

**UNIVERSITY OF HOUSTON SYSTEM  
ENDOWMENT FUND**

Independent Auditor's Report and Basic Financial Statements  
August 31, 2015 and 2014



**UNIVERSITY OF HOUSTON SYSTEM**  
**ENDOWMENT FUND**  
August 31, 2015 and 2014

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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, 2015 and 2014, 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, 2015 and 2014, 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, 2015 and 2014, 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 16, 2015

**UNIVERSITY OF HOUSTON SYSTEM**  
**ENDOWMENT FUND**  
**Management's Discussion and Analysis – (Unaudited)**  
**August 31, 2015**

**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, 2015, as compared to fiscal year ended August 31, 2014, with summary comparisons for the year ended August 31, 2013. 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 2015, the Endowment Management Committee of the 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 1,610 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 57 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>2015</u>	<u>2014</u>	<u>2013</u>
<u>Developed U.S. Equity</u>			
State Street Global Advisors	<1%	7%	9%
Mayo Capital	2	3	3
Institutional Capital	<1	3	3
Northern Trust	5	0	0
Columbia Management	3	3	3
Vulcan Value Partners	3	0	0
Gotham	2	0	0
Cougar Investment Fund	< 1	< 1	< 1
Luther King Capital Management	2	2	2
Subtotal – developed U.S. equity	<u>17</u>	<u>18</u>	<u>20</u>
<u>Developed International Equity</u>			
William Blair	6	7	7
Silchester	9	10	9
Deutsche ETF	2	0	0
Subtotal – developed international equity	<u>17</u>	<u>17</u>	<u>16</u>
<u>Developing Markets</u>			
Aberdeen Emerging Markets Equity	0	0	4
Doddington Emerging Markets	3	4	0
Somerset	3	3	0
Northern Trust	0	3	0
JO Hambro	4	0	0
Subtotal – developing markets	<u>10</u>	<u>10</u>	<u>4</u>
<u>Absolute Return</u>			
Anchorage Capital Partners	2	1	1
HBK	2	2	2
Davidson Kempner	1	1	1
Covalent Capital	1	1	1
Whipporwill	<1	<1	<1
Mason Capital	<1	2	2
Senator Global Opportunity	2	2	2
AllBlue Limited	0	2	2
York Institutional Partners	2	2	2
OZ Overseas Fund II	0	2	2
Standard Life	3	0	0
ISAM	2	0	0
Subtotal – absolute return	<u>15</u>	<u>15</u>	<u>15</u>

	<b>2015</b>	<b>2014</b>	<b>2013</b>
<u>Hedged Equity</u>			
Highline Capital	2	1	1
Asian Century Quest	0	0	1
Three Bridges Europe	0	0	1
Maverick Fund	0	0	1
Partner Fund Management	2	2	2
Samlyn	0	<1	1
Scout Capital	0	0	2
Coatue	2	1	2
Sheffield Int'l Partners	2	2	0
SRS Partners	2	2	0
Proxima Capital	2	0	0
Marble Arch	2	0	0
Brahman	2	0	0
Subtotal – hedged equity	16	8	11
<u>Inflation Hedge</u>			
Morgan Stanley	1	1	1
Van Eck Global Hard Assets	1	2	0
Wellington DIH	2	3	5
Subtotal – inflation hedge	4	6	6
<u>Bonds</u>			
Smith Graham	3	6	6
Mondrian	0	4	4
Laddered U.S. Treasuries	0	2	3
Franklin Templeton	4	0	0
Subtotal – bonds	7	12	13
<u>Private Investments</u>			
HarbourVest Partners IV	0	0	<1
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	2
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
EnCap Flatrock Midstream II-C	<1	<1	<1
EnCap Flatrock Midstream III	<1	<1	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

