

# UNIVERSITY OF ILLINOIS SYSTEM



**Office of Investments Annual Report**  
**Fiscal Year Ending June 30, 2023**

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## Introduction

**W**e are pleased to present the University of Illinois System Office of Investments Annual Report for the 2023 fiscal year. All data in the report is as of June 30, 2023, unless noted otherwise.

Despite a slow start to the year, performance across financial markets was largely positive – a welcome reprieve from the headwinds faced during fiscal year 2022. The endowment pool gained 6.4% on the year, lagging its benchmark; while the operating pool outpaced its benchmarked with a 2.5% return. Collectively, the program distributed \$124.3 million in investment and farm income to the University System. Despite the optimistic tone to end the year, risks remain. Banking system strains, the most aggressive Fed tightening campaign in over four decades, persistent inflationary concerns, and unresolved geopolitical tensions provide a basis for caution. As such, the pools are positioned defensively to both protect capital and take advantage of opportunities that may arise.

The investment program executed several new investments throughout the year. In the endowment pool, investments were made in the following partnerships/funds: Sierra Ventures XIII, LP (global equity); Pflingsten Fund VI, L.P. (global equity); BlackRock ESG World ex-US Equity (global equity); BlackRock Emerging Markets Free Fund (global equity); Palmer Square and Pugh Capital via Attucks Asset Management (global fixed income); Oaktree Opportunities Fund XII (global fixed income); Artisan High Income Fund (global fixed income); Balyasny Atlas Enhanced Fund, Ltd. (diversifying strategies); and Farallon Real Estate Partners IV (real assets). In the operating pool, investments were made in Loop Capital, Longfellow Investment Management, and Ducenta Squared Asset Management via Attucks Asset Management.

Enclosed is an overview of invested assets and key performance and asset allocation measures for the endowment and operating pools. A fee summary, security inventory, and transaction report are included as separate reports in the Board materials.

### Office of Investments Overview

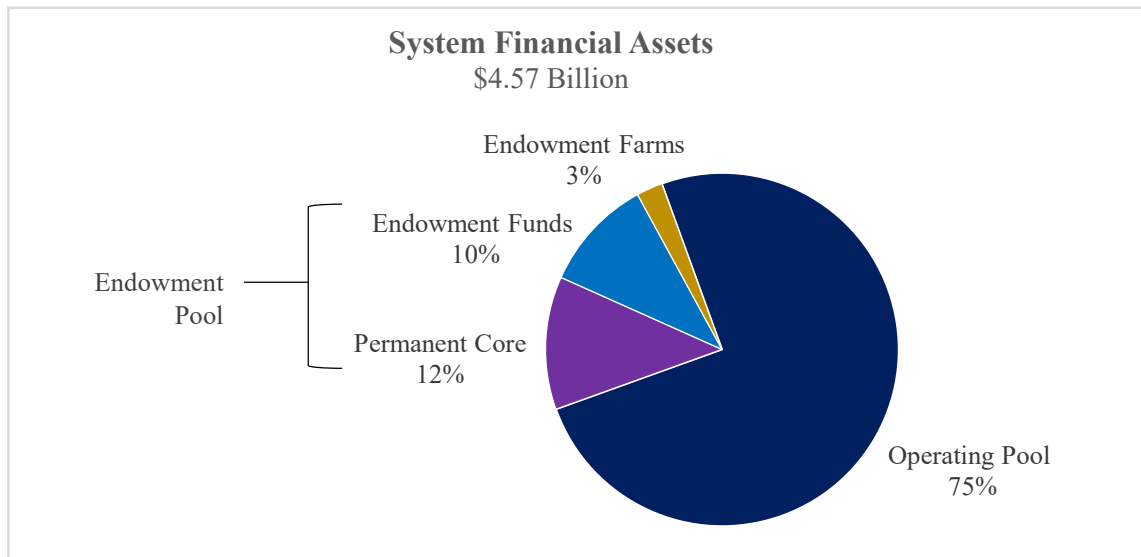
Under supervision of the CFO, the Office of Investments manages the University System's operating and endowment assets, including farmland donated to the University. Operating and endowment assets are invested through carefully selected external investment firms, while farmland is managed internally by the Agricultural Property Services department.

