Finance & Planning Committee

THE UNIVERSITY OF TEXAS SYSTEM
BOARD OF REGENTS

January 7, 2003

FINANCE AND PLANNING COMMITTEE
THE UNIVERSITY OF TEXAS SYSTEM
BOARD OF REGENTS
AGENDA

January 7, 2003
8:30 – 10:30 a.m.
Board Room, 9th Floor, Ashbel Smith Hall
Austin, Texas

8:30 a.m.	1.	**Welcome and Opening Remarks**	*Chairman Hunt*
	2.	**Agenda Topics for February Board of Regents' Meeting**	
8:30 a.m.		a. UTIMCO Investment Report [Action Item] (Tab 2a)	*Mr. Bob Boldt*
		b. Approval of Investment Policies [Action Item] (Tab 2b)	*Mr. Bob Boldt*
9:30 a.m.		c. Amendments to the Environmental Review Policy for Acquisitions of Real Property Assets [Action Item] (Tab 2c)	*Mr. Jim Wilson*
9:35 a.m.		d. Equipment Financing Requests – U. T. El Paso and U. T. - Health Center Tyler [Action Item] (Tab 2d)	*Mr. Philip Aldridge*
9:40 a.m.		e. Interest Rate Swap Policy [Action Item] (Tab 2e)	*Mr. Philip Aldridge*
9:55 a.m.		f. Appointment of Carrier for Vision Plan [Action Item] (Tab 2f)	*Mr. Dan Stewart*
10:00 a.m.		g. Appointment of Carrier for Long Term Disability and Short Term Disability Plans [Action Item] (Tab 2g)	*Mr. Dan Stewart*
10:05 a.m.		h. Proposed Amendments to the Regents' Rules regarding UTGRA [Action Item] (Tab 2h)	*Mr. Dan Stewart*
10:10 a.m.	3.	**2002 Financial Reports** a. Annual Financial Report (Tab 3a) b. Financial Condition Report (Tab 3b)	*Mr. Randy Wallace*
10:25 a.m.	4.	**Quarterly Permanent University Fund Update** (Tab 4)	*Mr. Philip Aldridge*
10:35 a.m.	5.	**October Monthly Financial Report** (Tab 5)	*Mr. Randy Wallace*
10:45 a.m.	6.	**Adjourn**	

REPORT

Pages 2 - 10 contain the Summary Reports on Investments for the two months ended October 31, 2002.

Item I on Pages 2 - 4 reports summary activity for the Permanent University Fund (PUF) investments. The PUF's net investment return for the two months was negative 1.79%. The PUF's net investment return for marketable securities for the two months was negative 2.45% versus its composite benchmark return of negative 2.14%. The PUF's net asset value decreased by $465.7 million since the beginning of the year to $6,272.6 million. This decrease reflects the annual distribution to the AUF made in September 2002 for $363.0 million.

Item II on Pages 5 - 8 reports summary activity for the General Endowment Fund (GEF), the Permanent Health Fund (PHF), and Long Term Fund (LTF). The GEF's net investment return for the two months was negative 1.97%. The GEF's net investment return for marketable securities for the two months was negative 2.48% versus its composite benchmark return of negative 2.14%. The GEF's net asset value decreased $33.7 million since the beginning of the year to $3,259.5 million.

Item III on Page 9 reports summary activity for the Short Intermediate Term Fund (SITF). Total net investment return on the SITF was 0.36% for the two months versus the SITF's performance benchmark of 1.06%. The SITF's net asset value increased by $40.4 million since the beginning of the year to $1,476.3 million.

Item IV on Page 10 presents book and market value of cash, fixed income, equity, and other securities held in funds outside of internal investment pools. Total cash and equivalents, consisting primarily of component operating funds held in the Dreyfus money market fund, decreased by $79,585 thousand to $1,278,130 thousand during the two months. Market values for the remaining asset types were fixed income securities: $283,452 thousand versus $317,209 thousand at the beginning of the year; equities: $131,845 thousand versus $136,650 thousand at the beginning of the year; and other investments: $21 thousand versus $13,020 thousand at the beginning of the year.