	<b>2015</b>	<b>2014</b>	<b>2013</b>
TrueBridge-Kauffman Fellows III	<1	<1	0
Dover Street VIII	<1	<1	0
LiveOak Venture Partners I	<1	<1	0
Silver Lake Partners IV	<1	<1	0
Great Hill Equity Partners V	<1	<1	0
Fisher Lynch Buyout II	<1	<1	<1
Fisher Lynch Venture II	<1	<1	<1
Lexington Capital VIII	<1	0	0
Insight Equity III	<1	0	0
Francisco Partners IV-A	<1	0	0
EnCap Energy X	<1	0	0
Blackstone Real Estate Partners VIII	<1	0	0
Subtotal – private investments	10	9	9
Cash and equivalents	4	5	6
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 year ending August 31, 2015, 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 2013 through 2015, endowment payouts to the beneficiary accounts, excluding distributed income returned to principal, in total and by the System's components were as follows.

	<b>2015</b>	<b>2014</b>	<b>2013</b>
University of Houston	\$ 14,848,342	\$ 13,886,612	\$ 9,982,001
UH – Clear Lake	853,089	795,673	466,519
UH – Downtown	1,043,212	983,910	693,590
UH – Victoria	441,709	417,726	302,622
System-wide endowments	4,532,425	4,313,287	3,968,883
Total	<u>\$ 21,718,777</u>	<u>\$ 20,397,208</u>	<u>\$ 15,413,615</u>

### **Overview of the Financial Statements**

The financial statements for the fiscal year ended August 31, 2015, are presented comparatively to financial statements issued for the fiscal year ended August 31, 2014. 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 Statements of Net Position, (2) the Statements of Revenues, Expenses and Changes in Net Position, and (3) the Statements 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 Statements 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 reflects 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 represent net positions that can be utilized only in accordance with third-party imposed restrictions. On August 31, 2015, the fund's assets totaled \$594.7 million, and liabilities totaled \$29.4 million, resulting in a net position of \$565.3 million.

The net position of the Endowment Fund as contributed by the System's components as of August 31, 2015, compared to the corresponding values as of August 31, 2014, and August 31, 2013, were as follows.

	<b>2015</b>	<b>2014</b>	<b>2013</b>
University of Houston	\$ 394,387,835	\$ 413,459,004	\$ 369,183,195
UH – Clear Lake	21,545,489	23,343,082	21,115,044
UH – Downtown	26,758,557	29,052,014	26,447,307
UH – Victoria	11,078,961	12,177,864	11,096,713
System-wide endowments	111,539,043	122,040,870	111,708,734
Total	<u>\$ 565,309,885</u>	<u>\$ 600,072,834</u>	<u>\$ 539,550,993</u>

***Variance Analysis-Changes in the Statements of Net Position***

	<b>2015</b>	<b>2014</b>	<b>Change 2015-2014</b>	<b>2013</b>
Total assets	\$ 594,685,793	\$ 630,761,637	\$ (36,075,844)	\$ 563,564,590
Total liabilities	29,375,908	30,688,803	(1,312,895)	24,013,597
Restricted nonexpendable endowments	403,109,529	425,759,093	(22,649,564)	380,600,689
Restricted expendable endowments	45,500,068	47,529,727	(2,029,659)	43,721,595
Unrestricted endowments	116,700,288	126,784,014	(10,083,726)	115,228,709
Net position	<u>\$ 565,309,885</u>	<u>\$ 600,072,834</u>	<u>\$ (34,762,949)</u>	<u>\$ 539,550,993</u>

- **Total Assets:** The \$36.1 million decrease in fiscal year 2015 is attributable to a decrease in the fair value of investments resulting from the stock market decrease.
- **Total Liabilities:** The \$1.3 million decrease in liabilities is attributable to a \$1.7 million increase in the amount of income distributed to the components and an increase in the amount distributed for the institutional advancement assessment. Offsetting this increase was a decrease in the total amount of securities purchased and pending settlement at fiscal year-end 2015. A \$1 million payable was recorded at August 31, 2015, to recognize the future commitment to pay for pending securities purchases, compared to a \$4 million payable at August 31, 2014.
- **Restricted Nonexpendable Endowments:** The \$22.6 million decrease in restricted nonexpendable endowments is primarily attributable to a decrease in the fair value of the endowments resulting from a decrease in the stock market in fiscal year 2015.
- **Restricted Expendable Endowments:** The \$2 million decrease in restricted expendable endowments is primarily attributable to a decrease in the fair value of the endowments resulting from a decrease in the stock market if fiscal year 2015.
- **Unrestricted Endowments:** The \$10.1 million decrease in unrestricted endowments is primarily attributable to a decrease in the fair value of the endowments resulting from a decrease in the stock market in fiscal year 2015.