The University of Illinois BOT establishes policies for managing University asset pools. The Investment Policy sets forth asset allocation ranges for the endowment and operating pools. The Audit, Budget, Finance, and Facilities (ABFF) Committee of the BOT reviews asset allocation and performance and makes recommendations to the BOT regarding investment policy. The BOT has delegated to the CFO management of the University's assets within the BOT approved policies. The CFO has charged the Investment Office with the day-to-day management of the investment program. It is important to note that the assets managed by the Office of Investments are distinct from those managed by the University of Illinois Foundation (UIF). UIF is a university related organization with an independent board.

## Financial Asset Overview

The Investment Office manages two investment portfolios—the endowment pool and the operating pool. The permanent core is an investment of operating pool funds that, combined with the endowment funds, forms the endowment pool. Endowment farms are managed by the Agricultural Property Services Office. The distribution of the collective pools is displayed in Figure 1.

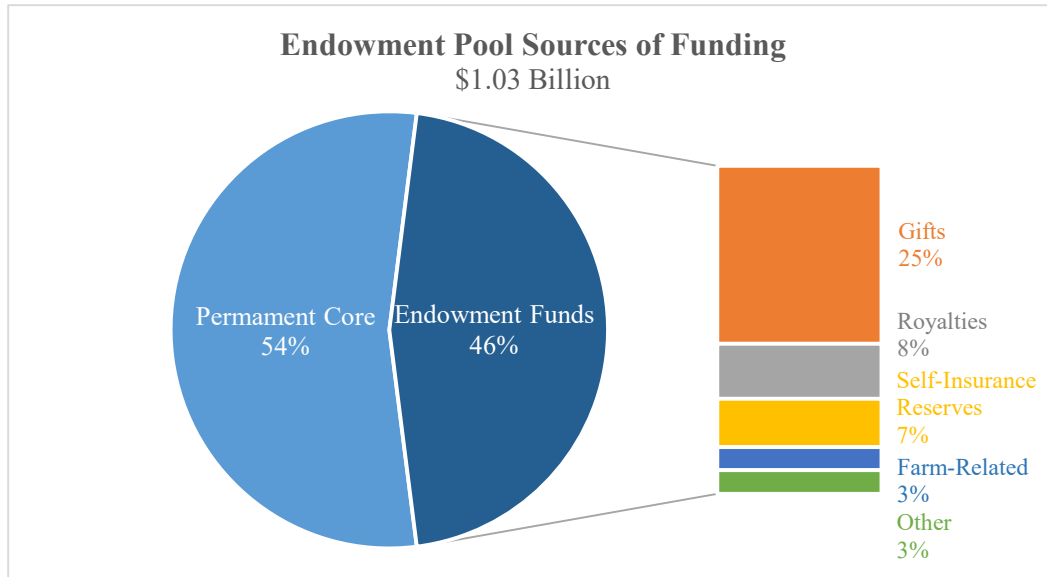
**Figure 1**



## Endowment Pool

The *Endowment Pool* (market value \$1.03 billion) consists of two categories of funding. The first source is *Endowment Funds*, defined as financial assets of the University System that have been deemed appropriate for long-term investment. Endowment funds comprise 46% of the endowment pool. The second source of funding consists of operating pool funds that are managed as part of the endowment pool—the *Permanent Core*. This comprises 54% of the endowment pool. The composition of the funding sources is summarized in Figure 2.

