

**University of Houston System
Endowment Fund**

Independent Auditor's Report and Basic Financial Statements
August 31, 2016 and 2015



University of Houston System
Endowment Fund
August 31, 2016 and 2015

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Independent Auditor's Report

Board of Regents
University of Houston System
Houston, Texas

We have audited the accompanying basic financial statements, which are comprised of the statements of net position as of August 31, 2016 and 2015, and the related statements of revenues, expenses and changes in net position and cash flows for the years then ended and the related notes to the basic financial statements, as listed in the table of contents, of University of Houston System (the System) Endowment Fund (the Endowment Fund).

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of University of Houston System Endowment Fund as of August 31, 2016 and 2015, and the changes in its financial position and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of a Matter

As discussed in Note 1, the financial statements present only the financial position, changes in financial position and cash flows of the Endowment Fund and do not purport to, and do not, present fairly the financial position of the System as of August 31, 2016 and 2015, the changes in its financial position and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis listed in the table of contents be presented to supplement the basic financial statements. Such information, although not part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements and other knowledge we obtained during our audits of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

BKD, LLP

Houston, Texas
December 21, 2016

University of Houston System
Endowment Fund
Management's Discussion and Analysis – (Unaudited)
August 31, 2016

Introduction

The following Management's Discussion and Analysis (MD&A) provides an overview of the activities and the financial position of University of Houston System (the System) Endowment Fund (the Endowment Fund) for the fiscal year ended August 31, 2016, as compared to fiscal year ended August 31, 2015, with summary comparisons for the year ended August 31, 2014. This MD&A offers a summary of significant current year activities of the Endowment Fund, resulting changes in net position, and currently known economic conditions and facts. This analysis should be read in conjunction with the Endowment Fund's basic financial statements and the notes to the financial statements. Responsibility of the financial statements, related footnote disclosures and MD&A rests with the Endowment Funds' management.

The System is a governmental entity of the State of Texas. The Endowment Fund is a fund group of the System's reporting entity. The financial statements of the Endowment Fund have been prepared in accordance with accounting principles generally accepted in the United States of America as prescribed by the Governmental Accounting Standards Board (GASB).

During fiscal year 2016, the Endowment Management Committee of the University of Houston (UH) System Board of Regents (Board of Regents) continued to review existing objectives, risks, asset allocation, and manager structure within the endowment portfolio and make adjustments as deemed appropriate. The Endowment Fund Statement of Investment Objectives and Policies, among other things, establishes financial objectives for the endowment and an asset allocation with targets and ranges and categorizes each asset class as either a risk reducer or a driver of return.

Endowment Fund Structure

Gifts to the UH System are placed in the Endowment Fund for investment and oversight purposes. The Board of Regents strives to maintain a plan to preserve and augment the value of the endowment. The Board of Regents works to preserve the broad objective of investing endowment assets so as to preserve both their real value and the long-range purchasing power of endowment income. The Endowment Management Committee of the Board of Regents is responsible for reviewing and approving investment managers and monitoring investment performance and allocations of funds to asset classes to ensure appropriate diversification of investment risks for the Endowment Fund, as well as making recommendations to the Board of Regents for any changes to the investment policy.

The Endowment Fund is a pooled investment fund consisting of approximately 1,670 individual endowments benefiting the four UH System universities. The investment pool functions similarly to a mutual fund, with each endowment account owning units that represent a claim on the Endowment Fund's net position. By pooling the investments, the UH System achieves increased diversification of investment risks and more effective management of endowment assets.

Management of the Fund

The Endowment Fund retains 59 independent investment managers who pursue various portfolio management strategies to diversify risk and maximize the total return through a variety of capital market cycles. Investment manager diversification of the endowment fund's assets is as follows:

	<u>2016</u>	<u>2015</u>	<u>2014</u>
<u>Developed U.S. Equity</u>			
State Street Global Advisors	0%	<1%	7%
Mayo Capital	2	2	3
Institutional Capital	0	<1	3
Northern Trust	6	5	0
Columbia Management	3	3	3
Vulcan Value Partners	3	3	0
Gotham	2	2	0
Cougar Investment Fund	<1	<1	<1
Luther King Capital Management	2	2	2
Subtotal – developed U.S. equity	18	17	18
<u>Developed International Equity</u>			
William Blair	7	6	7
Silchester	9	9	10
Deutsche ETF	1	2	0
Subtotal – developed international equity	17	17	17
<u>Developing Markets</u>			
Doddington Emerging Markets	4	3	4
Somerset	3	3	3
Northern Trust	0	0	3
JO Hambro	4	4	0
Subtotal – developing markets	11	10	10
<u>Absolute Return</u>			
Anchorage Capital Partners	2	2	1
HBK	2	2	2
Davidson Kempner	2	1	1
Covalent Capital	<1	1	1
Whipporwill	<1	<1	<1
Mason Capital	<1	<1	2
Senator Global Opportunity	1	2	2
AllBlue Limited	0	0	2
York Institutional Partners	0	2	2
OZ Overseas Fund II	0	0	2
Standard Life	2	3	0
ISAM	2	2	0
Subtotal – absolute return	11	15	15

	2016	2015	2014
<u>Hedged Equity</u>			
Highline Capital	2%	2%	1%
Partner Fund Management	2	2	2
Samlyn	0	0	<1
Coatue	2	2	1
Sheffield Int'l Partners	2	2	2
SRS Partners	2	2	2
Proxima Capital	<1	2	0
Marble Arch	2	2	0
Brahman	2	2	0
Subtotal – hedged equity	14	16	8
<u>Inflation Hedge</u>			
Morgan Stanley	1	1	1
Van Eck Global Hard Assets	2	1	2
Wellington DIH	2	2	3
Subtotal – inflation hedge	5	4	6
<u>Bonds</u>			
Smith Graham	6	3	6
Mondrian	0	0	4
Laddered U.S. Treasuries	0	0	2
Franklin Templeton	3	4	0
Subtotal – bonds	9	7	12
<u>Private Investments</u>			
Sustainable Woodlands Fund	1	1	1
Berwind Property Group VII	<1	<1	<1
Berwind Property Group VIII	<1	<1	<1
Newlin Realty Partners	<1	<1	<1
Newlin Realty Partners II	<1	<1	<1
Other – real estate holdings	<1	<1	<1
Commonfund Capital International VI	<1	<1	<1
Commonfund Capital PE VII	1	<1	<1
Commonfund Capital Venture VIII	<1	<1	<1
Denham Commodity Partners	<1	<1	<1
Denham Oil and Gas	<1	0	0
EnCap Flatrock Midstream II-C	<1	<1	<1
EnCap Flatrock Midstream III	<1	<1	<1
Embarcadero Capital	<1	0	0
Enervest Fund XIV A	1	0	0
Advent International GPE VII	1	<1	<1
EnCap Energy VII-B	<1	1	1
J.H. Whitney VII	1	<1	<1
TrueBridge-Kauffman Fellows II	1	<1	<1
TrueBridge-Kauffman Fellows III	<1	<1	<1

	2016	2015	2014
TrueBridge –Kauffman Fellow IV	<1%	0%	0%
Dover Street VIII	<1	<1	<1
LiveOak Venture Partners I	<1	<1	<1
Jackson Square Ventures II	<1	0	0
Silver Lake Partners IV	<1	<1	<1
SV Life Sciences Fund VI	<1	0	0
Great Hill Equity Partners V	<1	<1	<1
Fisher Lynch Buyout II	<1	<1	<1
Fisher Lynch Venture II	<1	<1	<1
Lexington Capital VIII	<1	<1	0
LiveOak Venture	<1	0	0
Insight Equity III	<1	<1	0
Francisco Partners IV-A	<1	<1	0
EnCap Energy X	<1	<1	0
Blackstone Real Estate Partners VIII	<1	<1	0
Subtotal – private investments	13	10	9
Cash and equivalents	2	4	5
Total	100%	100%	100%

Investment Manager Allocation

Investment managers are given discretion to manage the assets in each portfolio to best achieve investment objectives within the policies and requirements established by the Board of Regents. The objectives and comparative benchmarks are used to evaluate manager performance. The Endowment Management Committee reviews performance and adjusts allocation to investment managers and asset classes in response to current or future anticipated market conditions. Quarterly performance reports are distributed to the Endowment Management Committee.