## Statements of Revenues, Expenses and Changes in Net Position

The Statements of Revenues, Expenses and Changes in Net Position contains 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 2015, the Endowment Fund received \$18.3 million of gifts and other receipts, interest and investment income of \$11.7 million, and a \$36.3 million net decrease in the fair value of investments. The Endowment Fund's total deductions for fiscal year 2015 were \$28.4 million, including \$21.7 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 a decrease in net position of \$34.8 million for fiscal year 2015.

### *Variance Analysis for Statements of Revenues, Expenses and Changes in Net Position*

	2015	2014	Change 2015-2014	2013
Contributions to endowments	\$ 18,341,666	\$ 12,246,769	\$ 6,094,897	\$ 11,869,085
Net appreciation (depreciation) of investments (realized and unrealized)	(36,344,618)	67,261,755	(103,606,373)	21,186,785
Other non-operating revenues (expenses)	(28,449,796)	(26,668,351)	(1,781,445)	(20,585,079)
Transfers-in (out)	-	-	-	76,572
Interest and investment income	11,689,799	7,681,668	4,008,131	7,581,413
(Decrease) increase in net position	<u>\$ (34,762,949)</u>	<u>\$ 60,521,841</u>	<u>\$ (98,885,603)</u>	<u>\$ 20,128,776</u>

- Contributions to endowments increased \$6.1M in 2015 as compared to 2014 due to some relatively larger gifts to the endowment.
- Changes in investment activities included a \$36.3 million net depreciation in the fair value of investments in fiscal year 2015 compared to \$67.3 million net appreciation in fiscal year 2014. This net change fiscal year-over-year is the result of the stock market decrease in fiscal year 2015. Interest and investment income increased by \$4 million as compared to 2014 as the endowment realized additional distributions from some of its investments, particularly its alternative investments. Fund deductions increased \$1.8 million from 2015 to 2014 due to an increased amount for payout and annual advancement assessment resulting from an appreciation in the moving three-year average market value of endowments. The Endowment Fund continued the prohibition against the distribution of income or assessment of the institutional advancement fee on any endowment that has a net loss from inception to date. 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 \$0.8 million less in fiscal year 2015 compared to fiscal year 2014. 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 explains the change 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, Texas 77001-0988.

# **The Basic Financial Statements**

**UNIVERSITY OF HOUSTON SYSTEM**  
**ENDOWMENT FUND**  
Statements of Net Position  
August 31, 2015 and 2014

	<b>2015</b>	<b>2014</b>
<b>Assets:</b>		
Current assets:		
Cash and cash equivalents	\$ 29,305,640	\$ 37,751,983
Interest and dividends receivable	226,951	395,126
Receivables for investments sold	21,929,491	759,364
Other receivables	-	135
Short-term investments	-	7,277,240
Total current assets	51,462,082	46,183,848
Noncurrent assets:		
Investments	543,223,711	584,577,789
Total noncurrent assets	543,223,711	584,577,789
Total assets	\$ 594,685,793	\$ 630,761,637
<b>Liabilities:</b>		
Current liabilities:		
Payable for investments purchased	\$ 1,011,301	\$ 4,020,452
Due to other components	28,364,607	26,668,351
Total current liabilities	29,375,908	30,688,803
Total liabilities	29,375,908	30,688,803
<b>Net position:</b>		
Restricted nonexpendable endowments	403,109,529	425,759,093
Restricted for expendable endowments	45,500,068	47,529,727
Unrestricted	116,700,288	126,784,014
Total net position	\$ 565,309,885	\$ 600,072,834