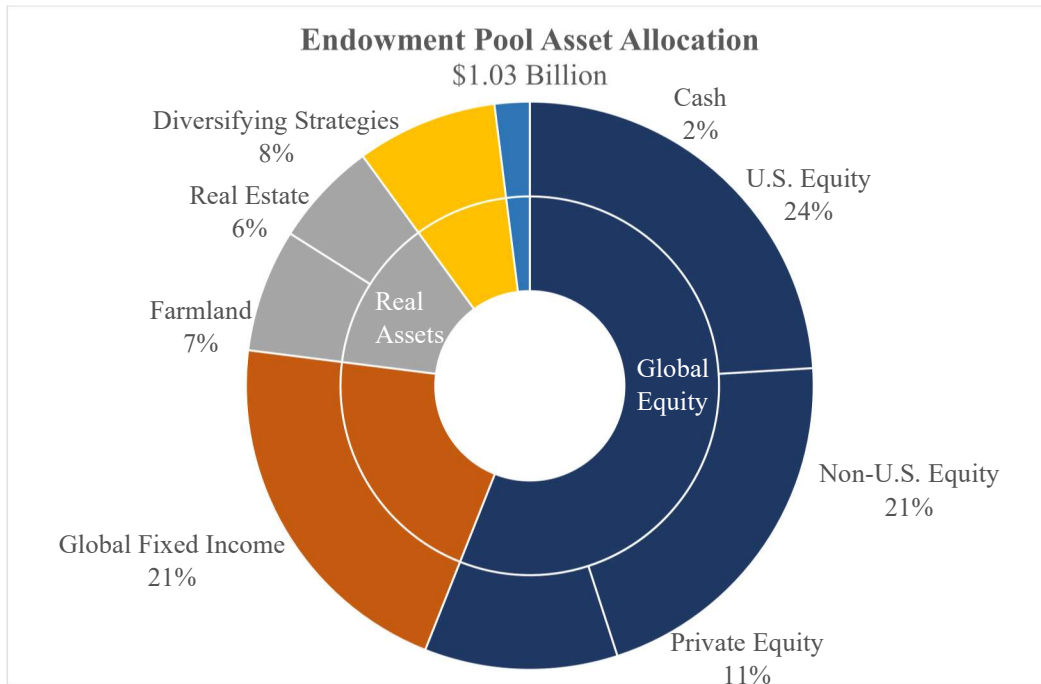
Figure 2



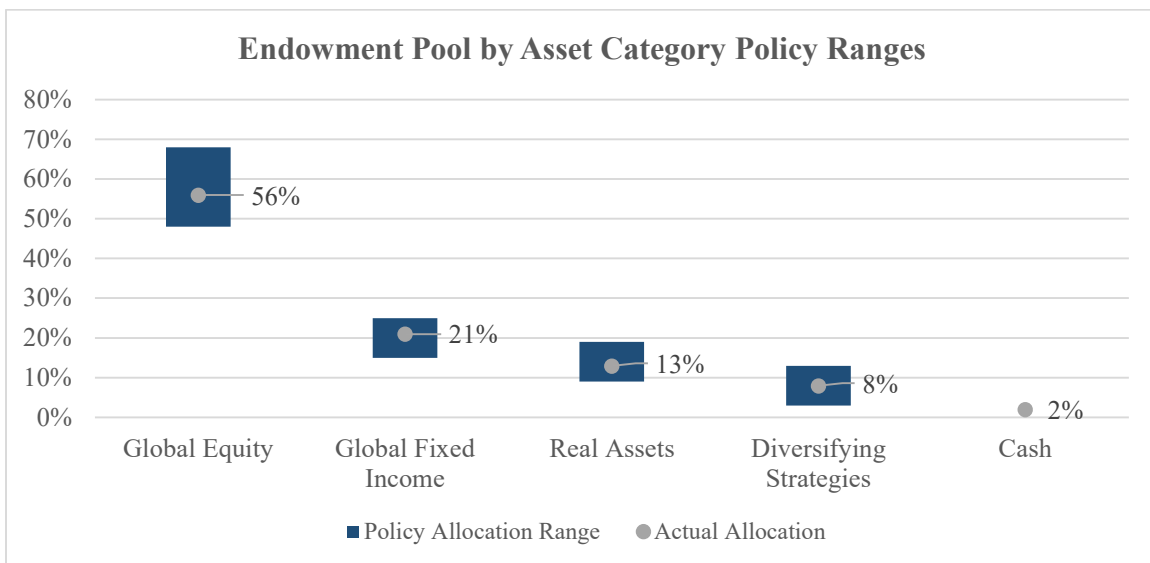
## Asset Allocation

The endowment pool is invested across a variety of asset classes in accordance with policy approved by the BOT. The current distribution of endowment pool funds across primary and sub-asset classes is shown in Figure 3. Figure 4 compares the actual allocations to long term policy ranges. All asset classes remain within policy ranges.

**Figure 3**



**Figure 4**



The endowment pool is reasonably liquid compared to peers. Relative to a policy requirement of 60% liquid assets (*i.e.*, at least weekly redemptions) and 70% semi-liquid assets (*i.e.*, at least quarterly redemptions), 69% of the pool meets the liquid asset definition while 79% is semi-liquid. This structure allows for efficient rebalancing and is well aligned with the liquidity profile of the underlying sources of funding. It also reduces expenses as liquid, public market allocations generally charge lower fees than closed-end investment vehicles. Our preference for low-cost passive investments in public equity markets further reduces the fee burden. The inclusion of farmland as an asset class also distinguishes the endowment pool from its peers. Farmland includes agricultural land donated to the University, as well as an investment into a closed-end U.S. farmland partnership, which serves to increase our allocation and diversify the geographical exposure. Income from endowment farms supports student scholarship and research programs.