Prepared by UTIMCO
12/18/2002

I. PERMANENT UNIVERSITY FUND (1)

DRAFT

a.) Summary Investment Report at October 31, 2002 (2)

($ millions)

	FY01-02 Full Year	FY02-03 Two Months Ending October 31, 2002
Beginning Net Assets	7,540.1	6,738.3
PUF Lands Receipts (3)	80.5	14.2
Investment Return	(522.9)	(113.8)
Expenses	(21.0)	(3.1)
Distributions to AUF	(338.4)	(363.0)
Ending Net Assets	6,738.3	6,272.6
AUF Distribution:		
From PUF Investments	338.4	363.0
From Surface Income	8.1	0.6
Total	346.5	363.6
Total Net Investment Return	-7.35%	-1.79%

(1) Report prepared in accordance with Texas Education Code Sec. 51.0032.

(2) General - The Investment Summary Report excludes PUF Lands mineral and surface interests with estimated August 31, 2002 values of $639.8 million and $161.1 million, respectively.

(3) PUF Land Receipts - As of October 31, 2002: 1,170,817 acres under lease; 521,217 producing acres; 3,150 active leases; and 2,067 producing leases.

I. PERMANENT UNIVERSITY FUND (continued)

Prior Asset Allocation

b.) Comparison of Asset Allocation Versus Endowment Neutral Policy Portfolio and Net Investment Return for the two months ended October 31, 2002

DRAFT

	Asset Allocation	Endowment Neutral Policy Portfolio	Endowment Neutral Policy Portfolio Return (1)	Benchmark
Cash	0.6%	0.0%	0.31%	90 Day T-Bills Average Yield
Domestic Common Stocks:				
Large/Medium Capitalization Equities	19.1%	25.0%	-3.02%	Standard and Poor's 500 Index
Small Capitalization Equities	7.6%	7.5%	-4.21%	Russell 2000 Index
Total Domestic Common Stocks	26.7%	32.5%		
International Common Stocks:				
Established Markets	10.9%	12.0%	-5.94%	Morgan Stanley Capital International Europe, Asia, Far East Index (net)
Emerging Markets	4.3%	3.0%	-5.26%	Morgan Stanley Capital International Emerging Markets Free
Total International Common Stocks	15.2%	15.0%		
Inflation Hedging	8.9%	7.5%	0.63%	33% (Goldman Sachs Commodity Index minus 100 basis points) plus 67% (National Commercial Real Estate Index Fund)
Fixed Income:				
Domestic	16.4%	15.0%	1.16%	Lehman Brothers Aggregate Bond Index
International	4.0%	5.0%	0.43%	Salomon Non-U.S. World Government Bond Index, Unhedged
Total Fixed Income	20.4%	20.0%		
Marketable Alternative Equities	12.9%	10.0%	1.48%	90 Day T-Bills Average Yield + 7%
Total Marketable Securities	**84.7%**	**85.0%**	**-1.32%**	
Non-Marketable Alternative Equities	**15.3%**	**15.0%**	**-2.49%**	Wilshire 5000 U.S. Equities Index + 4%
Total	**100.0%**	**100.0%**	**-1.72%**	

(1) The benchmark return for the endowment neutral policy portfolio is calculated by summing the neutrally weighted index return (% weight for the asset class multiplied by the benchmark return for the asset class) for the various asset classes in the endowment portfolio for the period reported.

I. PERMANENT UNIVERSITY FUND (continued)

Prior Asset Allocation

b.) Comparison of Asset Allocation Versus Endowment Neutral Policy Portfolio and Net Investment Return for the two months ended October 31, 2002

DRAFT

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(1) The benchmark return for the endowment neutral policy portfolio is calculated by summing the neutrally weighted index return (% weight for the asset class multiplied by the benchmark return for the asset class) for the various asset classes in the endowment portfolio for the period reported.