Endowment Payout Policy

The Endowment Management Committee is responsible for reviewing the income payout rate of the Endowment Fund, which is a balance between current income needs and long-term investment objectives. The endowment will maintain a payout rate of approximately 4 percent to 5 percent, with any change to this range to be approved by the Board of Regents. The endowment income payout rate for the years ended August 31, 2016, 2015 and 2014, was 4 percent of the average year-end market value for the three prior fiscal years. If an endowment has been in existence less than three years, the average is based on the number of years in existence. This trailing three-year method is used to smooth large year-over-year changes in market value, thereby allowing the UH System's colleges and departments to more reasonably predict future distributions of endowment income intended to benefit their area.

In the three fiscal years 2014 through 2016, endowment payouts to the beneficiary accounts, excluding distributed income returned to principal, in total and by the System's components were as follows:

	2016	2015	2014
University of Houston	\$ 14,631,316	\$ 14,848,342	\$ 13,886,612
UH – Clear Lake	783,384	853,089	795,673
UH – Downtown	987,162	1,043,212	983,910
UH – Victoria	426,567	441,709	417,726
System-wide endowments	4,556,334	4,532,425	4,313,287
Total	\$ 21,384,763	\$ 21,718,777	\$ 20,397,208

Overview of the Financial Statements

The financial statements for the fiscal year ended August 31, 2016, are presented comparatively to financial statements issued for the fiscal year ended August 31, 2015. The financial statements have been prepared in accordance with the standards of the GASB, which establishes generally accepted accounting principles for state and local governments. The three primary financial statements presented are (1) the statement of net position, (2) the statement of revenues, expenses and changes in net position, and (3) the statement of cash flows. The information contained in the financial statements of the Endowment Fund is incorporated within the System's Combined Annual Financial Report.

The financial operations of the System, and therefore inclusively the Endowment Fund, are considered a business-type (or proprietary fund) activity. The operating activities of the System are financed by tuition and fees, state appropriations, contracts and grants, and auxiliary enterprise revenue. The Endowment Fund is an internally managed pooled-fund and its beneficiaries are internal to the System. The statement of net position reports resources held and administered by the System, as described in the previous sections of this discussion and analysis. These resources are customarily characterized by the existence of a written agreement that affects the degree of management involvement, the programs supported by income earned by the resources, and the length of time that the resources are held by the System.

Statements of Net Position

The statements of net position reflect the Endowment Fund's assets and liabilities using the economic resources measurement focus and accrual basis of accounting, and represents the financial position as of the conclusion of the fiscal year. Net position is equal to assets minus liabilities. Unrestricted net position are available to the System for any lawful purpose. Unrestricted net position often has constraints imposed by management, but such constraints can be removed or modified. Restricted net position represents net position that can be utilized only in accordance with third-party imposed restrictions. On August 31, 2016, the fund's assets totaled \$602.9 million, and liabilities totaled \$29 million, resulting in a net position of \$573.9 million.

The net position of the Endowment Fund as contributed by the System's components as of August 31, 2016, compared to the corresponding values as of August 31, 2015 and August 31, 2014, were as follows:

	2016	2015	2014
University of Houston	\$ 407,022,461	\$ 394,387,835	\$ 413,459,004
UH – Clear Lake	21,341,300	21,545,489	23,343,082
UH – Downtown	26,418,032	26,758,557	29,052,014
UH – Victoria	10,835,111	11,078,961	12,177,864
System-wide endowments	108,282,020	111,539,043	122,040,870
Total	\$ 573,898,924	\$ 565,309,885	\$ 600,072,834

Variance Analysis-Changes in the Statement of Net Position

	2016	2015	Change 2016-2015	2014
Total assets	\$ 602,872,073	\$ 594,685,793	\$ 8,186,280	\$ 630,761,637
Total liabilities	28,973,149	29,375,908	(402,759)	30,688,803
Restricted nonexpendable endowments	414,739,236	403,109,529	11,629,707	425,759,093
Restricted expendable endowments	44,330,661	45,500,068	(1,169,407)	47,529,727
Unrestricted endowments	114,829,027	116,700,288	(1,871,261)	126,784,014
Net Position	\$ 573,898,924	\$ 565,309,885	\$ 8,589,039	\$ 600,072,834

- Total assets: The \$8.2 million increase in fiscal year 2016 is attributable to an increase in the fair value of investments resulting from an increase in gifts.
- Total liabilities: The \$0.4 million decrease in liabilities is attributable to an increase in the amount of institutional advancement fee assessed. Additionally there was a decrease in the liability for securities purchased and pending settlement at fiscal year-end 2016.
- Restricted nonexpendable endowments: The \$11.6 million increase in restricted nonexpendable endowments is primarily attributable to an increase in gifts.
- Restricted expendable endowments: The \$1.2 million decrease in restricted expendable endowments is primarily attributable a change in the method of calculating distributable income in fiscal year 2016.
- Unrestricted endowments: The \$1.9 million decrease is primarily attributable to a change in the method of calculating distributable income in fiscal year 2016.

Statements of Revenues, Expenses and Changes in Net Position

The statements of revenues, expenses and changes in net position contain information about the additions to, the deductions from, and the resulting net increase or decrease in the fair value of the net position for the fiscal year. During fiscal year 2016, the Endowment Fund received \$22 million of gifts and other receipts, interest and investment income of \$6.1 million, and a \$8.8 million net increase in the fair value of investments. The Endowment Fund's total deductions for fiscal year 2016 were \$28.3 million, including \$21.4 million earmarked for distribution to the beneficiary endowment accounts under the planned payout policy and \$6.7 million for gift acquisition and fundraising efforts. As a result of these activities, the Endowment Fund realized an increase in net position of \$8.6 million for fiscal year 2016.

Variance Analysis for Statement of Revenues, Expenses and Changes in Net Position

	2016	2015	Change 2016-2015	2014
Contributions to endowments	\$ 21,976,440	\$ 18,341,666	\$ 3,634,774	\$ 12,246,769
Net appreciation/(depreciation) (realized and unrealized)	8,773,731	(36,344,618)	45,118,349	67,261,755
Other non-operating revenues/(expenses)	(28,256,562)	(28,449,796)	193,234	(26,668,351)
Interest and investment income	6,095,430	11,689,799	(5,594,369)	7,681,668
(Decrease) increase in net position	<u>\$ 8,589,039</u>	<u>\$(34,762,949)</u>	<u>\$ 43,351,988</u>	<u>\$ 60,521,841</u>

- Contributions to endowments increased \$3.6 million in 2016 as compared to 2015 due to additional fundraising efforts.
- Changes in investment activities included an \$8.8 million net appreciation in the fair value of investments in fiscal year 2016 compared to \$36.3 million net depreciation in fiscal year 2015. This net change fiscal year-over-year is the result of the stock market increase in certain sectors in fiscal year 2016. Interest and investment income decreased by \$6 million as compared to 2015. Fund deductions increased by \$193 thousand from 2016 to 2015 due to an increased amount for the annual advancement assessment resulting from an appreciation in the moving three-year average market value of endowments. The Endowment Fund established a tiered payout policy for underwater endowments effective 2016. The institutional advancement fee was approved by the Board of Regents to offset costs associated with gift acquisition and fundraising efforts at the System components. Administrative costs were \$194,930 more in fiscal year 2016 compared to fiscal year 2015. Administrative costs are comprised primarily of investment management fees and consulting fees, and these costs will fluctuate year-over-year as fees are calculated based on the market value of the funds under each firm's advisement.

Statements of Cash Flows

The statements of cash flows explain the changes during the fiscal year in cash and cash equivalents, regardless of whether there are restrictions on their use. The statements of cash flows should be read in conjunction with related disclosures and information in the other financial statements.

Capital Assets

The Endowment Fund does not hold any capitalized assets, such as buildings or furniture and equipment. The Endowment Fund invests in financial instruments which constitutes most of the Endowment Fund's assets. Although the Endowment Fund is generally not prohibited from acquiring tangible physical assets to be held as investments for their appreciation qualities, such assets are typically not acquired or held by the Endowment Fund. Presently, the Endowment Fund holds certain parcels of land, which were received as gifts and are being held for future sale.

