

**University of Houston System
Endowment Fund**

Independent Auditor's Report and Basic Financial Statements
August 31, 2018 and 2017



University of Houston System
Endowment Fund
August 31, 2018 and 2017

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Independent Auditor's Report

Board of Regents
University of Houston System
Houston, Texas

We have audited the accompanying financial statements of University of Houston System (the System) Endowment Fund (the Endowment Fund) as of and for the years ended August 31, 2018 and 2017, and the related notes to the financial statements, which collectively comprise the Endowment Fund's basic financial statements as listed in the table of contents.

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 opinions.

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, 2018 and 2017, and the changes in financial position and cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of 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, 2018 and 2017, 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.

Other 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 a 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 audit 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
January 4, 2019

University of Houston System
Endowment Fund
Management's Discussion and Analysis – (Unaudited)
August 31, 2018

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, 2018, as compared to fiscal year ended August 31, 2017, with summary comparisons for the year ended August 31, 2016. 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 2018, 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 1,796 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 62 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>2018</u>	<u>2017</u>	<u>2016</u>
<u>Developed U.S. Equity</u>			
Mayo Capital	0%	0%	2%
Northern Trust	7	9	6
Columbia Management	6	6	3
Vulcan Value Partners	6	4	3
Gotham	4	3	2
Cougar Investment Fund	<1	<1	<1
Luther King Capital Management	0	0	2
Subtotal – developed U.S. equity	<u>23</u>	<u>22</u>	<u>18</u>
<u>Developed International Equity</u>			
William Blair	6	7	7
Silchester	9	10	9
Deutsche ETF	3	0	1
Subtotal – developed international equity	<u>18</u>	<u>17</u>	<u>17</u>
<u>Developing Markets</u>			
Doddington Emerging Markets	1	2	4
Somerset	1	3	3
JO Hambro	1	1	4
Subtotal – developing markets	<u>3</u>	<u>6</u>	<u>11</u>
<u>Absolute Return</u>			
Anchorage Capital Partners	2	2	2
HBK	2	3	2
Davidson Kempner	3	3	2
Covalent Capital	0	0	<1
Whipporwill	<1	<1	<1
Mason Capital	0	0	<1
Senator Global Opportunity	0	<1	1
Standard Life	2	2	2
ISAM	1	1	2
Subtotal – absolute return	<u>10</u>	<u>11</u>	<u>11</u>
<u>Hedged Equity</u>			
Highline Capital	2	2	2
AQR	2	2	0
Partner Fund Management	0	2	2
Coatue	2	3	2
Sheffield Int'l Partners	0	1	2
SRS Partners	2	2	2

	2018	2017	2016
Proxima Capital	0%	0%	<1%
Marble Arch	<1	2	2
Brahman	2	2	2
Subtotal – hedged equity	10	16	14
<u>Inflation Hedge</u>			
Morgan Stanley	1	1	1
Van Eck Global Hard Assets	1	2	2
Wellington DIH	2	2	2
Subtotal – inflation hedge	4	5	5
<u>Bonds</u>			
Smith Graham	9	7	6
Franklin Templeton	0	0	3
Subtotal – bonds	9	7	9
<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	<1	<1
EnCap Flatrock Midstream II-C	<1	<1	<1
EnCap Flatrock Midstream III	<1	<1	<1
Embarcadero Capital	<1	1	<1
Enervest Fund XIV A	1	1	1
Advent International GPE VII	1	1	1
Advent International VIII	<1	0	0
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
TrueBridge – Kauffman Fellow IV	<1	<1	<1
TrueBridge – Kauffman Fellow V	<1	0	0
Dover Street VIII	<1	<1	<1
LiveOak Venture Partners I	<1	<1	<1
Silver Lake Partners V	<1	0	0
Jackson Square Ventures II	<1	<1	<1
Mercury Fund IV	<1	0	0
Penzance DC Real Estate Fund	<1	0	0
Silver Lake Partners IV	1	<1	<1

	2018	2017	2016
SV Life Sciences Fund VI	1%	<1%	<1%
Great Hill Equity Partners V	1	1	<1
Great Hill Equity Partners VI	<1	0	0
Dover Street IX	<1	<1	0
Fisher Lynch Buyout II	<1	<1	<1
Binary Capital Fund II	<1	1	0
Fisher Lynch Venture II	<1	<1	<1
Lexington Capital VIII	1	1	<1
LiveOak Venture	<1	<1	<1
Weathergage Venture IV	<1	<1	0
Blackstone Europe V	1	<1	0
EnCap Energy XI	<1	<1	0
Insight Equity III	<1	<1	<1
Francisco Partners IV-A	1	1	<1
Francisco Partners V	<1	0	0
Trident VII	<1	0	0
EnCap Energy X	<1	<1	<1
EnCap Midstream IV	<1	0	0
Blackstone Real Estate Partners VIII	1	1	<1
Subtotal – private investments	<u>22</u>	<u>15</u>	<u>13</u>
Cash and equivalents	<u>1</u>	<u>1</u>	<u>2</u>
Total	<u><u>100%</u></u>	<u><u>100%</u></u>	<u><u>100%</u></u>

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 Fund 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, 2018, 2017 and 2016, was 4 percent of the average year-end market value for the twelve prior fiscal quarters. If an endowment has been in existence less than twelve quarters, the average is based on the number of quarters in existence. This trailing twelve-quarter 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 2016 through 2018, endowment payouts to the beneficiary accounts, excluding distributed income returned to principal, in total and by the System's components were as follows:

	2018	2017	2016
University of Houston	\$ 17,175,183	\$ 15,760,892	\$ 14,631,316
UH – Clear Lake	889,396	869,369	783,384
UH – Downtown	1,063,154	1,070,579	987,162
UH – Victoria	450,535	450,092	426,567
System-wide endowments	<u>4,495,622</u>	<u>4,615,402</u>	<u>4,556,334</u>
Totals	<u>\$ 24,073,890</u>	<u>\$ 22,766,334</u>	<u>\$ 21,384,763</u>

Overview of the Financial Statements

The financial statements for the fiscal year ended August 31, 2018, are presented comparatively to financial statements issued for the fiscal year ended August 31, 2017. 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 MD&A. 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, 2018, the Endowment Fund's assets totaled \$744.7 million and liabilities totaled \$33.7 million, resulting in a net position of \$711.0 million.