**UNIVERSITY OF HOUSTON SYSTEM**  
**ENDOWMENT FUND**  
 Statements of Revenues, Expenses and Changes in Net Position  
 Years Ended August 31, 2015 and 2014

	<u>2015</u>	<u>2014</u>
Operating revenues	\$ -	\$ -
Operating expenses	<u>-</u>	<u>-</u>
Operating income (loss)	<u>-</u>	<u>-</u>
Nonoperating revenues (expenses):		
Interest and investment income	11,689,799	7,681,668
Net appreciation (depreciation) of investments (realized and unrealized)	(36,344,618)	67,261,755
Other nonoperating revenues (expenses)	<u>(28,449,796)</u>	<u>(26,668,351)</u>
Total nonoperating revenues (expenses)	(53,104,615)	48,275,072
Contributions to endowments	<u>18,341,666</u>	<u>12,246,769</u>
Change in net position	(34,762,949)	60,521,841
Net position, beginning of year	<u>600,072,834</u>	<u>539,550,993</u>
Net position, end of year	\$ <u><u>565,309,885</u></u>	\$ <u><u>600,072,834</u></u>

**UNIVERSITY OF HOUSTON SYSTEM**  
**ENDOWMENT FUND**  
Statements of Cash Flows  
Years Ended August 31, 2015 and 2014

	<b>2015</b>	<b>2014</b>
Cash flows from operating activity	\$ -	\$ -
Net cash provided by operating activity	-	-
Cash flows from noncapital and related financing activities:		
Contributions to endowments	18,341,666	12,246,769
Increase in due to other components	1,696,256	6,159,844
Net cash provided by noncapital and related financing activities	20,037,922	18,406,613
Cash flows from capital and related financing activity	-	-
Net cash provided by capital and related financing activity	-	-
Cash flows from investing activities:		
Proceeds from sales and maturities of investments	285,918,886	218,115,588
Payments to purchase investments	(322,416,023)	(238,538,675)
Interest and dividends received on investments	11,858,139	7,688,474
Payments for asset management and stewardship	(3,845,267)	(4,678,742)
Net cash used in investing activities	(28,484,265)	(17,413,355)
Increase in cash and cash equivalents	(8,446,343)	993,258
Cash and cash equivalents – beginning of year	37,751,983	36,758,725
Cash and cash equivalents – end of year	\$ 29,305,640	\$ 37,751,983
Reconciliation of operating income (loss) to net cash provided by operating activities:		
Operating income (loss)	\$ -	\$ -
Adjustments	-	-
Net cash provided by operating activities	\$ -	\$ -

**UNIVERSITY OF HOUSTON SYSTEM  
ENDOWMENT FUND**

Notes to Basic Financial Statements

August 31, 2015 and 2014

**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, 2015 and 2014, 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 1,610 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 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, 2015 and 2014

**(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. 31, *Accounting and Financial Reporting for Certain Investments and External Investment Pools*, 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 held in the fund multiplied by the price per unit 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 of each fund as reported by the fund managers. When fund managers do not provide the net asset value 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 is 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.

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*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.

*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 appreciation (depreciation) 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 2015 and 2014, 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

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years, the average is based on the number of years in existence. The Endowment Fund did not make a payout from any endowment that had a net loss from inception to date. 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.

**(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 asset 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 Endowment Fund did not assess this fee in fiscal year 2015 or 2014 against any endowment that had a net loss from inception to date as of the net position date. 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, 2015 and 2014, was \$6,645,830 and \$6,271,143, 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

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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 and held no direct derivative instruments at August 31, 2015 or August 31, 2014.

**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 \$29,305,640 and \$37,751,983 at August 31, 2015 and 2014, 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:

	<b>2015</b>	<b>2014</b>
Cash	\$ 367,456	\$ -
Money market premier shares	28,938,184	7,291,021
Prime short-term investment funds	-	30,460,962
	<b>\$ 29,305,640</b>	<b>\$ 37,751,983</b>

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

Total cash and investments at August 31, 2015 and 2014, are as follows.