Debt Administration

The Endowment Fund does not issue long-term debt. The Endowment Fund is not currently engaged in any long-term financing transactions. The operation and administration of the Endowment Fund is currently structured such that its annual financial obligations and expenses are satisfied through earnings and other fund additions.

Economic Outlook

The U.S. and the world experienced a significant downturn in their financial environments and economies beginning in mid-calendar year 2008. The recessionary situation was characterized by a contraction of credit, high unemployment, falling prices in housing, rising foreclosures, and deflated valuations for equities and other investment instruments. While the recession of the late 2000's ended and improvement in the unemployment rate and housing market occurred, uncertainty surrounding global events and the future tax and interest rate policy in the U.S. continue to create uncertainty for the global capital markets. Valuations for equities and other investment instruments are expected to continue experiencing volatility.

Any questions related to the MD&A or financial statements should be directed to University of Houston, Office of the Treasurer, P.O. Box 988, Houston, TX 77001-0988.

The Basic Financial Statements

University of Houston System
Endowment Fund
Statements of Net Position
August 31, 2016 and 2015

	2016	2015
Assets:		
Current assets:		
Cash and cash equivalents	\$ 17,154,287	\$ 29,305,640
Interest and dividends receivable	240,867	226,951
Receivables for investments sold	819,879	21,929,491
Total current assets	18,215,033	51,462,082
Noncurrent assets:		
Investments	584,657,040	543,223,711
Total noncurrent assets	584,657,040	543,223,711
Total assets	602,872,073	594,685,793
Liabilities:		
Current liabilities:		
Payable for investments purchased	881,947	1,011,301
Due to other components	28,091,202	28,364,607
Total current liabilities	28,973,149	29,375,908
Total liabilities	28,973,149	29,375,908
Net position:		
Restricted nonexpendable endowments	414,739,236	403,109,529
Restricted for expendable endowments	44,330,661	45,500,068
Unrestricted	114,829,027	116,700,288
Total net position	\$ 573,898,924	\$ 565,309,885

**UNIVERSITY OF HOUSTON SYSTEM
ENDOWMENT FUND**

**Statements of Revenues, Expenses and Changes in Net Position
Years Ended August 31, 2016 and 2015**

	<u>2016</u>	<u>2015</u>
Operating revenues	\$ -	\$ -
Operating expenses	<u>-</u>	<u>-</u>
Operating income	<u>-</u>	<u>-</u>
Nonoperating revenues (expenses):		
Interest and investment income	6,095,430	11,689,799
Net appreciation (depreciation) of investments (realized and unrealized)	8,773,731	(36,344,618)
Other nonoperating expenses	<u>(28,256,562)</u>	<u>(28,449,796)</u>
Total nonoperating expenses	(13,387,401)	(53,104,615)
Contributions to endowments	<u>21,976,440</u>	<u>18,341,666</u>
Change in net position	8,589,039	(34,762,949)
Net position, beginning of year	<u>565,309,885</u>	<u>600,072,834</u>
Net position, end of year	\$ <u><u>573,898,924</u></u>	\$ <u><u>565,309,885</u></u>

**UNIVERSITY OF HOUSTON SYSTEM
ENDOWMENT FUND**

**Statements of Cash Flows
Years Ended August 31, 2016 and 2015**

	2016	2015
Cash flows from operating activities	\$ -	\$ -
Net cash provided by operating activities	-	-
Cash flows from noncapital and related financing activities:		
Contributions to endowments	21,976,440	18,341,666
Increase (decrease) in due to other components	(273,405)	1,696,256
Net cash provided by noncapital and related financing activities	21,703,035	20,037,922
Cash flows from capital and related financing activities:	-	-
Net cash provided by capital and related financing activities	-	-
Cash flows from investing activities:		
Proceeds from sales and maturities of investments	88,473,250	285,918,886
Payments to purchase investments	(124,369,645)	(322,416,023)
Interest and dividends received on investments	6,081,349	11,858,139
Payments for asset management and stewardship	(4,039,342)	(3,845,267)
Net cash provided by (used in) investing activities	(33,854,388)	(28,484,265)
Decrease in cash and cash equivalents	(12,151,353)	(8,446,343)
Cash and cash equivalents, beginning of year	29,305,640	37,751,983
Cash and cash equivalents, end of year	\$ 17,154,287	\$ 29,305,640
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	\$ -	\$ -
Adjustments	-	-
Net cash provided by operating activities	\$ -	\$ -

UNIVERSITY OF HOUSTON SYSTEM ENDOWMENT FUND

Notes to Basic Financial Statements

August 31, 2016 and 2015

1) Reporting Entity

The University of Houston System (the System) is an agency of the State of Texas, established by the State of Texas to provide undergraduate and graduate university instruction, scholarly research and public service in the Houston, Texas area. The System is the State of Texas' only metropolitan higher education system, encompassing four universities and two multi-institution teaching centers. The University of Houston System Endowment Fund (the Endowment Fund) is a fund group of the System reporting entity, with the earliest endowment having been established in 1950. The accompanying financial statements present only the Endowment Fund of the System as of August 31, 2016 and 2015, the changes in its financial position, and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The Endowment Fund is a fund group that accounts for all of the System's endowment assets pooled together to ensure better management and uniform accountability for those assets. The Endowment Fund provides financial support for the System's students and the System's research endeavors. The Endowment Fund is presently comprised of approximately 1,670 restricted and unrestricted endowment funds located in the System's four universities and multi-institution teaching centers. Restricted endowment funds are funds with respect to which a donor or other outside entity has stipulated that the principal be maintained inviolate and in perpetuity, and that only the income from the investments is available for expenditure. Unrestricted endowment funds consist of funds for which the donor did not impose any restriction as to their use, as well as funds that are designated by the System's Board of Regents, rather than the donor, to function as endowment funds. The principal of these funds may be expended at the discretion of the System's Board of Regents.

2) Summary of Significant Accounting Policies

(a) General

All financial accounting records of the Endowment Fund are maintained by the System's Office of the Associate Vice Chancellor for Finance in accordance with accounting principles generally accepted in the United States of America for colleges and universities.

(b) Basis of Accounting and Presentation

The Endowment Fund is reported as a single-purpose business-type activity entity. The financial statements of the Endowment Fund have been prepared using the economic resources measurement focus and accrual basis of accounting whereby all revenues are recorded when earned and all expenses are recorded when they are incurred.

UNIVERSITY OF HOUSTON SYSTEM ENDOWMENT FUND

Notes to Basic Financial Statements

August 31, 2016 and 2015

(c) *Cash and Cash Equivalents*

The Endowment Fund believes the carrying value of cash and temporary investments approximates fair value. The Endowment Fund considers investments purchased with a maturity of three months or less from the statement of net position date to be cash equivalents.

(d) *Investments*

In accordance with GASB No. 72, *Fair Value Measurement and Application*, investments are recorded at fair value. Fair value is based on published closing market prices on the last trading day of the fiscal year. In the case of pooled funds or mutual funds, the fair value is determined as the number of units or shares held in the fund multiplied by the price per unit or share as publicly quoted. Investments in which a public market does not exist are based on the Endowment Fund's ownership interest in the net asset value (NAV) of each fund as reported by the fund managers. When fund managers do not provide the NAV of each fund at fiscal year-end, the fair value is estimated by the System using the most recent statement and adding contributions and subtracting the distributions during the intervening period. In accordance with GASB No. 52, *Land and Other Real Estate Held as Investments by Endowments*, land and other real estate held as investments are recorded at fair value. Chapter 163 of the Texas Property Code (also cited as the *Uniform Prudent Management of Institutional Funds Act*) grants the System the authority to spend net appreciation.

Because of inherent uncertainties of valuations, management's and fund managers' estimates of fair value may differ from the values that would have been used had a ready market existed.

Investments received as gifts are initially recorded at estimated fair value based on appraised values or broker closing prices for stocks at the date of the gift.

Short-term investments comprise U.S. Government obligations and corporate obligations with a maturity date of less than one year as of the statement of net position date.

(e) *Net Position*

The Endowment Fund's net position are classified as follows:

Restricted for nonexpendable endowments: Net position for restricted nonexpendable endowment funds are maintained permanently by the System following the externally imposed stipulations.