The net position of the Endowment Fund as contributed by the System's components as of August 31, 2018, compared to the corresponding values as of August 31, 2017 and August 31, 2016, were as follows:

	2018	2017	2016
University of Houston	\$ 524,237,108	\$ 453,267,516	\$ 407,022,461
UH – Clear Lake	24,438,688	23,195,668	21,341,300
UH – Downtown	32,467,226	30,322,820	26,418,032
UH – Victoria	12,222,471	11,579,321	10,835,111
System-wide endowments	117,605,880	114,397,196	108,282,020
Totals	<u>\$ 710,971,373</u>	<u>\$ 632,762,521</u>	<u>\$ 573,898,924</u>

Variance Analysis-Changes in the Statements of Net Position

	2018	2017	Change 2018-2017	2016
Total assets	\$ 744,686,820	\$ 664,490,406	\$ 80,196,414	\$ 602,872,073
Total liabilities	33,715,447	31,727,885	1,987,562	28,973,149
Restricted, nonexpendable endowments	494,404,979	463,437,338	30,967,641	414,739,236
Restricted, expendable endowments	48,846,804	47,055,108	1,791,696	44,330,661
Unrestricted endowments	167,719,590	122,270,075	45,449,515	114,829,027
Net position	<u>\$ 710,971,373</u>	<u>\$ 632,762,521</u>	<u>\$ 78,208,852</u>	<u>\$ 573,898,924</u>

- Total assets: The \$80.2 million increase in fiscal year 2018 is attributable to an increase in the fair value of investments resulting from an increase in gifts.
- Total liabilities: The \$2.0 million increase in liabilities is attributable to an increase in the amount of income distribution.
- Restricted, nonexpendable endowments: The \$30.9 million increase in restricted nonexpendable endowments is primarily attributable to an increase in gifts.
- Restricted, expendable endowments: The \$1.8 million increase in restricted expendable endowments is primarily attributable to an increase in gifts.
- Unrestricted endowments: The \$45.4 million increase is primarily attributable to an increase in funds sent from the campuses to the Core Pool Quasi Endowment.

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 2018, the Endowment Fund received \$59.0 million of gifts and other receipts, interest and investment income of \$9.7 million, and a \$45.0 million net increase in the fair value

of investments. The Endowment Fund's total deductions for fiscal year 2017 were \$35.5 million, including \$24.1 million earmarked for distribution to the beneficiary endowment accounts under the planned payout policy and \$6.5 million for gift acquisition and fund raising efforts. As a result of these activities, the Endowment Fund realized an increase in net position of \$78.2 million for fiscal year 2018.

Variance Analysis-Changes in the Statements of Revenues, Expenses and Changes in Net Position

	2018	2017	Change 2018-2017	2016
Contributions to endowments	\$ 58,990,090	\$ 22,937,617	\$ 36,052,473	\$ 21,976,440
Net appreciation/(depreciation) (realized and unrealized)	45,005,116	59,178,687	(14,173,571)	8,773,731
Other non-operating revenues/(expenses)	(35,505,360)	(29,773,722)	(5,731,638)	(28,256,562)
Interest and investment income	9,719,006	6,521,015	3,197,991	6,095,430
Increase in net position	<u>\$ 78,208,852</u>	<u>\$ 58,863,597</u>	<u>\$ 19,345,255</u>	<u>\$ 8,589,039</u>

- Contributions to endowments increased \$36.1 million in 2018, as compared to 2017 due to additional funds from the System into the Core Pool Quasi Endowment.
- Changes in investment activities included a \$45.0 million net appreciation in the fair value of investments in fiscal year 2018 compared to \$59.2 million net appreciation in fiscal year 2017. This net change fiscal year-over-year is the result of the stock market decrease in certain sectors in fiscal year 2018. Interest and investment income increased by \$3.2 million as compared to 2017. Fund deductions increased by \$5.7 million from 2017 to 2018. 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 fund raising efforts at the System components. Administrative costs were \$120,256 more in fiscal year 2018 compared to fiscal year 2017. 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

Capital markets performance during the year was generally positive with broad-based economic growth and mostly healthy corporate fundamentals, but negative geopolitical developments generated some weakness in certain market segments. Global equities gained, European equities underperformed developed market peers amid increasing political uncertainty and weakening macroeconomic data across the continent. Emerging markets equities sold off on dollar strength and trade concerns. U.S. fixed income finished mixed. Commodity futures advanced and the U.S. dollar was universally stronger, appreciating against virtually all developer and emerging market currencies.

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, 2018 and 2017

	2018	2017
Assets		
Current assets:		
Cash and cash equivalents	\$ 40,620,665	\$ 12,394,678
Interest and dividends receivable	569,676	379,851
Receivables for investments sold	3,770,210	214,411
Total current assets	44,960,551	12,988,940
Noncurrent assets:		
Investments	699,726,269	651,501,466
Total assets	744,686,820	664,490,406
Liabilities		
Current liabilities:		
Payable for investments purchased	3,113,452	2,056,418
Due to other components	30,601,995	29,671,467
Total liabilities	33,715,447	31,727,885
Net Position		
Restricted for nonexpendable endowments	494,404,979	463,437,338
Restricted for expendable endowments	48,846,804	47,055,108
Unrestricted	167,719,590	122,270,075
Total net position	\$ 710,971,373	\$ 632,762,521

University of Houston System
Endowment Fund
Statements of Revenues, Expenses and Changes in Net Position
Years Ended August 31, 2018 and 2017