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Type of Security	Fair Value August 31, 2015	Fair Value August 31, 2014
Cash	\$ 367,456	\$ -
Money market premier shares	28,938,184	7,291,021
Aim Stit-Stic Prime Portfolio	-	30,460,962
Global fixed income	24,872,577	25,471,892
U.S. government obligations	20,435,753	28,218,059
U.S. government agencies	-	8,984,401
U.S. fixed income (non-government/agency)	708,983	14,238,502
U.S. equities	95,427,208	109,502,910
Global equities ex – U.S.	158,253,915	169,529,508
Hedged equity investments	80,715,117	50,420,555
Inflation hedge investments (including REITs)	25,361,439	38,180,550
Absolute return investments	75,819,081	96,642,661
Private equity partnerships	61,531,346	50,567,699
Real estate	98,292	98,292
Total investments	572,529,351	629,607,012
Less: Cash equivalents	(29,305,640)	(37,751,983)
Short-term investments	-	(7,277,240)
Total Noncurrent investments	\$ 543,223,711	\$ 584,577,789

(c) **Investment Maturities**

As of August 31, 2015 and 2014, the Endowment Fund had the following investments and weighted average maturities:

Investment Type	2015		2014	
	Fair Value	Weighted Average Maturity (Years)	Fair Value	Weighted Average Maturity (Years)
U.S. government obligations <sup>(1)</sup>	\$ 20,435,753	25.1	\$ 28,218,059	4.3
U.S. government agencies <sup>(1)</sup>	-	-	8,984,401	21.5
U.S. fixed income (non-government/agency) <sup>(1)</sup>	708,983	5.2	14,238,502	14.8
Equity, mutual funds, other investments	<u>551,384,615</u>	<u>Untenured</u>	<u>578,166,050</u>	<u>Untenured</u>
Total investments at fair value	<u>\$ 572,529,351</u>		<u>\$ 629,607,012</u>	
Weighted average maturity of tenured portfolio		24.4		10.2

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

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(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 39 percent and 41 percent of the overall investment portfolio (portfolio) at the end of fiscal year 2015 and 2014, respectively. Marketable alternative investments (*i.e.*, inflation hedges, commingled funds invested in marketable securities, absolute return and hedged equity) represent 50 percent and 51 percent of the portfolio, and non-marketable alternative investments (*i.e.*, venture capital, private equity, real estate, natural resources, energy) constitute 11 percent and 8 percent of the portfolio on a funded basis at the end of the fiscal years ending 2015 and 2014, 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, 2015 and 2014, 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 of Regents 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

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alternative investments are excluded from this limitation. At August 31, 2015 and 2014, the Endowment Fund's total investments at fair value under a master trust custodian agreement with a third-party financial institution was \$59,492,856 and \$167,254,850, respectively. The third-party custodian operates its business world-wide and, at August 31, 2015 and 2014, 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, 2015 and 2014, the Endowment Fund's investments at fair value not covered by the master trust custodian agreement were \$513,036,495 and \$462,352,162, respectively. These investments, excluding real estate valued at \$98,292 at August 31, 2015 and 2014, were under various custodian agreements between the investment managers and the investment funds or limited partnerships in which the Endowment Fund is 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

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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.

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:

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 In	6.38%	06/01/2018	261,563	BB-	0.05%
United Continental Holdings In	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	946,568	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%

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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, 2014, are as follows:

Issuer	Coupon Rate	Maturity Date	Fair Value	S&P Risk Rating	Concentration of Credit Exposure
21St Century Fox America Inc	5.40%	10/01/2043	\$ 380,365	BBB+	0.06%
Actavis Funding Scs 144A	4.85%	06/15/2044	406,384	BBB-	0.06%
Ameriprise Financial Inc	4.00%	10/15/2023	392,182	A	0.06%
Aon Corp	3.50%	09/30/2015	340,223	A-	0.05%
Apple Inc	2.40%	05/03/2023	239,833	AA+	0.04%
Apple Inc	2.10%	05/06/2019	392,367	AA+	0.06%
Banc Of America Commercia 5 A4	5.41%	09/10/2047	277,025	AAA	0.04%
Bank Of America Auto Trust 1 D	2.99%	03/15/2019	432,739	AA-	0.07%
Bank Of America Na	5.30%	03/15/2017	321,742	A-	0.05%
Bear Stearns Commercia Pw 12 A4	5.89%	09/11/2038	212,302	AAA	0.03%
Bear Stearns Commercia Pw 13 A4	5.54%	09/11/2041	225,509	AAA	0.04%
Bear Stearns Commercia Pw 14 A4	5.20%	12/11/2038	344,522	AAA	0.05%
Bear Stearns Commercial T22 Aj	5.76%	04/12/2038	232,329	AAA	0.04%
Bear Stearns Commercial T28 A4	5.74%	09/11/2042	548,579	AAA	0.09%
Bmw Vehicle Owner Trust 2 A A3	0.76%	08/25/2015	134	NA	0.00%
Celgene Corp	2.25%	05/15/2019	340,248	BBB+	0.05%
Cna Financial Corp	5.75%	08/15/2021	385,384	BBB	0.06%
Commit To Pur FNMA Sf Mtg	3.00%	09/01/2029	321,399	AA+	0.05%
Commit To Pur FNMA Sf Mtg	3.50%	09/01/2029	306,402	AA+	0.05%
Commit To Pur FNMA Sf Mtg	3.50%	09/01/2042	1,225,295	AA+	0.19%
Commit To Pur FNMA Sf Mtg	4.00%	09/01/2042	747,187	AA+	0.12%
Commit To Pur GNMA Sf Mtg	3.50%	09/15/2044	364,056	AA+	0.06%
Constellation Energy Group Inc	5.15%	12/01/2020	347,606	BBB-	0.06%
Dow Chemical Co/The	4.13%	11/15/2021	267,763	BBB	0.04%
Duke Energy Corp	3.55%	09/15/2021	78,984	BBB	0.01%
Federal Home Ln Mtg Corp	5.13%	11/17/2017	112,532	AA+	0.02%
Federal Home Ln Mtg Corp Disc	0.00%	04/22/2015	649,224	AA+	0.10%
Federal Natl Mtg Assn	7.25%	05/15/2030	392,730	AA+	0.06%
Fedex Corp	3.88%	08/01/2042	389,287	BBB	0.06%
FHLMC Pool #A9-7047	4.50%	02/01/2041	133,749	AA+	0.02%
FHLMC Pool #C0-3490	4.50%	08/01/2040	81,068	AA+	0.01%
FHLMC Pool #G0-4715	6.00%	06/01/2038	124,527	AA+	0.02%
FHLMC Pool #G1-1630	3.50%	06/01/2019	39,705	AA+	0.01%
FHLMC Pool #G1-8024	4.00%	09/01/2019	67,499	AA+	0.01%
Fiserv Inc	3.50%	10/01/2022	365,314	BBB	0.06%