## **Spending Policy**

The investment objective of the endowment pool is to preserve the purchasing power of pool assets and provide annual support for an infinite period. The endowment pool annual spending policy for fiscal year 2023 is based on a percentage of a six-year moving average of the unit market value of the endowment pool. The spending rate—set by the Comptroller annually in consultation with the President—is 5.3%, inclusive of a 1.2% administrative fee. The endowment pool distributed approximately \$28 million during the 2023 fiscal year (inclusive of the administrative fee and excluding income distributed from the permanent core allocation).

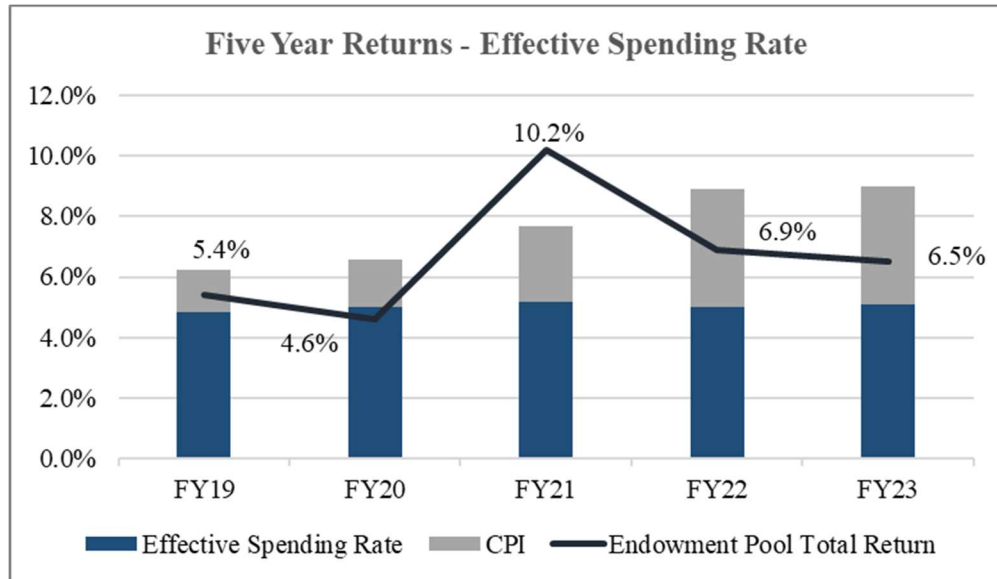
## **Performance Measurement**

A variety of approaches can be taken in measuring investment performance. Three methods — (1) total return relative to the combined rate of spending and inflation, (2) total return relative to the performance benchmark, and (3) cash flow activity—are presented below to provide a holistic view of endowment pool performance.

### Total Return Relative to Spending and Inflation Rates

Five year returns as of fiscal years 2019-2023 are presented relative to the endowment pool's hurdle rate (*i.e.*, effective spending rate plus the consumer price index (CPI)) in Figure 5. The effective spending rate is inclusive of the administrative fee. This comparison provides a medium-term assessment of whether endowment returns are sufficient to offset inflation and spending. Endowment pool returns exceeded the hurdle rate for one of the five periods under consideration with the FY22 and 23 hurdle rates impacted by a drastic increase in inflation. Forward-looking inflationary expectations will be monitored to ensure that the endowment's asset allocation and spending rate remain appropriate.