Restricted for expendable endowments: Net position for restricted expendable endowment funds are those that may be expended for either a stated purpose or for a general purpose subject to externally imposed stipulations.

UNIVERSITY OF HOUSTON SYSTEM ENDOWMENT FUND

Notes to Basic Financial Statements

August 31, 2016 and 2015

Unrestricted: Net position for unrestricted endowment funds are donated by third parties or created internally by the System and represent resources that are available to the System.

When both restricted and unrestricted resources are available for use, it is the Endowment Fund's policy to use restricted resources first, then unrestricted resources as they are needed.

(f) Revenue Recognition

Contributions to the Endowment Fund and transfers-in from other funds such as distribution payouts returned by beneficiaries for reinvestment are recognized as additions to the Endowment Fund's assets. Dividend income is recorded as income on the date the stock traded ex-dividend. Interest is recognized on fixed-income investments on the accrual basis.

The net change in fair value of investments represents both realized and unrealized gains and losses on investments. The calculation of realized gains and losses is independent of the calculation of the net change in the fair value of investments. Realized gain or loss is computed as the difference between the cost of marketable securities sold and the sale price. The cost of marketable securities sold is determined on specific identification of investments sold. Realized gain is recorded as of the trade date regardless of when the transaction is settled. Unrealized gains or losses are calculated based on the changes in investment fair value between the beginning and end of the fiscal year for investments held since the beginning of the year, or as the difference between the fair value at end of year and the purchase cost for investments purchased during the year. Unrealized gains (losses) are determined and recorded as of the fiscal year-end.

The Endowment Fund does not currently earn or incur operating revenues and expenses.

(g) Distribution Payout

Effective September 1, 1995, the System's Board of Regents adopted an endowment payout policy whereby the payout rate is based on a percentage of the fiscal year-end net position averaged over rolling three-year periods. For the fiscal years 2016 and 2015, the payout rate was 4 percent applied to the endowments' average net position balances for the preceding three fiscal years, respectively. If an endowment was in existence less than three years, the average was based on the number of years the endowment was in existence. Effective May 1, 2009, no endowment receives a pro rata income distribution from current fiscal year contributions. If an endowment were in existence less than three years, the average is based on the number of years in existence. The payout is calculated and recorded at the end of each fiscal year. Actual endowment return earned in excess of distributions is reinvested. For years actual endowment return is less than the distribution payout, the shortfall is covered by realized returns from prior years.

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(h) *Institutional Advancement Assessment*

The System's Board of Regents has adopted a policy whereby an assessment is made against the earnings of various endowment funds to offset expenses associated with gift acquisition and fundraising at the System's component universities and multi-institution teaching centers. The policy allows for 1.5 percent to be assessed on the average of the preceding three years' net position balances of all endowments except those exempt on the basis of donor imposed restrictions or recommended by University Advancement, a division of the System which is responsible for fundraising, internal and external communications, and marketing. The assessment is made at the end of each fiscal year to make funds available for the System's institutional advancement activities in the following fiscal year. The total amount assessed for the years ended August 31, 2016 and 2015, was \$6,706,439 and \$6,645,830, respectively.

(i) *Estimates*

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

3) Authorized Investments

The System's Board of Regents is charged with the fiduciary responsibility for preserving and augmenting the value of the Endowment Fund. The System retains the services of a custodial financial institution under a master trust custodian agreement, as well as the services of independent investment managers each of whom plays a part in meeting the System's goals over a variety of capital market cycles. The System's Board of Regents has adopted a written investment policy, including investment manager guidelines for each of the separately invested accounts of the Endowment Fund, regarding the investment of endowment assets as defined in the System's Investment Policies. The primary long-term financial objective for the Endowment Fund is to preserve the real (inflation adjusted) purchasing power of endowment assets when measured over rolling periods of at least five years. The medium term objective is to outperform each of the capital markets in which the endowment assets are invested, measured over rolling periods of three to five years or complete market cycles, with emphasis on whichever measure is longer.

4) Derivatives

Derivatives are investment products that may be a security or contract that derives its value from another security, currency, commodity or index, regardless of the source of funds used. The Endowment Fund did not directly invest in derivatives during the years ended August 31, 2016 or 2015, and held no direct derivative instruments at August 31, 2016 or August 31, 2015.

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5) Cash and Investments

(a) Composition of Cash and Cash Equivalents

Cash and cash equivalents consist of money market funds and securities maturing within three months totaling \$17,154,287 and \$29,305,640 at August 31, 2016 and 2015, respectively. The money market funds are invested in commercial paper, certificates of deposit, repurchase agreements, corporate notes, time deposits, and similar short term investments considered generally acceptable and prudent for money market funds.

Cash and cash equivalents included in the statements of net position consist of the items reported below:

	2016	2015
Cash	\$ 823,771	\$ 367,456
Money market funds	16,330,516	28,938,184
Total cash and cash equivalents	\$ 17,154,287	\$ 29,305,640

(b) Reconciliation of Cash and Investments to Statements of Net Position

Total cash and investments at August 31, 2016 and 2015, are as follows:

Type of Security	Market Value August 31, 2016	Market Value August 31, 2015
Cash	\$ 832,771	\$ 367,456
Money market funds	16,321,516	28,938,184
Global fixed income	18,948,370	24,872,577
U.S. Government obligations	23,786,613	20,435,753
U.S. fixed income (non-government/agency)	-	708,983
U.S. equities	102,583,613	95,427,208
Global equities ex – U.S.	168,907,851	158,253,915
Hedged equity funds	95,105,993	80,715,117
Inflation hedge funds (including REITs)	27,579,537	25,361,439
Absolute return funds	68,135,734	75,819,081
Private equity partnerships	79,498,580	61,531,346
Real estate	110,749	98,292
Total investments	601,811,327	572,529,351
Less: Cash and cash equivalents	(17,154,287)	(29,305,640)
Total Non-current investments	\$ 584,657,040	\$ 543,223,711

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(c) Investment Maturities

As of August 31, 2016 and 2015, the Endowment Fund had the following investments and weighted average maturities:

Investment Type	2016		2015	
	Fair Value	Weighted-average maturity (Years)	Fair Value	Weighted-average maturity (Years)
U.S. Government obligations ⁽¹⁾	\$ 23,786,613	25.3	\$ 20,435,753	25.1
U.S. fixed income (non-government/agency) ⁽¹⁾	-	0.0	708,983	5.2
Equity, mutual funds, other investments	<u>578,024,714</u>	Untenured	<u>551,384,615</u>	Untenured
Total investments at fair value	<u>\$ 601,811,327</u>		<u>\$ 572,529,351</u>	
Weighted average maturity of tenured portfolio		25.3		24.4

(1) Includes tenured securities classified as cash equivalents and short term investments.

(d) Asset Selection and Allocation

The Endowment Fund's Statement of Investment Objectives and Policies governs the overall allocation of endowment funds to asset classes and considerations of limits to investment risk exposures. Allocation of funds to asset classes is based on expected returns, risk levels, desired risk diversification, interaction of various asset classes, and income generation and capital appreciation potentials of each asset class. The market value of investments in each asset class is maintained within an approved range of ratios to the market value of the Endowment Fund's total investments, except for minor deviations due to fluctuations in market value. The Endowment Management Committee monitors asset allocation targets and limits and may authorize the reallocation of funds among investment managers. The Endowment Fund currently invests in a broad array of asset classes in order to diversify the portfolio's risk. Marketable securities, such as domestic or international common stocks, domestic bonds, equity money market funds, and cash equivalents comprise 35 percent and 36 percent of the overall investment portfolio (portfolio) at the end of fiscal year 2016 and 2015, respectively. Marketable alternative investments (*i.e.*, inflation hedge funds, commingled funds invested in marketable securities, absolute return and hedged equity

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funds) represent 52 percent and 53 percent of the portfolio, and non-marketable alternative investments (*i.e.*, venture capital, private equity, real estate, natural resources, energy) constitute 13 percent and 11 percent of the portfolio on a funded basis at the end of the fiscal years ending 2016 and 2015, respectively. The Endowment Fund's overall investment risk is diversified by asset class and within each class by strategy, economic sector, geography, industry, market capitalization, manager and with regard to non-marketable alternatives, by vintage year as well. Such diversification is aimed at managing the risks specifically associated with any single strategy, economic sector, geographic area, industry, vintage year or manager.