	<u>2018</u>	<u>2017</u>
Operating Revenues	\$ -	\$ -
Operating Expenses	<u>-</u>	<u>-</u>
Operating income	<u>0</u>	<u>0</u>
Nonoperating Revenues (Expenses)		
Interest and investment income	9,719,006	6,521,015
Net appreciation of investments (realized and unrealized)	45,005,116	59,178,687
Other nonoperating expenses	<u>(35,505,360)</u>	<u>(29,773,722)</u>
Total nonoperating revenues	<u>19,218,762</u>	<u>35,925,980</u>
Contributions to Endowments	<u>58,990,090</u>	<u>22,937,617</u>
Change in Net Position	78,208,852	58,863,597
Net Position, Beginning of Year	<u>632,762,521</u>	<u>573,898,924</u>
Net Position, End of Year	\$ <u><u>710,971,373</u></u>	\$ <u><u>632,762,521</u></u>

University of Houston System
Endowment Fund
Statements of Cash Flows
Years Ended August 31, 2018 and 2017

	2018	2017
Cash Flows From Operating Activities	\$ 0	\$ 0
Cash Flows From Noncapital and Related Financing Activities		
Contributions to endowments	58,990,090	22,937,617
Increase in due to other components	930,528	1,580,265
Net cash provided by noncapital and related financing activities	59,920,618	24,517,882
Cash Flows From Capital and Related Financing Activities	0	0
Cash Flows From Investing Activities		
Proceeds from sales and maturities of investments	1,823,207,680	201,811,195
Payments to purchase investments	(1,859,554,298)	(232,687,608)
Interest and dividends received on investments	9,555,352	6,382,031
Payments for asset management and stewardship	(4,903,365)	(4,783,109)
Net cash used in investing activities	(31,694,631)	(29,277,491)
Increase (Decrease) in Cash and Cash Equivalents	28,225,987	(4,759,609)
Cash and Cash Equivalents, Beginning of Year	12,394,678	17,154,287
Cash and Cash Equivalents, End of Year	\$ 40,620,665	\$ 12,394,678

University of Houston System
Endowment Fund
Notes to Basic Financial Statements
August 31, 2018 and 2017

1) Reporting Entity

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. 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, 2018 and 2017, 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 1,796 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, 2018 and 2017

(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 statements 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 statements 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.

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, 2018 and 2017

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, 2017, 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 a twelve quarter rolling period. For the fiscal years 2018 and 2017, the payout rate was 4 percent applied to the endowments' average net position balances for the preceding twelve quarters. If an endowment was in existence less than twelve quarters, the average was based on the number of quarters the endowment was in existence. Effective May 1, 2009, no endowment receives a pro rata income distribution from current fiscal year contributions. 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 will annually assess a reasonable fee against the earnings of specified endowment funds to offset expenses associated with gift acquisition and fundraising at the component universities. The System's Board of Regents shall annually review and approve the fee. The fee will be based as a percentage of the fiscal year-end market value averaged over rolling twelve quarter periods. For the fiscal years 2018 and 2017, the assessment fee was 1.3 percent and 1.5 percent, respectively. If an endowment has been in existence less than twelve quarters, the average will be based on the number of quarters in existence.

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, 2018 and 2017, was \$6,528,105 and \$6,905,133, 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, expenses and other changes in net position during the reporting period. Actual results could differ from those estimates.

(j) *Reclassifications*

Certain reclassifications have been made to the 2017 financial statements to conform to the 2018 financial statement presentation. These reclassifications had no effect on the change in net position.

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.

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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, 2018 or 2017, and held no direct derivative instruments at August 31, 2018 or 2017.

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 \$40,620,665 and \$12,394,678 at August 31, 2018 and 2017, 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:

	2018	2017
Cash	\$ 1,321,355	\$ 3,452,127
Money market funds	39,299,310	8,942,551
Total cash and cash equivalents	\$ 40,620,665	\$ 12,394,678

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

Total cash and investments at August 31, 2018 and 2017, are as follows:

Type of Security	Fair Value	
	2018	2017
Cash	\$ 1,321,355	\$ 3,452,127
Money market funds	39,299,310	8,942,551
U.S. Government obligations	23,614,336	16,326,573
U.S. Government agencies	11,621,441	8,442,522
U.S. fixed income (non-government/agency)	27,614,311	17,926,031
U.S. equities	88,392,151	63,874,950
Global equities ex – U.S.	159,177,660	154,933,013

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Type of Security (Continued)	Fair Value	
	2018	2017
Hedged equity funds	\$ 81,409,072	\$ 106,558,524
Inflation hedge funds (including REITs)	26,273,041	31,363,493
Absolute return funds	73,376,459	69,908,137
Private equity partnerships	208,137,049	182,057,474
Real estate	110,749	110,749
Total investments	740,346,934	663,896,144
Less cash and cash equivalents	(40,620,665)	(12,394,678)
Total non-current investments	<u>\$ 699,726,269</u>	<u>\$ 651,501,466</u>

(c) Investment Maturities

As of August 31, 2018 and 2017, the Endowment Fund had the following investments and weighted-average maturities:

Investment Type	2018		2017	
	Fair Value	Weighted-average Maturity (Years)	Fair Value	Weighted-average Maturity (Years)
U.S. Government obligations ⁽¹⁾	\$ 23,614,336	4.5	\$ 16,326,573	3.9
U.S. Government agencies ⁽¹⁾	11,621,441	24.4	8,442,522	25.9
U.S. fixed income (non-government/agency) ⁽¹⁾	27,614,311	8.3	17,926,031	8.2
Equity, mutual funds, other investments	<u>677,496,846</u>	Untenured	<u>621,201,018</u>	Untenured
Total investments at fair value	<u>\$ 740,346,934</u>		<u>\$ 663,896,144</u>	
Weighted-average maturity of tenured portfolio		10.4		10.0