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FNMA Pool #0190367	5.50%	01/01/2036	57,636	AA+	0.01%
FNMA Pool #0254801	6.00%	07/01/2023	24,545	AA+	0.00%
FNMA Pool #0254972	6.00%	10/01/2023	12,271	AA+	0.00%
FNMA Pool #0255319	5.00%	08/01/2019	46,170	AA+	0.01%
FNMA Pool #0729175	2.35%	06/01/2034	44,642	AA+	0.01%
FNMA Pool #0735500	5.50%	05/01/2035	68,333	AA+	0.01%
FNMA Pool #0735667	5.00%	07/01/2035	44,811	AA+	0.01%
FNMA Pool #0735676	5.00%	07/01/2035	102,115	AA+	0.02%
FNMA Pool #0735893	5.00%	10/01/2035	253,460	AA+	0.04%
FNMA Pool #0735925	5.00%	10/01/2035	62,112	AA+	0.01%
FNMA Pool #0745275	5.00%	02/01/2036	379,114	AA+	0.06%
FNMA Pool #0745516	5.50%	05/01/2036	89,402	AA+	0.01%
FNMA Pool #0809800	5.50%	03/01/2035	100,408	AA+	0.02%
FNMA Pool #0888219	5.50%	03/01/2037	162,772	AA+	0.03%
FNMA Pool #0888637	6.00%	09/01/2037	251,226	AA+	0.04%
FNMA Pool #0889506	6.00%	03/01/2037	91,519	AA+	0.01%
FNMA Pool #0889691	6.00%	07/01/2038	44,254	AA+	0.01%
FNMA Pool #0889983	6.00%	10/01/2038	51,807	AA+	0.01%
FNMA Pool #0932359	4.00%	01/01/2025	32,535	AA+	0.01%
FNMA Pool #0Ad0095	6.00%	11/01/2038	43,972	AA+	0.01%
FNMA Pool #0Ae0375	4.00%	07/01/2025	24,958	AA+	0.00%
FNMA Pool #0Ae0395	4.50%	10/01/2040	245,434	AA+	0.04%
FNMA Pool #0Ae0949	4.00%	02/01/2041	736,954	AA+	0.12%
FNMA Pool #0Ae0988	4.00%	09/01/2025	39,956	AA+	0.01%
FNMA Pool #0Ah3431	3.50%	01/01/2026	59,316	AA+	0.01%
FNMA Pool #0Al0065	4.50%	04/01/2041	100,023	AA+	0.02%
Ford Credit Auto Owner					
Tru A D	2.94%	07/15/2018	247,754	AA-	0.04%
Ford Motor Credit Co Llc	6.63%	08/15/2017	531,077	BBB-	0.08%
Ge Capital Commercial Mo					
C1 A4	5.45%	03/10/2044	329,543	AAA	0.05%
Georgia Power Co	4.30%	03/15/2042	349,557	A	0.06%
Gilead Sciences Inc	3.70%	04/01/2024	354,593	A-	0.06%
GNMA Pool #0511631	9.00%	08/15/2030	8,712	AA+	0.00%
GNMA II Pool #0004266	5.50%	10/20/2038	61,764	AA+	0.01%
GNMA II Pool #0004496	5.00%	07/20/2039	314,026	AA+	0.05%
GNMA II Pool #0004658	5.00%	03/20/2040	341,590	AA+	0.05%
GNMA II Pool #0004679	5.00%	04/20/2040	297,611	AA+	0.05%
GNMA II Pool #0080817	1.63%	01/20/2034	225,580	AA+	0.04%
Home Depot Inc/The	5.88%	12/16/2036	393,136	A	0.06%
Hyundai Auto Receivables					
T A B	1.13%	09/17/2018	179,363	AA+	0.03%
Hyundai Auto Receivables					
T B C	2.10%	11/15/2019	89,960	AA-	0.01%
Jpmorgan Chase & Co	5.40%	01/06/2042	449,041	A	0.07%