II. GENERAL ENDOWMENT FUND (1)

DRAFT

a.) Summary Investment Report at October 31, 2002

($ millions)

	FY01-02 Full Year		FY02-03 Two Months Ending October 31, 2002	
Beginning Net Assets	3,723.9		3,293.2	
Net Contributions	(230.7)		(7.9)	
Investment Return	(245.3)		(65.4)	
Expenses	(7.2)		(0.7)	
Allocations (3)	52.5		40.3	
Ending Net Assets	3,293.2		3,259.5	
Net Asset Value per Unit	90.932		89.124	
Units and Percentage Ownership (End of Period):				
PHF	7,676,762	21.2%	7,676,762	21.0%
LTF	28,539,389	78.8%	28,895,452	79.0%
Total	36,216,151	100.0%	36,572,214	100.0%
Total Net Investment Return	-6.96%		-1.97%	

(1) Report prepared in accordance with Texas Education Code Sec. 51.0032.

(2) The GEF allocates its net investment income and realized gain or loss to its unitholders at month end. The allocated investment income and realized gain amounts are considered reinvested as GEF contributions. Any allocated realized losses reduce the cost basis of the units in the GEF. Since the allocation is proportional to the percentage of ownership by the unitholders, no additional units are purchased.

II. GENERAL ENDOWMENT FUND (continued) **DRAFT**

b.) Unitholders' Summary Investment Report at October 31, 2002 (1)

($ millions)

	FY01-02 Full Year	FY02-03 Two Months Ending October 31, 2002
PERMANENT HEALTH FUND		
Beginning Net Assets	881.4	698.2
Withdrawals	(88.2)	-
Investment Return	(52.6)	(13.9)
Expenses	(0.6)	(0.1)
Distributions (Payout) (2)	(41.8)	(6.4)
Ending Net Assets	698.2	677.8
Net Asset Value per Unit (3)	0.851524	0.826627
No. of Units (End of Period)	820,000,000	820,000,000
Distribution Rate per Unit	0.04700	0.00783
Total Net Investment Return	-7.05%	-2.01%
LONG TERM FUND		
Beginning Net Assets	2,843.3	2,595.1
Net Contributions	89.3	34.9
Investment Return	(199.7)	(52.2)
Expenses	(3.0)	(2.6)
Distributions (Payout) (2)	(134.8)	(23.6)
Ending Net Assets	2,595.1	2,551.6
Net Asset Value per Unit (3)	4.788	4.645
No. of Units (End of Period)	542,049,359	549,346,011
Distribution Rate per Unit	0.25100	0.04300
Total Net Investment Return	-6.97%	-1.96%

(1) The Permanent Health Fund (PHF) and Long Term Fund (LTF) are internal mutual funds for the pooled investment of endowment funds. The PHF is comprised of endowments for health-related institutions of higher education and the LTF is comprised of privately raised endowments and other long term funds of UT System components.

(2) The PHF and LTF accrue for their respective quarterly distributions on a monthly basis. In order to generate the cash for the distributions, the PHF and LTF sell units at quarter end. Therefore, the total PHF and LTF net assets will be less than the GEF net assets on month ends other than fiscal quarter ends.

(3) The asset allocation of the PHF and LTF is representative of the asset allocation for the GEF. A nominal amount of cash is held in PHF and LTF to pay expenses incurred separately by these funds.

II. GENERAL ENDOWMENT FUND (continued)

Current Asset Allocation (Approved by UTIMCO Board; Pending Board of Regents Approval)

c.) Comparison of Asset Allocation Versus Endowment Neutral Policy Portfolio and Net Investment Return for the two months ended October 31, 2002