(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 59 percent and 54 percent of the overall investment portfolio (portfolio) at the end of fiscal years 2018 and 2017, respectively. Marketable alternative investments (*i.e.*, inflation hedge funds, commingled funds invested in marketable securities, absolute return and hedged-equity funds) represent 24 percent and 31 percent of the portfolio, and non-marketable alternative investments (*i.e.*, venture capital, private equity, real estate, natural resources, energy) constitute 17 percent and 15 percent of the portfolio on a funded basis at the end of the fiscal years ended 2018 and 2017, 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, 2018 and 2017, 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, 2018 and 2017, the Endowment Fund's total investments at fair value under a master trust custodian agreement with a third-party financial institution was \$110,478,401 and \$82,341,857, respectively. The third-party custodian operates its business world-wide and, at August 31, 2018 and 2017, 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, 2018 and 2017, the Endowment Fund's investments at fair value not covered by the master trust custodian agreement were \$630,525,294 and \$581,554,287, respectively. These investments, excluding real estate valued at \$110,749 at August 31, 2018 and 2017, respectively, 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, 2018, are as follows:

Issuer	Coupon Rate	Maturity Date	Fair Value	S&P Risk Rating	Concentration of Credit Exposure
U S Treasury Bond	4.50%	05/15/2038	\$ 820,783	AA+	0.11%
U S Treasury Bond	4.50%	02/15/2036	67,038	AA+	0.01%
U S Treasury Bond	2.75%	02/15/2028	872,133	AA+	0.12%
U S Treasury Bond	2.13%	06/30/2022	2,068,978	AA+	0.28%
U S Treasury Bond	2.13%	06/30/2021	4,455,903	AA+	0.60%
U S Treasury Bond	1.75%	05/15/2023	3,468,110	AA+	0.47%
U S Treasury Bond	1.63%	05/15/2026	394,559	AA+	0.05%
U S Treasury Bond	1.38%	05/31/2020	974,055	AA+	0.13%
U S Treasury Bond	1.63%	06/30/2019	4,301,595	AA+	0.58%
U S Treasury Bond	2.75%	11/15/2023	4,670,187	AA+	0.63%
U S Treasury Bond	2.38%	05/15/2027	892,116	AA+	0.12%
Vulcan Materials Co Hyundai Auto	3.90%	04/01/2027	491,456	BBB	0.07%
Receivables T B C	2.44%	05/15/2024	165,325	A+	0.02%
Apple Inc	2.30%	05/11/2022	663,809	AA+	0.09%
Unitedhealth Group Inc	3.10%	03/15/2026	478,556	A+	0.06%
California St	4.60%	04/01/2038	610,496	AA-	0.08%
Ge Capital International Fundi	2.34%	11/15/2020	406,530	A	0.05%
Mplx Lp	4.13%	03/01/2027	220,302	BBB	0.03%
Pnc Bank Na	2.15%	04/29/2021	794,829	A	0.11%

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Issuer	Coupon Rate	Maturity Date	Fair Value	S&P Risk Rating	Concentration of Credit Exposure
Sherwin-Williams Co/The	2.75%	06/01/2022	\$ 394,288	BBB	0.05%
Citigroup Inc	2.70%	03/30/2021	354,762	BBB+	0.05%
Abbvie Inc	2.85%	05/14/2023	638,649	A-	0.09%
Santander Retail Aut A A3 144A	2.93%	05/20/2021	294,127	AAA	0.04%
Lockheed Martin Corp	3.55%	01/15/2026	412,552	BBB+	0.06%
Cvs Health Corp	4.30%	03/25/2028	640,021	BBB	0.09%
Carmax Auto Owner Trust 20 1 B	2.54%	09/15/2022	418,077	NA	0.06%
Ford Credit Auto Owner Tru B	1.85%	09/15/2021	266,485	AA+	0.04%
Metlife Inc Discovery	3.00%	03/01/2025	500,308	A-	0.07%
Communications Llc	3.95%	03/20/2028	467,323	BBB-	0.06%
Wells Fargo Commercial C35 A4	2.93%	07/15/2048	286,155	NA	0.04%
General Electric Co	4.65%	10/17/2021	156,180	A	0.02%
Carmax Auto Owner Trust 20 2 B	2.16%	12/15/2021	245,743	AA+	0.03%
National Oilwell Varco Inc	2.60%	12/01/2022	95,837	BBB+	0.01%
Td Ameritrade Holding Corp	2.95%	04/01/2022	138,151	A	0.02%
Carmax Auto Owner Trust 20 1 C	2.84%	10/17/2022	316,138	NA	0.04%
Gm Financial Automobile Le 3 D	3.48%	08/20/2020	160,013	BBB+	0.02%
Commercial Mortgage Pa Cr28 A1	1.77%	02/10/2049	69,344	NA	0.01%
Fifth Third Bancorp Southern California	2.60%	06/15/2022	242,152	BBB+	0.03%
Edison Co	3.50%	10/01/2023	130,385	A	0.02%
At&T Inc	3.40%	05/15/2025	646,517	BBB	0.09%
Verizon Communications Inc	2.63%	08/15/2026	557,424	BBB+	0.08%
Goldman Sachs Group Inc/The	3.75%	02/25/2026	342,895	BBB+	0.05%
Keurig Dr Pepper Inc 144A	4.60%	05/25/2028	304,491	BBB	0.04%
Gilead Sciences Inc	3.25%	09/01/2022	634,625	A	0.09%
Amgen Inc	2.65%	05/11/2022	414,604	A	0.06%
Oracle Corp	1.90%	09/15/2021	604,994	AA-	0.08%