(e) *Investment Related Risks*

Custodial Credit Risk – Custodial credit risk for deposits is the risk that, in the event of failure of a depository financial institution, the Endowment Fund will not be able to recover its deposits. Custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, the Endowment Fund will not be able to recover the value of its investment or collateral securities that may be in the possession of another party. Securities owned by the endowment but held in custody by the endowment custodian may be lent to other parties through a contract between the System and the custodian pursuant to a written agreement approved by the Board of Regents. As of August 31, 2016 and 2015, the System did not have a securities lending agreement with its custodian. Managers may not enter into securities lending agreements without the consent of the Board of Regents. The System recognizes, however, that, for those investments placed in commingled vehicles, the Board cannot dictate whether or not the manager will engage in securities lending. Therefore, the System and its investment consultant make every effort either to avoid commingled investments, or to otherwise limit investment to those managers who will not engage in securities lending. The limited partnerships of marketable and non-marketable alternative investments are excluded from this limitation. At August 31, 2016 and 2015, the Endowment Fund's total investments at fair value under a master trust custodian agreement with a third party financial institution was \$64,780,988 and \$59,492,856, respectively. The third-party custodian operates its business world-wide and, at August 31, 2016 and 2015, held risk insurance contracts with various local and foreign insurance organizations providing coverage for loss due to theft, fraud, and damage to securities while in the custodian's custody; loss of securities while in transit; property damage; and, loss due to business interruption, acts of terrorism, officer negligence, and general liability. The insurance coverage limits ranged from \$1,000,000 to \$500,000,000. The coverage did not protect against market risks and fluctuations associated with market investments.

At August 31, 2016 and 2015, the Endowment Fund's investments at fair value not covered by the master trust custodian agreement were \$537,030,339 and \$513,036,495, respectively. These investments, excluding real estate valued at \$110,749 and \$98,292 at August 31, 2016 and 2015, respectively, were under various custodian agreements between the investment managers and the investment funds or limited partnerships in which the Endowment Fund is

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invested. The investments are subject to custodial risks associated with those independent investment managers, and to market risks and fluctuations associated with market investments. The System controls these risks through its credit and concentration risk policies as described in the credit risk and concentration of credit risk paragraph below.

Interest Rate Risk – Interest rate risk is the risk that changes in market interest rates will adversely affect the value of an investment. Generally, the longer the maturity of an investment, the greater the sensitivity of its value to changes in market interest rates. The System's investment policy, by way of the investment manager guidelines, requires the weighted average duration of the portfolio should remain in a range of a minimum of 90 percent and a maximum of 110 percent of the Barclays Aggregate Bond Index for active fixed income managers in which a separate account structure exists. The System's investment policy is driven primarily by the goal to preserve the long-term real (inflation adjusted) purchasing power of endowment assets while achieving short term maximum earnings with an acceptable level of risk. In order to balance these two primary goals, the Board of Regents is closely involved in managing the exposure to declines in investment fair value and earnings.

Credit Risk and Concentration of Credit Risk – Credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. This is measured by the assignment of a rating by a nationally recognized statistical rating organization (NRSRO). Per GASB Statement No. 40 (GASB 40), *Deposit and Investment Risk Disclosures, and amendment to GASB Statement No.3*, unless there is information to the contrary, obligations of the U.S. Government or obligations explicitly guaranteed by the U.S. Government are not considered to have credit risk and do not require disclosure of credit quality. In accordance with the System's investment policy and manager guidelines, where applicable, investments in securities within the fixed income allocation of the portfolio must be investment grade and have an average portfolio credit quality of "AA" or better. Securities should be readily marketable and liquid. The use of options, futures, and other derivatives (excepting mortgage-backed securities) is prohibited within the domestic fixed income allocation, wherein there is a separate account vehicle, without prior approval by the Endowment Management Committee. The use of leverage is prohibited. The investment manager guidelines, where applicable, limit the amount each active manager may invest in any one issuer. Other than U.S. Government securities (including agency securities), no security may be purchased so that it will constitute more than 5 percent of the market value of the portfolio; however, obligations issued or guaranteed by the full faith and credit of the U.S. Government may be held without limitation. The System's endowment funds also include an allocation to alternative investments, which by their nature, include higher levels of risk, including credit and concentration of credit risk, with the expectation of higher returns relative to traditional equities and fixed income securities. The investment policy does not specify limits as to credit quality or concentration for alternatives as these investments may include highly concentrated positions and may include investing in companies that are either privately held or in financial distress.

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The credit quality (ratings) of tenured securities and concentration of credit exposure as a percentage of total investments as of August 31, 2016, are as follows:

Issuer	Coupon Rate	Maturity Date	Fair Value	S&P Risk Rating	Concentration of Credit Exposure
U S Treasury Bond	6.50%	11/15/2026	\$ 117,321	AA+	0.02%
U S Treasury Bond	5.25%	11/15/2028	843,600	AA+	0.14%
U S Treasury Bond	5.25%	02/15/2029	979,916	AA+	0.16%
U S Treasury Bond	4.50%	05/15/2038	166,112	AA+	0.03%
U S Treasury Bond	4.25%	05/15/2039	683,663	AA+	0.11%
U S Treasury Bond	4.63%	02/15/2040	727,284	AA+	0.12%
U S Treasury Bond	4.38%	05/15/2040	1,124,020	AA+	0.19%
U S Treasury Bond	3.88%	08/15/2040	664,865	AA+	0.11%
U S Treasury Bond	4.38%	05/15/2041	1,123,563	AA+	0.19%
U S Treasury Bond	3.75%	08/15/2041	1,690,055	AA+	0.28%
U S Treasury Bond	3.00%	05/15/2042	691,967	AA+	0.11%
U S Treasury Bond	2.75%	08/15/2042	1,151,158	AA+	0.19%
U S Treasury Bond	2.75%	11/15/2042	694,287	AA+	0.12%
U S Treasury Bond	3.13%	02/15/2043	1,123,407	AA+	0.19%
U S Treasury Bond	2.88%	05/15/2043	1,158,975	AA+	0.19%
U S Treasury Bond	3.63%	08/15/2043	1,026,139	AA+	0.17%
U S Treasury Bond	3.75%	11/15/2043	916,354	AA+	0.15%
U S Treasury Bond	3.63%	02/15/2044	1,136,922	AA+	0.19%
U S Treasury Bond	3.13%	08/15/2044	1,089,957	AA+	0.18%
U S Treasury Bond	3.00%	11/15/2044	1,559,840	AA+	0.26%
U S Treasury Bond	2.50%	02/15/2045	2,413,166	AA+	0.40%
U S Treasury Bond	3.00%	05/15/2045	1,007,050	AA+	0.17%
U S Treasury Bond	3.00%	11/15/2045	1,223,617	AA+	0.20%
U S Treasury Bond	2.50%	02/15/2046	364,528	AA+	0.06%
U S Treasury Bond	2.00%	08/15/2025	108,847	AA+	0.02%

The credit quality (ratings) of tenured securities and concentration of credit exposure as a percentage of total investments as of August 31, 2015, are as follows.