DRAFT

	Asset Allocation	Endowment Neutral Policy Portfolio	Actual Net Investment Return	Endowment Neutral Policy Portfolio Return (1)	Benchmark
Cash and Cash Equivalents	0.6%	0.0%	0.30%	0.31%	91 Day T-Bills Average Yield
Domestic Public Equities					Wilshire 5000 U.S. Equities Index
Passive Long	16.8%	11.0%	-3.65%	-3.15%	
Active Long	11.6%	10.0%	-3.49%	-3.15%	
Hedge and Alpha Transport	5.1%	10.0%	1.25%	-3.15%	
Total Domestic Public Equities	33.5%	31.0%	-2.86%	-3.15%	
International Public Equities					Morgan Stanley Capital International - All Country World Free ex U.S.
Passive Long	7.2%	6.5%	-5.70%	-5.80%	
Active Long	8.4%	7.5%	-5.59%	-5.80%	
Hedge and Alpha Transport	0.6%	5.0%	0.05%	-5.80%	
Total International Public Equities	16.2%	19.0%	-5.45%	-5.80%	
Absolute Return	8.2%	10.0%	0.88%	0.98%	91 Day T-Bills Average Yield + 4%
Inflation Hedging	9.0%	10.0%	-5.20%	-2.22%	(25% Goldman Sachs Commodity Index minus 100 basis points) + (25% Treasury Inflation Protected Securities) + (25% National Commercial Real Estate Index Fund) + (25% Wilshire Associates Real Estate Securities Index)
Fixed Income	20.6%	15.0%	0.46%	1.34%	(33% Lehman Brothers Aggregate Bond Index ex- U.S. Governments) + (67% Lehman Brothers Government Bond Index)
Total Marketable Securities	**88.1%**	**85.0%**	**-2.48%**	**-2.14%**	
Private Capital	**11.9%**	**15.0%**	**2.08%**	**-2.49%**	Wilshire 5000 U.S. Equities Index + 4% **(2)**
Total	**100.0%**	**100.0%**	**-1.97%**	**-2.17%**	

(1) The benchmark return for the endowment neutral policy portfolio is calculated by summing the neutrally weighted index return (% weight for the asset class multiplied by the benchmark return for the asset class) for the various asset classes in the endowment portfolio for the period reported.
(2) Due to valuation and liquidity characteristics associated with Private Capital, short-term benchmark comparisons are not appropriate.

c.) Comparison of Asset Allocation Versus Endowment Neutral Policy Portfolio and Net Investment Return for the two months ended October 31, 2002.

DRAFT

	Asset Allocation	Endowment Neutral Policy Portfolio	Endowment Neutral Policy Portfolio Return (1)	Benchmark
Cash	0.7%	0.0%	0.31%	90 Day T-Bills Average Yield
Domestic Common Stocks:				
Large/Medium Capitalization Equities	20.2%	25.0%	-3.02%	Standard and Poor's 500 Index
Small Capitalization Equities	8.2%	7.5%	-4.21%	Russell 2000 Index
Total Domestic Common Stocks	28.4%	32.5%		
International Common Stocks:				
Established Markets	11.1%	12.0%	-5.94%	Morgan Stanley Capital International Europe, Asia, Far East Index (net)
Emerging Markets	4.5%	3.0%	-5.26%	Morgan Stanley Capital International Emerging Markets Free
Total International Common Stocks	15.6%	15.0%		
Inflation Hedging	9.0%	7.5%	0.63%	33% (Goldman Sachs Commodity Index minus 100 basis points) plus 67% (National Commercial Real Estate Index Fund)
Fixed Income:				
Domestic	16.2%	15.0%	1.16%	Lehman Brothers Aggregate Bond Index
International	4.4%	5.0%	0.43%	Salomon Non-U.S. World Government Bond Index, Unhedged
Total Fixed Income	20.6%	20.0%		
Marketable Alternative Equities	13.8%	10.0%	1.48%	90 Day T-Bills Average Yield + 7%
Total Marketable Securities	**88.1%**	**85.0%**	**-1.32%**	
Non-Marketable Alternative Equities	**11.9%**	**15.0%**	**-2.49%** (2)	Wilshire 5000 U.S. Equities Index + 4%
Total	**100.0%**	**100.0%**	**-1.72%**	

(1) The benchmark return for the endowment neutral policy portfolio is calculated by summing the neutrally weighted index return (% weight for the asset class multiplied by the benchmark return for the asset class) for the various asset classes in the endowment portfolio for the period reported.

III. SHORT INTERMEDIATE TERM FUND (1) **DRAFT**

Summary Investment Report at October 31, 2002

($ millions)

	FY01-02 Full Year	FY02-03 Two Months Ended October 31, 2002
Beginning Net Assets	1,704.6	1,435.9
Net Contributions	(261.0)	45.1
Investment Return	60.3	5.4
Expenses	(0.7)	(0.1)
Distributions of Income	(67.3)	(10.0)
Ending Net Assets	1,435.9	1,476.3
Net Asset Value per Unit	10.099	10.066
No. of Units (End of Period)	142,184,975	146,653,309
Total Net Investment Return	3.75%	0.36%

(1) Report prepared in accordance with Texas Education Code Sec. 51.0032.