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Issuer	Coupon Rate	Maturity Date	Fair Value	S&P Risk Rating	Concentration of Credit Exposure
Stryker Corp	2.00%	03/08/2019	\$ 183,442	A	0.02%
American Express Credit Corp	2.25%	05/05/2021	795,766	A-	0.11%
Towd Point Mortgage 2 A1 144A	3.25%	03/25/2058	892,415	NA	0.12%
Comm 2013-Lc6 Mortgage Lc6 A4	2.94%	01/10/2046	394,668	AAA	0.05%
Jpmorgan Chase & Co Wfrbs Commercial	3.25%	09/23/2022	607,218	A-	0.08%
Mortga C12 As	3.56%	03/15/2048	598,320	AAA	0.08%
World Omni Auto Receivable B B	1.73%	07/15/2023	437,134	AA+	0.06%
Regions Bank/Birmingham Al Carmax Auto Owner Trust 20 4 B	2.75%	04/01/2021	428,675	A-	0.06%
Trust 20 4 B	2.46%	08/15/2023	195,590	AA	0.03%
Citigroup Inc	3.14%	01/24/2023	236,638	BBB+	0.03%
Bb&T Corp	2.05%	05/10/2021	795,900	A-	0.11%
Blackrock Inc	3.38%	06/01/2022	353,818	AA-	0.05%
Capital One Financial Corp	3.20%	01/30/2023	502,959	BBB	0.07%
Abbott Laboratories	3.75%	11/30/2026	612,343	BBB	0.08%
Phillips 66 Partners Lp	3.75%	03/01/2028	290,439	BBB	0.04%
Bank Of America Corp Bank 2018-Bnk12 Bn12 As	3.25%	10/21/2027	418,296	A-	0.06%
As	4.49%	05/15/2061	355,317	AAA	0.05%
Progress Energy Inc	3.15%	04/01/2022	256,841	BBB+	0.03%
Gm Financial Automobile Le 2 C	3.50%	04/20/2022	220,055	A+	0.03%
General Motors Financial Co In	4.35%	01/17/2027	629,488	BBB	0.09%
Morgan Stanley Bank Of C29 A4	3.33%	05/15/2049	637,468	NA	0.09%
Morgan Stanley	3.63%	01/20/2027	399,819	BBB+	0.05%
Bank Of America Corp	2.88%	04/24/2023	443,643	A-	0.06%
Tapestry Inc	4.13%	07/15/2027	627,745	BBB-	0.08%
Morgan Stanley Bank Of C32 A4	3.72%	12/15/2049	341,703	NA	0.05%
Jpmorgan Chase & Co	3.30%	04/01/2026	569,338	A-	0.08%
Wells Fargo & Co	3.07%	01/24/2023	694,870	A-	0.09%
Wfrbs Commercial Mortga C13 As	3.35%	05/15/2045	49,239	NA	0.01%

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Jp Morgan Mortgage 6 1A4 144A	3.50%	12/25/2048	\$ 165,579	AAA	0.02%
Utah St Goldman Sachs Group Inc/The	4.55%	07/01/2024	377,694	AAA	0.05%
Exelon Generation Co Llc	2.35%	11/15/2021	305,399	BBB+	0.04%
Ford Credit Auto Owner Tr B A3	3.40%	03/15/2022	228,972	BBB	0.03%
Fhlmc Pool #G0-1837	1.16%	11/15/2019	3,977	NA	0.00%
Fnlma Pool #0A17521	5.00%	07/01/2035	34,305	AA+	0.00%
Fnlma Pool #0735925	5.00%	06/01/2039	652,067	AA+	0.09%
Fnlma Pool #0As5696	5.00%	10/01/2035	194,839	AA+	0.03%
Fnlma Pool #0A19578	3.50%	08/01/2045	121,270	AA+	0.02%
Fnlma Pool #0A19578	4.00%	06/01/2045	53,992	AA+	0.01%
Fhlmc Pool #G0-8732	3.00%	11/01/2046	1,415,705	AA+	0.19%
Gnlma li Pool #0Ma3663	3.50%	05/20/2046	483,195	AA+	0.07%
Fnlma Pool #0Ae0698	4.50%	12/01/2040	21,338	AA+	0.00%
Fnlma Pool #0Ae0949	4.00%	02/01/2041	170,639	AA+	0.02%
Fnlma Pool #0Ah3431	3.50%	01/01/2026	90,772	AA+	0.01%
Fnlma Pool #0A13322	4.00%	02/01/2043	35,545	AA+	0.00%
Fnlma Pool #0A14911	3.00%	10/01/2027	110,201	AA+	0.01%
Fhlmc Pool #G0-8615	3.50%	11/01/2044	59,744	AA+	0.01%
Fhlmc Pool #G0-8667	3.50%	09/01/2045	500,588	AA+	0.07%
Fnlma Pool #0A13802	3.00%	02/01/2028	233,645	AA+	0.03%
Fnlma Pool #0A17767	4.50%	06/01/2044	387,948	AA+	0.05%
Fnlma Pool #0A17306	4.50%	09/01/2042	105,082	AA+	0.01%
Fnlma Pool #0555330	5.50%	04/01/2033	92,431	AA+	0.01%
Fnlma Pool #0Ad7128	4.50%	07/01/2040	167,612	AA+	0.02%
Fnlma Pool #0254903	5.00%	10/01/2033	152,333	AA+	0.02%
Fhlmc Pool #G0-8698	3.50%	03/01/2046	300,140	AA+	0.04%
Fnlma Pool #0Ma3088	4.00%	07/01/2047	319,381	AA+	0.04%
Fnlma Pool #0725690	6.00%	08/01/2034	42,570	AA+	0.01%
Fnlma Pool #0A10160	4.50%	05/01/2041	215,752	AA+	0.03%
Gnlma li Pool #0005056	5.00%	05/20/2041	90,277	AA+	0.01%
Fnlma Pool #0725773	5.50%	09/01/2034	158,787	AA+	0.02%
Fnlma Pool #0A18383	4.50%	10/01/2045	62,740	AA+	0.01%
Fnlma Pool #0725231	5.00%	02/01/2034	25,112	AA+	0.00%
Fhlmc Pool #G1-8561	3.00%	07/01/2030	18,856	AA+	0.00%
Fnlma Pool #0A13519	4.50%	11/01/2041	29,932	AA+	0.00%