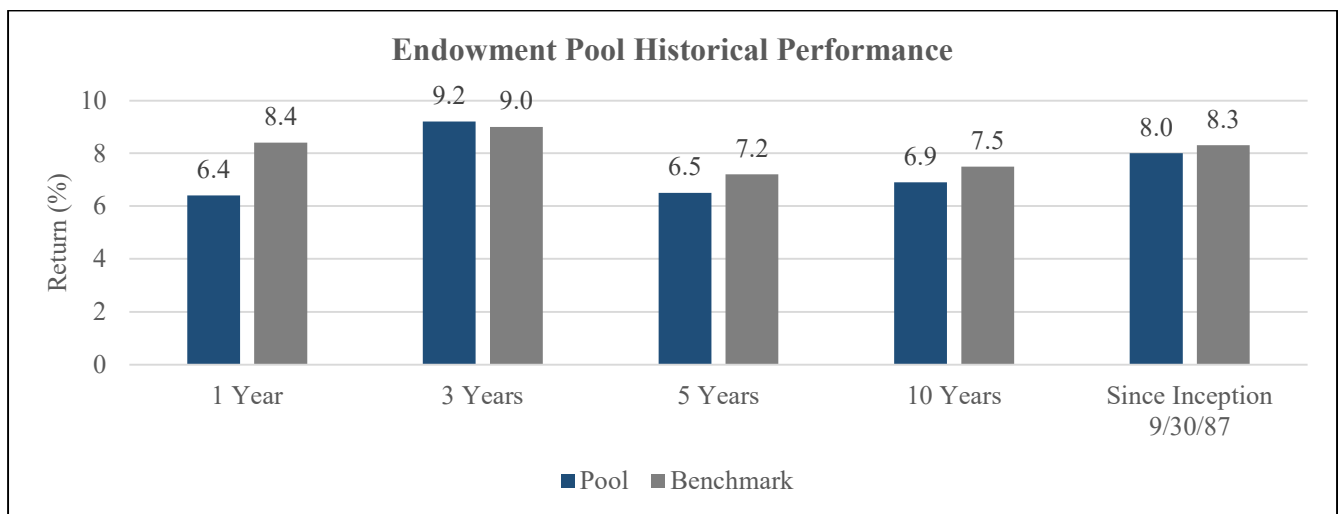
**Figure 5**



Total Return Relative to Performance Benchmark

The endowment outperformed its performance benchmark over the three-year period but lagged over the 1-year and longer-term periods. Over the one-year period, the primary detractor of relative performance was the farmland allocation, which led or approximated its benchmark all other periods. Over longer periods, U.S. equity and diversifying strategies underperformed; however, the team’s approach to these asset classes has shifted in recent years, leading to relative outperformance under the new strategies. The historical investment performance of the endowment has been provided in Figure 6.

**Figure 6**





Cash Flow Activity

The endowment pool balance is impacted by three factors—net additions, the spending distribution, and capital appreciation. The impact of these factors on the pool (excluding the permanent core allocation) over a ten-year period as of June 30, 2023, is summarized in Figure 7.

**Figure 7**

<b>Summary of Endowment Pool Activity</b>	
<b>FY14 - FY23</b>	
All figures in millions	
	<b>Ten Year Totals</b>
<b>Beginning Balance</b>	<b>268.1</b>
Net Additions	145.1
Distributions	-180.8
Capital Appreciation	240.1
<b>Ending Balance</b>	<b>472.5</b>

## Operating Pool

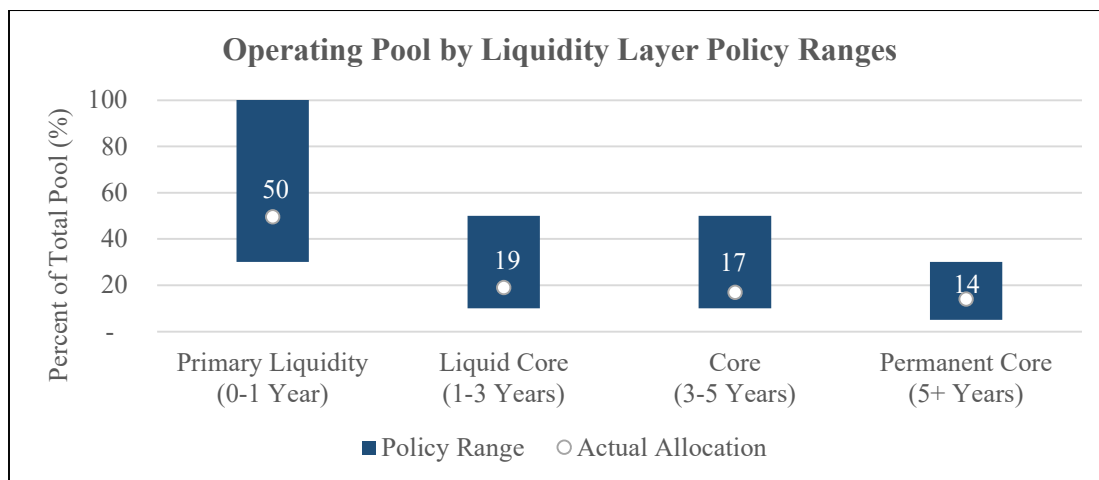
The *Operating Pool* (market value \$3.43 billion) consists of funds available for current use by academic and administrative units within the System. The pool includes cash from state appropriations, tuition and fees, student loan funds, grants, self-insurance programs, and hospital and auxiliary services. The consolidated management of funds provides robust tracking and efficient investment management.