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Issuer	Coupon Rate	Maturity Date	Fair Value	S&P Risk Rating	Concentration of Credit Exposure
Apple, Inc.	2.40%	05/03/2023	\$ 238,670	AA+	0.04%
United Continental Holdings Inc.	6.38%	06/01/2018	261,563	BB-	0.05%
United Continental Holdings Inc.	6.00%	12/01/2020	208,750	BB-	0.04%
U S Treasury Bond	6.50%	11/15/2026	439,654	AA+	0.08%
U S Treasury Bond	5.25%	11/15/2028	990,158	AA+	0.17%
U S Treasury Bond	5.25%	02/15/2029	693,861	AA+	0.12%
U S Treasury Bond	4.50%	02/15/2036	917,036	AA+	0.16%
U S Treasury Bond	4.50%	05/15/2038	503,357	AA+	0.09%
U S Treasury Bond	4.25%	05/15/2039	1,100,568	AA+	0.19%
U S Treasury Bond	4.63%	02/15/2040	695,328	AA+	0.12%
U S Treasury Bond	4.38%	05/15/2040	1,001,459	AA+	0.17%
U S Treasury Bond	3.88%	08/15/2040	1,089,271	AA+	0.19%
U S Treasury Bond	4.38%	05/15/2041	1,000,702	AA+	0.17%
U S Treasury Bond	3.75%	08/15/2041	1,496,439	AA+	0.26%
U S Treasury Bond	3.00%	05/15/2042	602,973	AA+	0.11%
U S Treasury Bond	2.75%	08/15/2042	997,140	AA+	0.17%
U S Treasury Bond	2.75%	11/15/2042	601,294	AA+	0.11%
U S Treasury Bond	3.13%	02/15/2043	1,292,775	AA+	0.23%
U S Treasury Bond	2.88%	05/15/2043	1,004,996	AA+	0.18%
U S Treasury Bond	3.63%	08/15/2043	897,717	AA+	0.16%
U S Treasury Bond	3.75%	11/15/2043	801,966	AA+	0.14%
U S Treasury Bond	3.63%	02/15/2044	993,624	AA+	0.17%
U S Treasury Bond	3.13%	08/15/2044	946,567	AA+	0.17%
U S Treasury Bond	3.00%	11/15/2044	1,004,333	AA+	0.18%
U S Treasury Bond	2.50%	02/15/2045	1,364,535	AA+	0.24%

(f) Alternative Investments

Investments reported at fair value of approximately \$391,626,136 and \$364,613,746, as of August 31, 2016 and 2015, respectively, are not publicly traded, and have been estimated by management and fund managers in the absence of readily available market values. These funds are invested with external investment managers, generally in commingled funds, limited liability partnerships or corporations in which the System has an interest, who invest, for example, in hedge funds, real estate, natural resources, private equity, managed futures, and distressed opportunities. These investments are domestic and international in nature and

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some of the investments may not be realized for a period of several years after the investments are made. Risks associated with these investments include liquidity risk, market risk, event risk, foreign exchange risk, interest rate risk and investment manager risk. More specifically, the risks include the following:

Non-regulation risk – Historically, these funds were not required to register with the Securities and Exchange Commission (SEC) and therefore were not subject to regulatory control. With the passage of the Dodd-Frank Act of 2010, almost all alternative investment managers are required to register with the SEC under the Investment Advisers Act of 1940. As of August 31, 2016, the Endowment Fund has no specific policy statement with respect to non-regulation risk. The policy does contain limitations on the percent that can be allocated to alternative investments.

Managerial risk – Fund managers for non-publicly traded investments may fail to produce the intended returns and are not subject to oversight. However, the fund managers are subject to oversight by the Endowment Fund. The Endowment Fund has no specific policy statement with respect to managerial risk for alternative investments. However, the Endowment Fund diversifies across managers to mitigate systematic and organizational risk without creating over-diversification. The Endowment Fund further attempts to mitigate managerial risk by emphasizing the qualitative evolution of managers, discouraging the use of significant leverage, emphasizing managers with a demonstrated skill in generating returns.

Liquidity risk – Many of the Endowment Fund's investment funds impose restrictions on redemptions or require multi-year lock-up periods that restrict investors from redeeming their shares or may impose penalties to redeem. The Endowment Fund has no specific policy statement with respect to liquidity risk. The policy does contain limitations on the percent that can be allocated to alternative investments and liquidity is measured.

Limited transparency – Any unregistered investment vehicles are not required to disclose the holdings in their portfolios to investors. This risk is mitigated somewhat by the Dodd-Frank Act of 2010 and the increased transparency provided by the requirement to file Form ADV with the SEC. The Endowment Fund has no specific policy statement with respect to transparency risk.

Investment strategy risk – Alternative investments often employ sophisticated and more risky investment strategies, as compared to traditional investments, and one or more may use leverage, which could result in volatile returns. To mitigate this risk, emphasis is placed on those managers who have extensive experience in employing these strategies, a demonstrated ability to consistently employ them effectively, and an established track record of superior performance. The Endowment Fund has no specific policy statement with respect to investment strategy risk. The policy does contain limitations on the percent that can be allocated to alternative investments.

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Foreign currency risk – Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of the Endowment Fund's non-U.S. dollar investments. Investment managers may hedge some, all or none of their foreign currency risk. The Endowment Fund has no specific policy statement with respect to foreign currency risk. The estimated foreign currency risk of the endowment, as measured by the un-hedged exposure of non-U.S. dollar investments, as of August 31, 2016 and 2015, is as follows:

	Fair Value ⁽¹⁾	
	2016	2015
Currency:		
Euro	\$ 210,522	\$ 216,812
Canadian dollar	53,929	70,191
Japanese yen	128,861	143,634
Pound Sterling	174,783	151,243
Swiss Franc	42,771	29,778
Total	\$ 610,866	\$ 611,658

(1) These figures represent the Endowment Fund's proportional value.

6) Fair Value Measurements

The Endowment Fund applies GASB guidance on fair value measurements and disclosures, which requires enhanced disclosure about the investments that are measured and reported at fair value and establishes a hierarchical disclosure framework that prioritizes and ranks the level of market price observability used in measuring investments at fair value. Market price observability is impacted by a number of factors, including the type of investment and the characteristics specific to the investment. Investments with readily available active quoted prices or for which fair value can be measured for actively quoted prices generally will have a high degree of market price observability and a lesser degree of judgment used in measuring fair value.

All investments are measured and reported at fair value on a recurring basis and are classified and disclosed in one of the following categories:

Level I – Quoted prices are available in active markets for identical investments as of the reporting date.

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Level II – Pricing inputs are other than quoted prices in active markets, which are either directly or indirectly observable as of the reporting date, and fair value is determined through the use of models or other valuation methodologies.

Level III – Pricing inputs are unobservable for the investment and include situations where there is little, if any, market activity for the investment. The inputs into the determination of fair value require significant management judgment or estimation.

In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, the determination of which category within the fair value hierarchy is appropriate for any given instrument is based on the lowest level of input that is significant to the fair value measurement.

Investments held by the Endowment Fund for which market quotes are readily available are valued based on third-party pricing systems and reported at quoted prices as of the reporting date. Investments held for which market quotes are not readily available are reported based on appraised value. Investments with funds held and invested by external managers where the Endowment Fund holds a share of the external manager's fund are valued and reported at NAV and are not categorized according to fair market value.

Assets at fair value as of August 31, 2016 and 2015, were as follows:

Assets at Fair Value as of August 31, 2016

Investment Category	Level 1	Level 2	Level 3	Total
Equities	\$ 38,551,202	\$ -	\$ -	\$ 38,551,202
Externally managed domestic	30,251,044			30,251,044
Externally managed international	8,845,459	-	-	8,845,459
Fixed income – money market and bond mutual funds	17,151,291	-	-	17,151,291
International equities	72,540,463	-	-	72,540,463
Other comingled funds	18,948,370			18,948,370
Real estate	-	110,749	-	110,749
U.S. treasury securities	<u>23,786,613</u>	<u>-</u>	<u>-</u>	<u>23,786,613</u>
Total	<u>\$ 210,074,442</u>	<u>\$ 110,749</u>	<u>\$ 0</u>	<u>\$ 210,185,191</u>

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Assets at Fair Value as of August 31, 2015

Investment Category	Level 1	Level 2	Level 3	Total
Corporate obligations	\$ 708,983	\$ -	\$ -	\$ 708,983
Equities	35,912,176	-	-	35,912,176
Externally managed domestic	18,416,652	-	-	18,416,652
Externally managed international	8,050,918	-	-	8,050,918
Fixed income – money market and bond mutual funds	29,237,982	-	-	29,237,982
International equities	70,182,272	-	-	70,182,272
Other comingled funds	24,872,577	-	-	24,872,577
Real estate	-	98,292	-	98,292
U.S. treasury securities	<u>20,435,753</u>	<u>-</u>	<u>-</u>	<u>20,435,753</u>
Total	<u>\$ 207,817,313</u>	<u>\$ 98,292</u>	<u>\$ 0</u>	<u>\$ 207,915,605</u>

Investments measured at NAV as of August 31, 2016 and 2015, were as follows:

Investments Measured at NAV as of August 31, 2016

Investment Category	Fair Value	Unfunded Commitments	Redemption Frequency	Redemption Notice Period
Equities and equity funds	\$ 33,034,558	\$ -	As needed	30-60 days
Externally managed domestic	79,495,407	47,335,217	N/A	30–60 days
Externally managed international	223,606,293	56,868,031	N/A	30–60 days
Fixed income – money market and bond mutual funds	2,996	-	N/A	N/A
International equities	54,466,964	-	As needed	5 days
Other comingled funds	<u>1,019,918</u>	<u>-</u>	As needed	6 months
Total	<u>\$ 391,626,136</u>	<u>\$ 104,203,248</u>		

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Investments Measured at NAV as of August 31, 2015

Investment Category	Fair Value	Unfunded Commitments	Redemption Frequency	Redemption Notice Period
Equities and equity funds	\$ 29,572,219	\$ -	As needed	30-60 days
Externally managed domestic	76,166,029	24,880,158	N/A	30-60 days
Externally managed international	204,737,424	42,918,577	N/A	30-60 days
Fixed income – money market and bond mutual funds	67,658	-	N/A	N/A
International equities	53,063,005	-	As needed	5 days
Other comingled funds	<u>1,007,411</u>	<u>-</u>	As needed	6 months
Total	<u>\$ 364,613,746</u>	<u>\$ 67,798,735</u>		

(a) Equity Funds

This type includes investments in two funds that invest primarily in U.S. equities. Managers have the ability to shift investments within the range of stocks that comprise the Russell 1000 Index. The fair values of the investments in this type have been determined using the NAV per share of the investments. All investments in this category can be redeemed with 30 to 60 days' notice.

(b) Externally Managed Domestic

This type includes investments in 21 funds that invest in inflation hedges, oil and gas, real estate properties, renewable natural resources, commodities, public and private equities, and venture capital. Managers have the ability to invest in natural resources, venture capital, private equity, real estate, multi strategy funds and secondary market. Approximately 15 percent of this class is invested in natural resources, 5 percent in venture capital, 13 percent in real estate, 19 percent in private equity, 4 percent in distressed equity and 52 percent in multi strategy. The fair values of the investments in this type have been determined using the NAV per share of the investments. 26 percent of these investments may be redeemed within a 15-60 days' notice. 74 percent represent interests in limited partnerships whose terms are generally 10-12 years, redeeming these funds earlier than the terms of the LPA require approval by the general partner. 41 percent of the funds in this class have distributions that will be received as the underlying investments of the funds are sold. The remaining funds in this class do not distribute proceeds from the sale of investments.

UNIVERSITY OF HOUSTON SYSTEM ENDOWMENT FUND

Notes to Basic Financial Statements

August 31, 2016 and 2015

(c) Externally Managed International

This type includes investments in 34 funds that invest in inflation hedges, hedged investments, oil and gas, real estate properties, technology, public and private domestic and international equities, fixed income securities, alternative market equities, long and short equities, global secondaries, and global venture capital. The fair values of the investments in this type have been determined using the NAV per share of the investments. 73 percent of these investments may be redeemed within a 15-60 days' notice. 27 percent represent interests in limited partnerships whose terms are generally 10-12 years, redeeming these funds earlier than the terms of the LPA require approval by the general partner. The limited partnerships in this class have distributions that will be received as the underlying investments of the funds are sold. The remaining funds in this class do not distribute proceeds from the sale of investments.

(d) Fixed Income Money Market and Bond Mutual Funds

This type includes temporary investments in cash equivalents such as money market funds by managers whose NAV is classified in another category. The fair values of the investments in this type have been determined using the cash value of the temporary investment. These investments are not intended for redemption as they represent a short term transaction within a separate category.

(e) International Equities

This type includes investments in two funds that invest in international stocks. The NAV of the investments in this type have been determined using the cash value of the temporary investment. The investment in this category can be redeemed with five days' notice.

(f) Other Comingled Funds

This type includes investments in one fund that invests primarily in equities. This equity fund is managed by the University of Houston C.T. Bauer College of Business. Stocks are traded on a daily basis. The fair values of the investments in this type have been determined using the NAV per share of the investments. All investments in this category can be redeemed with a 6-month notice.

7) Due to Other Components

Due to other components at August 31, 2016 and 2015, consists of the following.

**UNIVERSITY OF HOUSTON SYSTEM
ENDOWMENT FUND**

Notes to Basic Financial Statements

August 31, 2016 and 2015

	2016	2015
Payable to System components under the income payout policy	\$ 21,384,763	\$ 21,718,777
Payable to System components for institutional advancement	6,706,439	6,645,830
Total due to other components	\$ 28,091,202	\$ 28,364,607

8) Related-party Transactions

In addition to the transfers-in described in the revenue recognition policy in note 2, and distributions to other components described in Note 7, the Endowment Fund received in-kind contributions from the System in the form of personnel costs, office facilities, equipment and supplies in the fiscal years ended August 31, 2016 and 2015. The total estimated value of these in-kind contributions received from the System was \$614,862 and \$529,499 for the fiscal years 2016 and 2015, respectively, and was included in contributions and other nonoperating expenses on the statements of revenues, expenses and changes in net position.

9) Administrative Costs

The Endowment Fund pays custodial fees and expenses to the financial institution which acts as the custodian of the portion of the Endowment Fund's assets managed under a master trust custodian agreement. The fees are based on the number of accounts, market value of the securities, and transaction activities in accordance with the master trust custodian agreement.

Additionally, the Endowment Fund incurs asset management fees from the independent investment managers of the Endowment Fund. The fees are generally assessed on a quarterly basis on a percentage of the market value of investments held by each investment manager.

The Endowment Fund incurs other expenses related to its operations primarily consisting of professional service fees and expenses. The total fees and expenses incurred by the Endowment Fund for the fiscal years ended August 31, 2016 and 2015, were \$4,039,342 and \$3,845,267, respectively, and was included in net appreciation (depreciation) of investments on the statements of revenues, expenses and changes in net position.

10) Income Taxes

The System, of which the Fund is a division, is a university established as an agency of the State of Texas prior to 1969, and is qualified as a governmental entity not generally subject to federal income tax by reason of being a state or political subdivision thereof, or an integral part of a state or political subdivision thereof or an entity whose income is excluded from gross income for federal income tax purposes under section 115 of the Internal Revenue Code of 1986 (IRC). However, as a state college or university, the System is subject to unrelated business income pursuant to IRC

UNIVERSITY OF HOUSTON SYSTEM ENDOWMENT FUND

Notes to Basic Financial Statements

August 31, 2016 and 2015

section 511(a)(2)(B). No material unrelated business income tax was incurred for the years ended August 31, 2016 and 2015. Accordingly, no provision for income taxes has been made in the accompanying financial statements.

11) Subsequent Event

In the months subsequent to the fiscal year year-end, the U.S. and world's financial markets, as measured by the global stock markets, have continued to be unpredictable. These and other economic events have had an effect on the value of investments held by the Endowment Fund. Interim valuation information is not available for all investments through the date of this report. However, for the Endowment Fund, investment appreciation subsequent to year-end and through October 31, 2016, was \$1,823,367 (unaudited). As of that date, the Endowment Fund's total net position was \$603,813,493 (unaudited).

Board of Regents
University of Houston System
Houston, Texas

As part of our audit of the financial statements of University of Houston System Endowment Fund (the Endowment Fund) as of and for the year ended August 31, 2016, we wish to communicate the following to you.

Auditor's Responsibility Under Auditing Standards Generally Accepted in the United States of America

An audit performed in accordance with auditing standards generally accepted in the United States of America is designed to obtain reasonable, rather than absolute, assurance about the financial statements. In performing auditing procedures, we establish scopes of audit tests in relation to the financial statements taken as a whole. Our engagement does not include a detailed audit of every transaction. Our engagement letter more specifically describes our responsibilities.

These standards require communication of significant matters related to the financial statement audit that are relevant to the responsibilities of those charged with governance in overseeing the financial reporting process. Such matters are communicated in the remainder of this letter or have previously been communicated during other phases of the audit. The standards do not require the auditor to design procedures for the purpose of identifying other matters to be communicated with those charged with governance.

An audit of the financial statements does not relieve management or those charged with governance of their responsibilities. Our engagement letter more specifically describes your responsibilities.