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Fhlmc Pool #G0-8747	3.00%	02/01/2047	\$ 1,039,895	AA+	0.14%
Fnma Pool #0725704	6.00%	08/01/2034	49,134	AA+	0.01%
Fhlmc Pool #G0-8707	4.00%	05/01/2046	676,913	AA+	0.09%
Gnma Ii Pool #0005116	5.00%	07/20/2041	49,715	AA+	0.01%
Fnma Pool #0745428	5.50%	01/01/2036	108,339	AA+	0.01%
Fnma Pool #0995112	5.50%	07/01/2036	42,559	AA+	0.01%
Fhlmc Pool #G6-0024	3.50%	05/01/2043	209,612	AA+	0.03%
Fhlmc Pool #G0-8699	4.00%	03/01/2046	363,378	AA+	0.05%
Fnma Pool #0Ae0988	4.00%	09/01/2025	37,414	AA+	0.01%
Fhlmc Pool #G0-8681	3.50%	12/01/2045	1,037,065	AA+	0.14%
Fhlmc Pool #G0-8588	4.00%	05/01/2044	137,229	AA+	0.02%
Fhlmc Pool #G1-4225	4.00%	08/01/2026	25,400	AA+	0.00%
Fnma Pool #0Ad0198	5.50%	09/01/2038	56,019	AA+	0.01%
Fhlmc Pool #G1-4496	3.00%	06/01/2027	344,758	AA+	0.05%
Fnma Pool #0A11697	4.00%	10/01/2041	25,033	AA+	0.00%
Fhlmc Pool #G0-8687	3.50%	01/01/2046	1,072,180	AA+	0.14%

The credit quality (ratings) of tenured securities and concentration of credit exposure as a percentage of total investments as of August 31, 2017, are as follows:

Issuer	Coupon Rate	Maturity Date	Fair Value	S&P Risk Rating	Concentration of Credit Exposure
U.S. Treasury Bond	4.50%	02/15/2036	\$ 282,968	AA+	0.04%
U.S. Treasury Bond	4.50%	05/15/2038	191,655	AA+	0.03%
U.S. Treasury Bond	1.63%	05/15/2026	689,027	AA+	0.10%
U.S. Treasury Bond	1.38%	11/30/2018	1,321,544	AA+	0.20%
U.S. Treasury Bond	1.75%	05/15/2023	119,545	AA+	0.02%
U.S. Treasury Bond	1.38%	05/31/2020	314,805	AA+	0.05%
U.S. Treasury Bond	2.75%	11/15/2023	1,505,075	AA+	0.23%
U.S. Treasury Bond	2.13%	06/30/2021	4,993,096	AA+	0.75%
U.S. Treasury Bond	1.63%	06/30/2019	4,529,102	AA+	0.68%
U.S. Treasury Bond	2.13%	06/30/2022	1,701,513	AA+	0.26%
U.S. Treasury Bond	0.75%	03/31/2018	678,246	AA+	0.10%
Ford Credit Auto Owner Tr B A3	1.16%	11/15/2019	297,950	NA	0.04%
Wfrbs Commercial Mortga C12 As	3.56%	03/15/2048	417,324	AAA	0.06%

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Issuer	Coupon Rate	Maturity Date	Fair Value	S&P Risk Rating	Concentration of Credit Exposure
American Express Credit Corp.	1.70%	10/30/2019	\$ 403,311	A-	0.06%
American Express Credit Corp.	2.20%	03/03/2020	80,690	A-	0.01%
General Electric Co.	4.65%	10/17/2021	110,331	AA-	0.02%
Tyson Foods Inc.	3.55%	06/02/2027	204,678	BBB	0.03%
Carmax Auto Owner Trust 20 1 B	2.54%	09/15/2022	282,534	NA	0.04%
Lockheed Martin Corp.	3.55%	01/15/2026	292,421	BBB+	0.04%
Morgan Stanley Bank Of C29 A4	3.33%	05/15/2049	362,047	NA	0.05%
21St Century Fox America Inc.	3.00%	09/15/2022	383,325	BBB+	0.06%
Exelon Generation Co LLC	3.40%	03/15/2022	159,893	BBB	0.02%
Wells Fargo & Co	2.55%	12/07/2020	441,081	A	0.07%
Goldman Sachs Group Inc./The	3.75%	02/25/2026	242,513	BBB+	0.04%
Abbott Laboratories	2.90%	11/30/2021	422,155	BBB	0.06%
Jpmorgan Chase & Co.	3.30%	04/01/2026	398,448	A-	0.06%
Morgan Stanley	3.63%	01/20/2027	286,583	BBB+	0.04%
Blackrock Inc.	3.38%	06/01/2022	273,796	AA-	0.04%
Hyundai Auto Receivables T B C	2.44%	05/15/2024	169,958	A+	0.03%
Verizon Communications Inc.	2.63%	08/15/2026	389,295	BBB+	0.06%
Vulcan Materials Co.	3.90%	04/01/2027	435,498	BBB	0.07%
Oracle Corp.	1.90%	09/15/2021	413,958	AA-	0.06%
Goldman Sachs Group Inc/The	2.35%	11/15/2021	208,942	BBB+	0.03%
United Technologies Corp.	3.10%	06/01/2022	237,537	A-	0.04%
Bank of America Corp.	2.88%	04/24/2023	201,840	BBB+	0.03%
Progress Energy Inc.	3.15%	04/01/2022	179,405	BBB+	0.03%
Coach Inc.	4.13%	07/15/2027	442,644	BBB-	0.07%
AT&T Inc.	3.40%	05/15/2025	453,330	BBB+	0.07%
Berkshire Hathaway Finance Cor	1.30%	08/15/2019	671,544	AA	0.10%
Carmax Auto Owner Trust 20 2 B	2.16%	12/15/2021	250,493	AA	0.04%
Metlife Inc.	3.00%	03/01/2025	354,928	A-	0.05%