The investment objective for the operating pool is to preserve the value of the principal, maintain liquidity appropriate to the forecasted working capital requirements of the System, provide prudent diversification, and maximize the rate of return on investment. Income from the pool is returned to units in proportion to their share of the assets. During fiscal year 2023, approximately \$94 million was distributed from the operating pool (including the permanent core allocation) after banking and investment management fees were paid.

### Asset Allocation

Operating pool assets are invested in fixed income securities and cash equivalents. The assets are allocated by liquidity layer. Investment managers within a given liquidity layer follow fundamentally consistent investment guidelines that set forth restrictions on duration, credit quality, diversification, performance benchmarks, and permissible security types, amongst others. Provided that state regulation does not allow the System to borrow for working capital, the operating pool has ample liquidity and is of high quality with an average AA- credit rating. Figure 8 demonstrates the operating pool's asset allocation on June 30, 2023, within the policy ranges by liquidity layer.

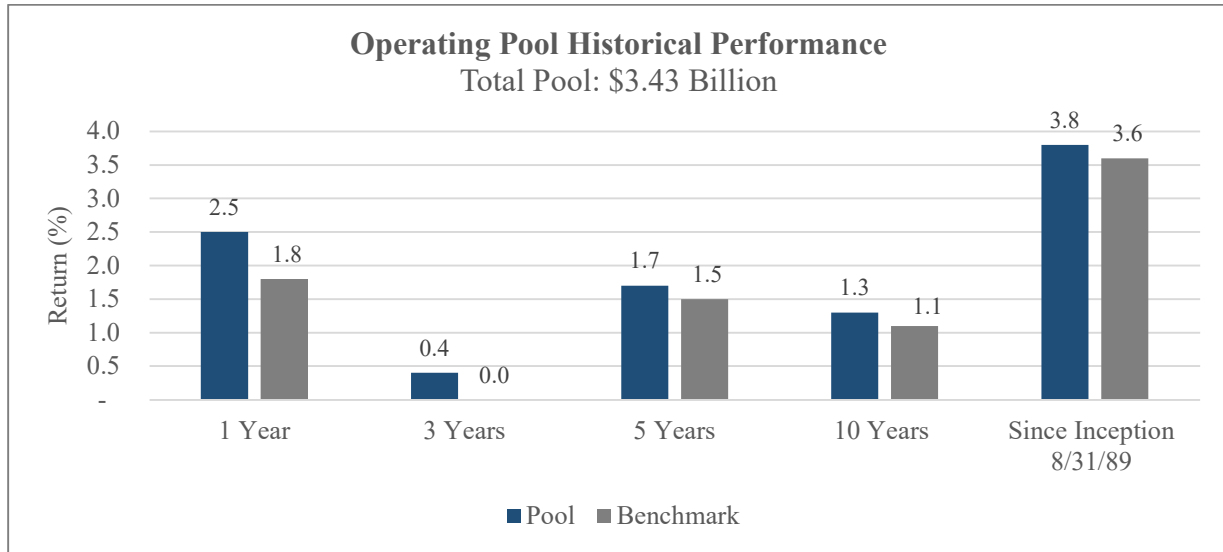
**Figure 8**



## Performance Measurement

Operating pool managers have consistently outperformed the performance benchmark. Historical performance relative to the performance benchmark is displayed in Figure 9.

**Figure 9**



\*Note: The total operating pool market value does not include the permanent core allocation. This allocation is included in the endowment pool market value.

## Financial Impact

The investment program generates investment income, as well as investment management costs, to the University System. All costs are offset or paid directly from investment income. The Investment Office works diligently to maintain the cost structure at a reasonable level.

### Income Distribution

During the 2023 fiscal year, the investment program distributed income of \$124 million to units across the University System after paying investment management fees. The summary of the distribution by source is shown in Figure 10.