IV. SEPARATELY INVESTED ASSETS

Summary Investment Report at October 31, 2002

DRAFT

($ thousands)

	FUND TYPE													
	CURRENT PURPOSE DESIGNATED		**CURRENT PURPOSE RESTRICTED**		**ENDOWMENT & SIMILAR FUNDS**		**ANNUITY & LIFE INCOME FUNDS**		**AGENCY FUNDS**		**OPERATING FUNDS**		**TOTAL**	
ASSET TYPES														
Cash & Equivalents:	BOOK	MARKET	BOOK	MARKET	BOOK	MARKET	BOOK	MARKET	BOOK	MARKET	BOOK	MARKET	BOOK	MARKET
Beginning value 9/1/0	4,064	4,064	2,353	2,353	35,612	35,612	525	525	79	79	######	######	#######	#######
Increase/(Decrease)	(2,299)	(2,299)	(1,047)	(1,047)	(20,068)	(20,068)	(453)	(453)	3	3	(55,721)	(55,721)	(79,585)	(79,585)
Ending value 10/31/0	1,765	1,765	1,306	1,306	15,544	15,544	72	72	82	82	######	######	#######	#######
Debt Securities:														
Beginning value 9/1/0	-	-	263	184	48,713	47,578	14,575	15,248	-	-	236,696	254,199	300,247	317,209
Increase/(Decrease)	-	-	-	5	(8,399)	(4,764)	(93)	(21)	-	-	14,765	(28,977)	6,273	(33,757)
Ending value 10/31/0	-	-	263	189	40,314	42,814	14,482	15,227	-	-	251,461	225,222	306,520	283,452
Equity Securities:														
Beginning value 9/1/0	40	3,750	1,970	1,632	32,701	32,844	23,277	17,131	-	-	136,062	81,293	194,050	136,650
Increase/(Decrease)	-	(172)	1	-	(534)	(1,540)	99	(635)	-	-	557	(2,458)	123	(4,805)
Ending value 10/31/0	40	3,578	1,971	1,632	32,167	31,304	23,376	16,496	-	-	136,619	78,835	194,173	131,845
Other:														
Beginning value 9/1/0	11,000	11,000	1,215	1,215	784	784	125	21	-	-	-	-	13,124	13,020
Increase/(Decrease)	#####	#####	(1,215)	(1,215)	(784)	(784)	-	-	-	-	-	-	(12,999)	(12,999)
Ending value 10/31/0	-	-	-	-	-	-	125	21	-	-	-	-	125	21

Report prepared in accordance with Texas Education Code Sec. 51.0032.
Details of individual assets by account furnished upon request.

Marketable Alternative Assets

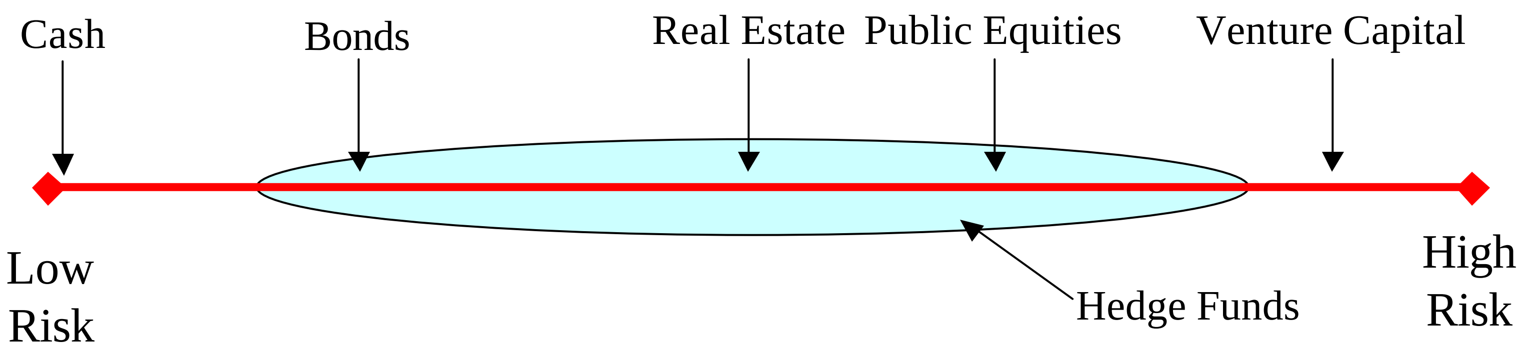
Presentation to the Finance and Planning Committee of the Board of Regents

January 2003

What are Hedge Funds?