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Issuer	Coupon Rate	Maturity Date	Fair Value	S&P Risk Rating	Concentration of Credit Exposure
Td Ameritrade Holding Corp.	2.95%	04/01/2022	\$ 163,976	A	0.02%
International Paper Co.	3.00%	02/15/2027	417,607	BBB	0.06%
Bank of America Corp.	3.25%	10/21/2027	295,683	BBB+	0.04%
Morgan Stanley Bank of C32 A4	3.72%	12/15/2049	319,722	NA	0.05%
Apple Inc.	2.10%	05/06/2019	419,179	AA+	0.06%
Citigroup Inc.	2.70%	03/30/2021	410,573	BBB+	0.06%
Abbvie Inc.	2.50%	05/14/2020	232,946	A-	0.04%
Chrysler Capital Aut Aa D 144A	2.64%	07/15/2021	190,405	AAA	0.03%
Fifth Third Bancorp	2.88%	07/27/2020	204,484	BBB+	0.03%
Jpmorgan Chase & Co.	3.25%	09/23/2022	419,317	A-	0.06%
Pnc Bank Na	2.15%	04/29/2021	330,917	A	0.05%
Bb&T Corp.	2.05%	05/10/2021	415,481	A-	0.06%
Stryker Corp.	2.00%	03/08/2019	134,441	A	0.02%
Ge Capital International Funding	2.34%	11/15/2020	283,430	AA-	0.04%
Comm 2013-Lc6 Mortgage Lc6 A4	2.94%	01/10/2046	410,312	AAA	0.06%
Amgen Inc.	2.65%	05/11/2022	287,280	A	0.04%
Southern California Edison Co.	3.50%	10/01/2023	121,407	A	0.02%
Commercial Mortgage Pa Cr28 A1	1.77%	02/10/2049	89,659	NA	0.01%
State Street Corp.	1.95%	05/19/2021	333,965	A	0.05%
Mplx Lp	4.13%	03/01/2027	497,237	BBB-	0.07%
Sherwin-Williams Co/The World Omni Auto Receivable B	1.73%	07/15/2023	445,874	AA	0.07%
Unitedhealth Group Inc.	3.10%	03/15/2026	336,016	A+	0.05%
Ford Credit Auto Owner Tru B	1.85%	09/15/2021	269,468	AA+	0.04%
Capital One Financial Corp.	4.75%	07/15/2021	412,593	BBB	0.06%
General Motors Financial Co Inc.	3.15%	06/30/2022	442,178	BBB	0.07%
Wells Fargo Commercial C35 A4	2.93%	07/15/2048	301,380	NA	0.05%
FNMA Pool #0725773	5.50%	09/01/2034	86,354	AA+	0.01%

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Issuer	Coupon Rate	Maturity Date	Fair Value	S&P Risk Rating	Concentration of Credit Exposure
FNMA Pool #0735925	5.00%	10/01/2035	\$ 253,674	AA+	0.04%
FNMA Pool #0A13519	4.50%	11/01/2041	37,882	AA+	0.01%
FHLMC Pool #G0-8681	3.50%	12/01/2045	920,708	AA+	0.14%
FHLMC Pool #G1-4496	3.00%	06/01/2027	435,069	AA+	0.07%
FNMA Pool #0Ad7128	4.50%	07/01/2040	209,526	AA+	0.03%
FNMA Pool #0725231	5.00%	02/01/2034	31,645	AA+	0.00%
FHLMC Pool #G1-4225	4.00%	08/01/2026	35,247	AA+	0.01%
FNMA Pool #0995112	5.50%	07/01/2036	54,223	AA+	0.01%
FHLMC Pool #G0-8667	3.50%	09/01/2045	600,119	AA+	0.09%
FNMA Pool #0Ad0198	5.50%	09/01/2038	72,423	AA+	0.01%
FHLMC Pool #G0-8707	4.00%	05/01/2046	845,590	AA+	0.13%
FHLMC Pool #G1-8561	3.00%	07/01/2030	23,582	AA+	0.00%
FNMA Pool #0Ae0698	4.50%	12/01/2040	26,324	AA+	0.00%
FHLMC Pool #G0-1837	5.00%	07/01/2035	43,241	AA+	0.01%
FHLMC Pool #G0-8699	4.00%	03/01/2046	461,266	AA+	0.07%
FHLMC Pool #G0-8687	3.50%	01/01/2046	866,011	AA+	0.13%
FNMA Pool #0Ah3431	3.50%	01/01/2026	121,551	AA+	0.02%
FNMA Pool #0A11697	4.00%	10/01/2041	30,539	AA+	0.00%
FNMA Pool #0A10160	4.50%	05/01/2041	94,410	AA+	0.01%
FNMA Pool #0Ae0988	4.00%	09/01/2025	51,727	AA+	0.01%
FNMA Pool #0745428	5.50%	01/01/2036	71,173	AA+	0.01%
FNMA Pool #0725690	6.00%	08/01/2034	53,686	AA+	0.01%
GNMA Ii Pool #0005116	5.00%	07/20/2041	63,914	AA+	0.01%
FNMA Pool #0A18383	4.50%	10/01/2045	77,059	AA+	0.01%
FNMA Pool #0Ae0949	4.00%	02/01/2041	158,158	AA+	0.02%
FNMA Pool #0725704	6.00%	08/01/2034	62,510	AA+	0.01%
FNMA Pool #0A17767	4.50%	06/01/2044	381,127	AA+	0.06%
Commit To Pur FNMA Sf Mtg	3.00%	09/01/2047	1,628,547	AA+	0.25%
GNMA Ii Pool #0Ma3663	3.50%	05/20/2046	602,236	AA+	0.09%
FNMA Pool #0A13322	4.00%	02/01/2043	43,001	AA+	0.01%

(f) Alternative Investments

Investments reported at fair value of approximately \$482,678,989 and \$459,298,087, as of August 31, 2018 and 2017, 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,

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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 August 31, 2018, 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, 2018 and 2017, is as follows.

	Fair Value ⁽¹⁾	
	2018	2017
Currency:		
Euro	\$ 505,171	\$ 313,211
Canadian dollar	46,165	76,082
Japanese yen	334,375	183,599
Pound Sterling	264,395	157,754
Swiss Franc	1,836,569	34,479
Total	\$ 2,986,675	\$ 765,125

(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 data, 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 use 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 are reported at NAV and are not categorized according to fair market value.