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Issuer	Coupon Rate	Maturity Date	Fair Value	S&P Risk Rating	Concentration of Credit Exposure
Keycorp	5.10%	03/24/2021	352,179	BBB+	0.06%
Kla-Tencor Corp	6.90%	05/01/2018	309,830	BBB+	0.05%
Macy'S Retail Holdings Inc	2.88%	02/15/2023	184,980	BBB+	0.03%
MI-Cfc Commercial Mortgag 9 A4	5.70%	09/12/2049	379,669	AA	0.06%
Morgan Stanley	4.75%	03/22/2017	378,592	A-	0.06%
Morgan Stanley Capital Hq8 A4	5.60%	03/12/2044	255,229	AAA	0.04%
Netapp Inc	3.38%	06/15/2021	352,252	BBB+	0.06%
Progress Energy Inc	3.15%	04/01/2022	253,795	BBB	0.04%
Prologis Lp	6.88%	03/15/2020	125,182	BBB+	0.02%
Prudential Financial Inc	3.50%	05/15/2024	364,878	A	0.06%
Suntrust Banks Inc	3.60%	04/15/2016	339,047	BBB	0.05%
U S Treasury Bond	6.38%	08/15/2027	270,395	AA+	0.04%
U S Treasury Bond	4.50%	02/15/2036	327,803	AA+	0.05%
U S Treasury Bond	5.00%	05/15/2037	195,479	AA+	0.03%
U S Treasury Bond	4.38%	02/15/2038	1,537,798	AA+	0.24%
U S Treasury Bond	4.38%	05/15/2041	137,947	AA+	0.02%
U S Treasury Note	3.75%	11/15/2018	355,748	AA+	0.06%
U S Treasury Note	2.25%	01/31/2015	4,237,548	AA+	0.67%
U S Treasury Note	3.63%	02/15/2020	955,643	AA+	0.15%
U S Treasury Note	2.75%	05/31/2017	336,326	AA+	0.05%
U S Treasury Note	1.75%	07/31/2015	2,029,840	AA+	0.32%
U S Treasury Note	2.00%	01/31/2016	2,820,008	AA+	0.45%
U S Treasury Note	1.50%	07/31/2016	2,395,167	AA+	0.38%
U S Treasury Note	1.38%	11/30/2018	2,551,194	AA+	0.41%
U S Treasury Note	0.88%	01/31/2017	4,116,646	AA+	0.65%
U S Treasury Note	0.50%	07/31/2017	1,283,542	AA+	0.20%
U S Treasury Note	2.00%	02/15/2023	1,125,317	AA+	0.18%
U S Treasury Note	0.75%	03/31/2018	2,835,868	AA+	0.45%
U S Treasury Note	1.63%	06/30/2019	345,297	AA+	0.05%
U S Treasury Notes	0.25%	07/31/2015	360,493	AA+	0.06%
Verizon Communications Inc	3.50%	11/01/2021	352,872	BBB+	0.06%
Wachovia Bank Commercia C20 Aj	5.33%	07/15/2042	221,590	AA-	0.04%
Wf-Rbs Commercial Mortg C13 As	3.35%	05/15/2045	79,916	NA	0.01%
Wfrbs Commercial Mortga C12 As	3.56%	03/15/2048	233,572	AAA	0.04%
Zoetis Inc	3.25%	02/01/2023	210,078	BBB-	0.03%

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(f) *Alternative Investments*

Investments reported at fair value of approximately \$381,140,848 and \$369,702,741, as of August 31, 2015 and 2014, 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 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 the August 31, 2015, 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'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.

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*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.

*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, 2015 and 2014, is as follows:

	<b>Fair Value <sup>(1)</sup></b>	
	<b>2015</b>	<b>2014</b>
Currency:		
Euro	\$ 216,812	\$ 182,023
Canadian dollar	70,191	82,949
Japanese yen	143,634	137,949
Pound Sterling	151,243	247,174
Swiss Franc	29,778	63,111
Total	\$ 611,658	\$ 713,206

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

**6) Due to Other Components**

Due to other components at August 31, 2015 and 2014, consists of the following:

	<b>2015</b>	<b>2014</b>
Payable to System components under the income payout policy	\$ 21,718,777	\$ 20,397,208
Payable to System components for institutional advancement	6,645,830	6,271,143
Total due to other components	\$ 28,364,607	\$ 26,668,351

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**7) 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 6, 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, 2015 and 2014. The total estimated value of these in-kind contributions received from the System was \$529,499 and \$518,636 for the fiscal years 2015 and 2014, respectively.

**8) 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, 2015 and 2014, were \$3,845,267 and \$4,678,742, respectively.

**9) 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 Section 511(a)(2)(B). No material unrelated business income tax was incurred for the year ended August 31, 2014. The System has not completed its fiscal year 2015 unrelated business income tax return, but management does not anticipate an unrelated business income tax liability at this time. Accordingly, no provision for income taxes has been made in the accompanying financial statements.

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**10) 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, 2015, was \$6,884,316 (unaudited). As of that date, the Endowment Fund's total net position was \$572,194,201 (unaudited).