Hedge funds are active management portfolios that use more aggressive management techniques than traditional active management such as shorting securities and using leverage to establish and maintain positions.

Where Do Hedge Funds Lie on the Risk Spectrum?



Why are Hedge Funds Attractive?

- Superior talent pool
- Fee structures feature greater alignment of interest than traditional active management; natural incentives to limit asset growth
- Pay only for pure active management, not diversification; managers' focus is narrow and deep
- Lower correlations to traditional managers and therefore provide additional diversification to the endowment funds' asset mix
- Attractive risk control characteristics which can aid in developing Structured Active Management Strategies
- High PVA

What are the Disadvantages?

- Less than 10% of all Hedge Funds are regulated by any governmental entity; most are established offshore
- Some strategies are exotic and are very difficult to understand and track
- Fees are higher than traditional active public securities management
- Some strategies use leverage which magnifies mistakes
- Fee structures can have “agency” problems
- The best managers are severely limited on capacity

Hedge Funds are High PVA Investments

Differences in Returns (%)	U.S. Equities	U.S. Fixed Income	Int'l Equities	Real Estate	Int'l Fixed Income	Small Cap U.S. Equity	Venture Capital	Hedge Funds	Private Equity
Selection Reward	1.10	1.10	1.20	2.10	2.90	5.63	9.00	9.50	10.60
Selection Penalty	(0.60)	(1.00)	(0.90)	(1.90)	(1.90)	(6.10)	(7.50)	(8.90)	(12.10)
Value-Added Spread	1.70	2.10	2.10	4.00	4.80	11.73	16.50	18.40	22.70

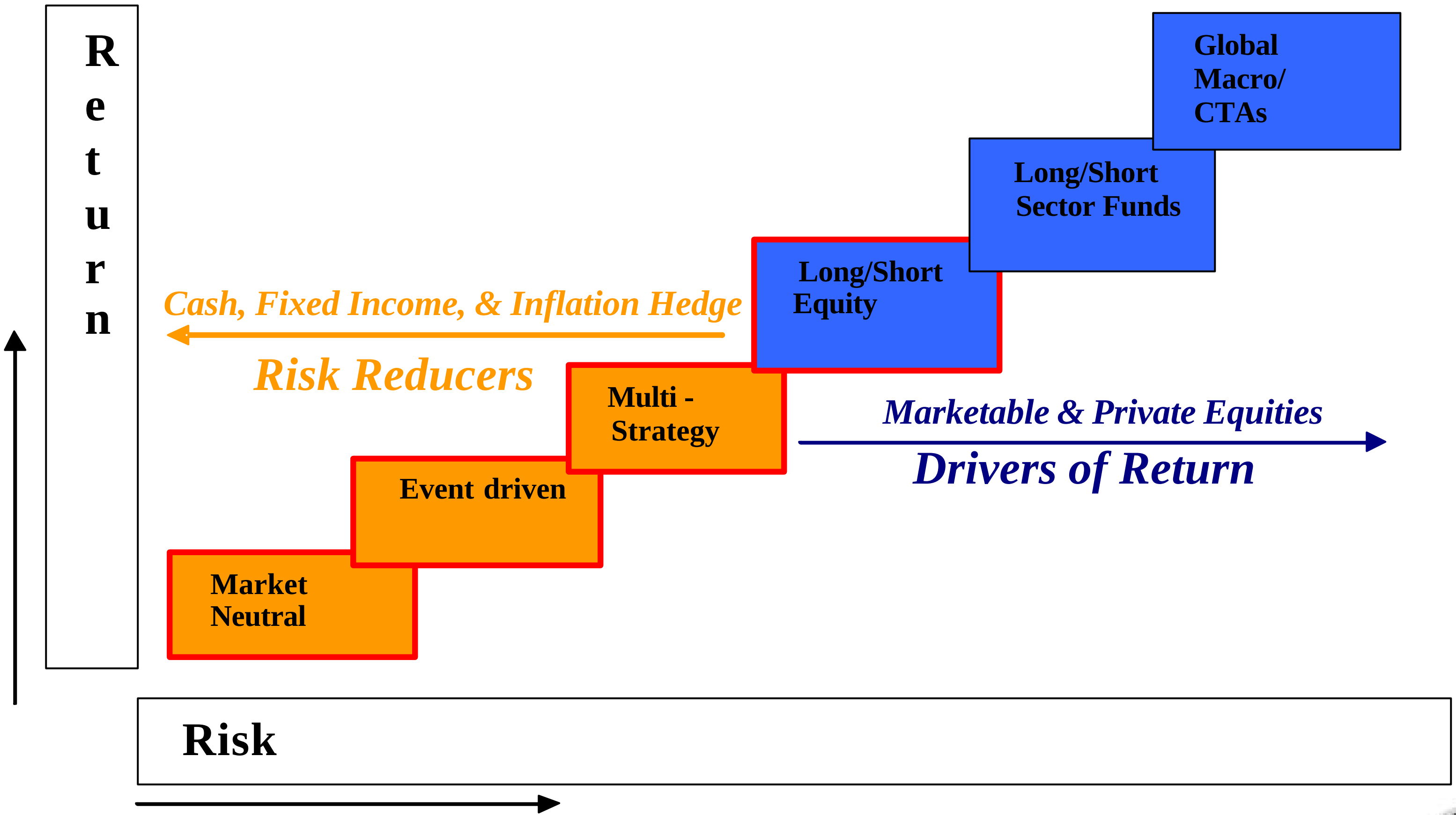
Selection Reward = First Quartile Return minus Median Return
Selection Penalty = Third Quartile Return minus Median Return
Value Added Spread = First Quartile Return minus Third Quartile Return