Qualitative Aspects of Significant Accounting Policies and Practices

Significant Accounting Policies

The Endowment Fund's significant accounting policies are described in Note 2 of the audited financial statements.

Alternative Accounting Treatments

No matters are reportable.

Management Judgments and Accounting Estimates

Accounting estimates are an integral part of financial statement preparation by management, based on its judgments. The following area involves significant estimates for which we are prepared to discuss management's estimation process and our procedures for testing the reasonableness of those estimates:

- Fair value of investments

Financial Statement Disclosures

No matters are reportable.

Audit Adjustments

No matters are reportable.

Auditor's Judgments About the Quality of the Endowment Fund's Accounting Principles

During the course of the audit, we made the following observation about the Endowment Fund's application of accounting principles:

- Adoption of Governmental Accounting Standards Board No. 72, *Fair Value Measurement and Application*

Other Information in Documents Containing Audited Financial Statements

No matters are reportable.

Disagreements with Management

No matters are reportable.

Difficulties Encountered in Performing the Audit

No matters are reportable.

Other Material Written Communication

Listed below is another material written communication between management and us related to the audit:

- Management representation letter (attached)

This letter is intended solely for the information and use of the Board of Regents, the Endowment Management Committee and management, and is not intended to be, and should not be, used by anyone other than these specified parties.

BKD, LLP

December 21, 2016



UNIVERSITY OF HOUSTON SYSTEM

Office of the Treasurer

December 21, 2016

BKD, LLP

Certified Public Accountants
2800 Post Oak Boulevard, Suite 3200
Houston, Texas 77056

We are providing this letter in connection with your audits of the financial statements of University of Houston System Endowment Fund (the Endowment) as of and for the years ended August 31, 2015 and 2014. We confirm that we are responsible for the fair presentation of the financial statements in conformity with accounting principles generally accepted in the United States of America. We are also responsible for adopting sound accounting policies, establishing and maintaining effective internal control over financial reporting, operations and compliance, and preventing and detecting fraud.

Certain representations in this letter are described as being limited to matters that are material. Items are considered material, regardless of size, if they involve an omission or misstatement of accounting information that, in light of surrounding circumstances, makes it probable that the judgment of a reasonable person relying on the information would be changed or influenced by the omission or misstatement.

We confirm, to the best of our knowledge and belief, the following:

1. We have fulfilled our responsibilities, as set out in the terms of our engagement letter dated August 31, 2016, for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America.
2. We acknowledge our responsibility for the design, implementation and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.
3. We acknowledge our responsibility for the design, implementation and maintenance of internal control to prevent and detect fraud.

4. We have provided you with:
 - (a) Access to all information of which we are aware that is relevant to the preparation and fair presentation of the financial statements such as records, documentation and other matters.
 - (b) Additional information that you have requested from us for the purpose of the audit.
 - (c) Unrestricted access to persons within the Endowment from whom you determined it necessary to obtain audit evidence.
 - (d) All minutes of meetings of the governing body held through the date of this letter.
 - (e) All significant contracts and grants.
5. All transactions have been recorded in the accounting records and are reflected in the financial statements.
6. We have informed you of all current risks of a material amount that are not adequately prevented or detected by the Endowment's procedures with respect to:
 - (a) Misappropriation of assets.
 - (b) Misrepresented or misstated assets, liabilities or net position.
7. We have no knowledge of any known or suspected:
 - (a) Fraudulent financial reporting or misappropriation of assets involving management or employees who have significant roles in internal control.
 - (b) Fraudulent financial reporting or misappropriation of assets involving others that could have a material effect on the financial statements.
8. We have no knowledge of any allegations of fraud or suspected fraud affecting the Endowment received in communications from employees, customers, regulators, suppliers or others.
9. We have disclosed to you the identity of the Endowment's related parties and all the related party relationships and transactions of which we are aware. Related party relationships and transactions have been appropriately accounted for and disclosed in accordance with accounting principles generally accepted in the United States of America. We understand that the term related party refers to an affiliate; management and members of their immediate families, component units; and any other party with which the Endowment may deal if the Endowment can significantly influence, or be influenced by, the management or operating policies of the other. The term affiliate refers to a party that directly or indirectly controls, or is controlled by, or is under common control with, the Endowment.

10. Except as reflected in the financial statements, there are no:
 - (a) Plans or intentions that may materially affect carrying values or classifications of assets and liabilities.
 - (b) Material transactions omitted or improperly recorded in the financial statements.
 - (c) Material gain/loss contingencies requiring accrual or disclosure, including those arising from environmental remediation obligations.
 - (d) Events occurring subsequent to the statement of net position date through the date of this letter requiring adjustment or disclosure in the financial statements.
 - (e) Agreements to purchase assets previously sold.
 - (f) Restrictions on cash balances or compensating balance agreements.
 - (g) Guarantees, whether written or oral, under which the Endowment is contingently liable.
11. We have disclosed to you all known instances of noncompliance or suspected noncompliance with laws and regulations whose effects should be considered when preparing financial statements.
12. We are not aware of any pending or threatened litigation or claims whose effects should be considered when preparing the financial statements. We have not sought or received attorney's services related to pending or threatened litigation or claims during or subsequent to the audit period. Also, we are not aware of any litigation or claims, pending or threatened, for which legal counsel should be sought.
13. Except as disclosed in the financial statements, the Endowment has:
 - (a) Satisfactory title to all recorded assets, and they are not subject to any liens, pledges or other encumbrances.
 - (b) Complied with all aspects of contractual and grant agreements, for which noncompliance would materially affect the financial statements.
14. The fair values of financial and nonfinancial assets and liabilities, if any, recognized in the financial statements or disclosed in the notes thereto are reasonable estimates based on the methods and assumptions used. The methods and significant assumptions used result in measurements of fair value appropriate for financial statement recognition and disclosure purposes and have been applied consistently from period to period, taking into account any changes in circumstances. The significant assumptions appropriately reflect market participant assumptions.
15. We have not been designated as a potentially responsible party (PRP or equivalent status) by the Environmental Protection Agency (EPA) or other cognizant regulatory agency with authority to enforce environmental laws and regulations.

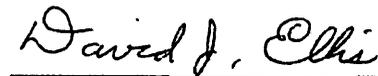
16. With regard to deposit and investment activities:
 - (a) All deposit, repurchase and reverse repurchase agreements and investment transactions have been made in accordance with legal and contractual requirement.
 - (b) Disclosures of deposit and investment balances and risks in the financial statements are consistent with our understanding of the applicable laws regarding enforceability of any pledges of collateral.
 - (c) We understand that your audit does not represent an opinion regarding the enforceability of any collateral pledges
17. The financial statements disclose all significant estimates and material concentrations known to us. Significant estimates are estimates at the statement of net position date which could change materially within the next year. Concentrations refer to volumes of business, revenues, available sources of supply, or markets for which events could occur which would significantly disrupt normal finances within the next year. Significant assumptions used by us in making accounting estimates, including those measured at fair value, are reasonable.
18. The supplementary information required by the Governmental Accounting Standards Board (GASB), consisting of management's discussion and analysis, has been prepared and is measured and presented in conformity with the applicable GASB pronouncements, and we acknowledge our responsibility for the information. The information contained therein is based on all facts, decisions and conditions currently known to us and is measured using the same methods and assumptions as were used in the preparation of the financial statements. We believe the significant assumptions underlying the measurement and/or presentation of the information are reasonable and appropriate. There has been no change from the preceding period in the methods of measurement and presentation.
19. With regard to supplementary information:
 - (a) We acknowledge our responsibility for the presentation of the supplementary information in accordance with the applicable criteria.
 - (b) We believe the supplementary information is fairly presented, both in form and content, in accordance with the applicable criteria.
 - (c) The methods of measurement and presentation of the supplementary information are unchanged from those used in the prior period.
 - (d) We believe the significant assumptions or interpretations underlying the measurement and/or presentation of the supplementary information are reasonable and appropriate.

- (e) If the supplementary information is not presented with the audited financial statements, we acknowledge we will make the audited financial statements readily available to intended users of the supplementary information no later than the date such information and the related auditor's report are issued.

University of Houston System Endowment Fund



Roberta Puryear,
Treasurer



David Ellis, Executive Director Financial
Reporting University of Houston