**Figure 10**

<b>(\$ Millions)</b>	<b>Distribution</b>
Endowment Pool	28.3
Operating Pool	93.9
Endowment Farms	2.1
<b>Total Distribution</b>	<b>124.3</b>

### Program Costs

The most significant cost to the investment program is external counterparty (*i.e.*, investment manager, custody, investment consultant) fees. For fiscal year 2023, this comprised \$12.6 million or 28 basis points of total assets. Investment manager fees are net against performance. A fee schedule is enclosed in the appendix to this report, while the fiscal year 2023 fee summary is included separately in the board materials.

Internally, the Investment Office is comprised of three full-time employees with a fiscal year 2023 salary cost to the System of approximately \$370k and additional budgetary expenses (*i.e.*, travel, technology, training) totaling approximately \$90k. In total, investment office expenses comprised 1 basis point (0.01%) of total assets or less than 5 basis points (0.05%) of endowment assets.

The fiscal year 2023 security listing and endowment transaction report have also been included as separate attachments in the board materials.

## University of Illinois System

### Investment Fee Schedule – Traditional Investments

<b>Firm</b>	<b>Terms</b>
<u>Money Market Funds</u>	
JP Morgan (U.S. Government Money Market Fund & JP Morgan Prime Money Market Fund)	0.18%
Northern Trust (U.S. Government Select Siebert Williams Shank Shares)	0.20%
Illinois Funds	0.05% (plus administrative expenses)
<u>Fixed Income</u>	
Galliard Capital Management (Short Duration)	0.18% - first \$200 million 0.15% - balance
Income Research + Management (Short Duration and Intermediate)	0.21% - first \$100 million 0.18% - next \$100 million 0.15% - balance
JP Morgan (Managed Reserves)	0.15% - first \$50 million 0.125% - next \$50 million 0.10% - next \$100 million 0.08% - next \$100 million
Neuberger Berman (Enhanced Cash)	0.175% - first \$50 million 0.15% - next \$50 million 0.12% - next \$150 million (10% rebate on total fee)
Neuberger Berman (Intermediate)	0.20% - flat fee (10% rebate on total fee)
Northern Trust (Short Duration)	0.20% - first \$100 million 0.18% - balance
Allspring Global Investments (Conservative Income and Short Duration)	0.09% - first \$100 million 0.07% - balance
Attucks Asset Management (Operating)	0.26% - flat fee

## University of Illinois System

### Investment Fee Schedule – Traditional Investments

<b>Firm</b>	<b>Terms</b>
<u>Fixed Income (Continued)</u>	<u>Management Fee</u>
Attucks Asset Management (Endowment)	0.35% - first \$50 million 0.30% - next \$50 million 0.27% - next \$50 million 0.25% - next \$100 million 0.22% - over \$250 million
Vanguard Total Bond Market Index	0.05% flat fee
Artisan High Income Fund	0.85% flat fee
<u>Equity</u>	
BlackRock (ESG U.S. All Cap Equity)	0.055% flat fee
BlackRock (ESG Insights World ex-USA)	0.12% flat fee
BlackRock (MSCI Emerging Markets Free Fund)	0.08% flat fee
Ariel Capital Management (Small Mid Cap Value)	1.00% - first \$10 million 0.75% - next \$10 million 0.50% - balance
<u>Real Estate Investment Trust</u>	
Vanguard (Real Estate Investment Trust Index Fund)	0.09% flat fee

## University of Illinois System

### Investment Fee Schedule – Alternative Investments

Firm	Terms	
<u>Private Equity</u>	<u>Management Fee</u>	<u>Carried Interest</u>
Adams Street Partners		
ASP 2004 U.S. Fund	0.00%	10% on Secondary
ASP 2004 Non-U.S. Fund	0.00%	10% on Secondary
ASP 2006 U.S. Fund	0.00%	10% on Secondary
ASP 2006 Non-U.S. Fund	0.00%	10% on Secondary
ASP 2006 Direct Fund	0.00%	20%
ASP 2007 U.S. Fund	0.00%	10% on Secondary
ASP 2007 Non-U.S. Fund	0.00%	10% on Secondary
ASP 2007 Direct Fund	0.00%	20%
ASP 2008 U.S. Fund	0.10%	10% on Secondary
ASP 2008 Non-U.S. Fund	0.10%	10% on Secondary
ASP 2008 Direct Fund	0.00%	20%
ASP 2009 U.S. Fund	0.20%	10% on Secondary
ASP 2009 Non-U.S. Developed Fund	0.20%	10% on Secondary
ASP 2009 Non-U.S. Emerging Markets Fund	0.20%	10% on Secondary
ASP 2009 Direct Fund	0.19%	20%
ASP 2010 U.S. Fund	0.30%	10% on Secondary
ASP 2010 Non-U.S. Developed Fund	0.30%	10% on Secondary
ASP 2010 Non-U.S. Emerging Markets Fund	0.30%	10% on Secondary
ASP 2010 Direct Fund	0.39%	20%
ASP 2011 U.S. Fund	0.40%	10% on Secondary
ASP 2011 Non-U.S. Developed Fund	0.40%	10% on Secondary
ASP 2011 Non-U.S. Emerging Markets Fund	0.40%	10% on Secondary
ASP 2011 Direct Fund	0.59%	20%
ASP 2013 Global Fund	0.64%	10% - Secondary & Co-Investment, 20% Direct
ASP Co-Investment Fund III	0.63%	10%