Assets at fair value as of August 31, 2018 and 2017, were as follows:

August 31, 2018				
Investment Category	Level 1	Level 2	Level 3	Total
Equities	\$ 45,610,012	\$ -	\$ -	\$ 45,610,012
Externally managed domestic	46,946,630	-	-	46,946,630
Externally managed international	9,584,538	-	-	9,584,538
Fixed income – money market and bond mutual funds	40,620,665	-	-	40,620,665
International equities	51,945,262	-	-	51,945,262
Real estate	-	110,749	-	110,749
Corporate obligations	27,614,311	-	-	27,614,311
U.S. Government agencies	11,621,442	-	-	11,621,442
U.S. Government obligations	<u>23,614,336</u>	<u>-</u>	<u>-</u>	<u>23,614,336</u>
Totals	<u>\$ 257,557,196</u>	<u>\$ 110,749</u>	<u>\$ 0</u>	<u>\$ 257,667,945</u>

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August 31, 2017				
Category	Level 1	Level 2	Level 3	Total
Equities	\$ 36,826,964	\$ -	\$ -	\$ 36,826,964
Externally managed domestic	46,092,052	-	-	46,092,052
Externally managed international	9,173,495	-	-	9,173,495
Fixed income – money market and bond mutual funds	12,394,678	-	-	12,394,678
International equities	57,304,993	-	-	57,304,993
Global fixed income	17,926,031	-	-	17,926,031
Real estate	-	110,749	-	110,749
U.S. Government agencies	8,442,522	-	-	8,442,522
U.S. Government obligations	<u>16,326,573</u>	<u>-</u>	<u>-</u>	<u>16,326,573</u>
Totals	<u>\$ 204,487,308</u>	<u>\$ 110,749</u>	<u>\$ 0</u>	<u>\$ 204,598,057</u>

Investments measured at NAV as of August 31, 2018 and 2017, were as follows:

August 31, 2018				
Investment Category	Fair Value	Unfunded Commitments	Redemption Frequency	Redemption Notice Period
Equities and equity funds	\$ 48,980,551	\$ -	As needed	30-60 days
Externally managed domestic	130,629,036	63,500,883	N/A	30–60 days
Externally managed international	214,230,534	62,132,984	N/A	30–60 days
International equities	87,530,715	-	As needed	5 days
Other comingled funds	<u>1,308,153</u>	<u>-</u>	As needed	6 months
Totals	<u>\$ 482,678,989</u>	<u>\$ 125,633,867</u>		

August 31, 2017				
Investment Category	Fair Value	Unfunded Commitments	Redemption Frequency	Redemption Notice Period
Equities and equity funds	\$ 61,505,242	\$ -	As needed	30-60 days
Externally managed domestic	97,480,155	49,480,536	N/A	30–60 days
Externally managed international	232,993,183	74,203,366	N/A	30–60 days
International equities	66,157,323	-	As needed	5 days
Other comingled funds	<u>1,162,184</u>	<u>-</u>	As needed	6 months
Totals	<u>\$ 459,298,087</u>	<u>\$ 123,683,902</u>		

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(a) *Equity Funds*

This type includes investments in one fund at August 31, 2018 and 2017, 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 30 funds at August 31, 2018 and 2017, 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. At August 31, 2018, approximately 28 percent of this class is invested in natural resources, 19 percent in venture capital, 12 percent in real estate, 16 percent in private equity, and 25 percent in multi strategy. At August 31, 2017, approximately 17 percent of this class is invested in natural resources, 7 percent in venture capital, 8 percent in real estate, 8 percent in private equity, 3 percent in secondary markets and 57 percent in multi strategy. The fair values of the investments in this type have been determined using the NAV per share of the investments. All of these investments may be redeemed within a 30-60 days' notice, but early redemption requires complete exit from the fund. At August 31, 2018 and 2017, 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 will have the proceeds from the sale of the equities reinvested back into the fund.

(c) *Externally Managed International*

This type includes investments in 33 funds at August 31, 2018, and 26 funds at August 31, 2017, 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. At August 31, 2018, approximately 2 percent of the portfolio is invested in real estate, 8 percent in private equity, 3 percent in venture capital, 2 percent in the secondary market and 85 percent in public and private domestic and global equities. At August 31, 2017, approximately 3 percent of the portfolio is invested in real estate, 11 percent in private equity, 6 percent in venture capital, and 80 percent in public and private domestic and global equities. 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 within a 30-60 days' notice, but early redemption requires complete exit from the fund. Funds in this category have expected maturity dates that range from 5 to 10 years. At August 31, 2018 and 2017, 21 percent of the funds in this category will have distributions that will be received as the underlying investments of the funds are liquidated. The remaining funds in this category will have the proceeds from the sale of the equities reinvested back into the fund.

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(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 one fund at August 31, 2018 and 2017, that invests in international equities. The manager has the ability to shift investments to gain a more favorable outcome. The fair values of the investments in this category have been determined using the NAV per share of the investments. The investment in this category can be redeemed with five days' notice.

(f) Other Comingled Funds

This type includes investments in one fund at August 31, 2018 and 2017, that invests primarily in equities. This equity fund is managed by University of Houston C.T. Bauer College of Business and 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 three days' notice.

7) Due to Other Components

Due to other components at August 31, 2018 and 2017, consists of the following:

	<u>2018</u>	<u>2017</u>
Payable to System components under the income payout policy	\$ 24,073,890	\$ 22,766,334
Payable to System components for institutional advancement	<u>6,528,105</u>	<u>6,905,133</u>
Total due to other components	<u>\$ 30,601,995</u>	<u>\$ 29,671,467</u>

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, 2018 and 2017. The total estimated value of these

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in-kind contributions received from the System was \$679,760 and \$679,713 for the fiscal years 2018 and 2017, 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, 2018 and 2017, were \$4,903,365 and \$4,783,109, respectively, and was included in net appreciation 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 Section 511(a)(2)(B). No material unrelated business income tax was incurred for the years ended August 31, 2018 and 2017. 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-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 depreciation subsequent to year-end and through October 31, 2018, was \$27,251,431 (unaudited). As of that date, the Endowment Fund's total net position was \$714,261,937 (unaudited).