017.

The amended policy will become effective upon the approval of OSU's Board of Trustees, due to their role as the Designated University for the Fund. An initial review of the policy and fossil fuel divestment request was conducted on October 20, 2016 with follow-up discussions scheduled for December 2016. A final review by the OSU Board of Trustees is schedule for January 21, 2016.