❖ Fee Tail Down: Fees above reflect reduction to 90% of the management fee in year eight of a subscription, 80% in year nine, 70% in year ten, etc. The tail down begins in year seven for direct funds.

## University of Illinois System

### Investment Fee Schedule – Alternative Investments

Firm	Terms	
<u>Private Equity (continued)</u>	<u>Management Fee</u>	<u>Carried Interest</u>
Clearlake Capital Partners IV	2.0%	20% (8% hurdle rate)
Clearlake Opportunities Fund	1.75%	20% (8% hurdle rate)
Clearlake Capital Partners V	1.75%	20% (8% hurdle rate)
Clearlake Capital Partners VI	1.75%	20% (8% hurdle rate)
Clearlake Capital Partners VII	1.70%	20% (8% hurdle rate)
Clearlake Flagship Plus	1.25%	20% (8% hurdle rate)
Clearlake Icon	1.0%	20% (8% hurdle rate)
Clearlake Icon II	1.0%	15%-25% step up (8% hurdle rate)
Clearlake Icon IV	1.0%	15%-25% step up (8% hurdle rate)
Centana Growth Partners II	2.5% with scale down to 2.0% after 5 <sup>th</sup> year	20% (8% hurdle rate)
Illinois Ventures IETF III	2.5%	20%
Oaktree Opportunities Fund X	1.6%	20% (8% hurdle rate)
Oaktree Opportunities Fund X(b)	1.6%	20% (8% hurdle rate)
ParkerGale Capital II, L.P.	2.0%	20% (8% hurdle rate)
Varsity Healthcare III	2.0%	20% (8% hurdle rate)
Varsity Healthcare IV	2.0%	20% (8% hurdle rate)
FEG Select Tiger Global Private Investment Partners XIV	2.0% (0.07% average FEG Select fee)	20-25% step up



## University of Illinois System

### Investment Fee Schedule – Alternative Investments

Firm	Terms	
<u>Private Fixed Income</u>	<u>Management Fee</u>	<u>Carried Interest</u>
Oaktree Opportunities XI	1.44%	20% (8% hurdle rate)
Merit Mezzanine Fund VI	1.75%	20% (8% hurdle rate)
Merit Capital Fund VII	1.75% during investment Period, 1.50% thereafter	20% (8% hurdle rate)
Antares Senior Loan Fund II	1.0%	10% (5% hurdle rate)
<u>Diversifying Strategies</u>		
Davidson Kempner International	1.5%	20%
Elliott International	1.5%	20%
Hudson Bay	2.0%	20% with high water mark
BlackRock Multi-Alternative Opportunities Fund	1.5%	20% (8% hurdle rate)
BAM Atlas Enhanced Fund	1.75%	20% with high water mark
<u>Real Assets</u>		
Heitman HART	1.1% - first \$10 million 1.0% - next \$15 million	NA
Prudential PRISA	1.0% - first \$10 million 0.95% - \$10M to \$25M (1.20% Maximum Annual Fee)	3% Operating Cash Flow 0.10% Cash Balance
Farallon Real Estate Partners III	1.5% (reduced by 15% of commitments for reserve)	20% (6% hurdle rate)
Singerman Real Estate Opportunity Fund IV	1.5% on commitments during investment period; 1.5% on unreturned contributions thereafter	20% (8% hurdle rate)
Homestead Capital USA Farmland Fund III, L.P.	1.5%	15% (6% hurdle rate)
Tembo Capital Mining Fund III	2.0%	15% (8% hurdle rate)