- Potential value added by hedge find managers is high
- Potential value added by UTIMCO staff in selecting hedge fund managers is high

Many Different Hedge Fund Strategies

- **Relative Value**
  - Equity Market Neutral Long/Short (or ß neutral)
  - Fixed Income Arbitrage
  - Statistical Arbitrage (Trading)
  - Convertible Arbitrage
- **Event Driven**
  - Merger Arbitrage
  - Distressed Debt
  - Corporate Reorg/Restr/Spin-off
  - Special Situations
- **Multi-Strategy (Rotational)**
- **Long/Short Equity**
  - Global/International
  - Opportunistic
  - Sector Specific
  - Short Biased
- **Global Macro**
  - Discretionary Trading
  - Systematic Trend Following
  - Tactical Asset Allocation

Hedge Fund Strategies by Functional Characteristics



What has Been our Experience with Hedge Funds?

- Four out of five managers have outperformed a very difficult benchmark (T-bills + 7%)
- The cumulative effect of superior performance since 1998 has added more than $516 million to the endowment funds' value above what would have been earned by traditional equity investments (after all fees and expenses)
- The superior performance was accomplished at a risk level 67% lower than that of a traditional equity portfolio
- An important negative surprise: WorldCom bonds

Alternative Marketable Assets

Manager Performance August 31, 2002

Function & Asset Category	Implementation Strategies	Manager	Allocation August 31, 2002 (in millions)	PUF and GEF Combined	One Year	Two Years	Three Years	Four Years
Drivers of Return:	**Long/Short Equity**	Maverick Capital	$452.1	4.5%	**(1.0)%**	**12.4%**	**16.7%**	**17.7%**
		OCM Emerging	$53.4	.5%	**-----**	**-----**	**-----**	**-----**
Subtotal			**$505.5**	**5.0%**				
Risk Reducers:	**Absolute Return**	Farallon Capital	$268.7	2.7%	**3.4%**	**8.4%**	**11.0%**	**12.9%**
	Multistrategy Event Driven	Perry Partners	$304.9	3.0%	**3.3%**	**10.1%**	**12.9%**	**14.7%**
		Satellite	$170.5	1.7%	**(22.4)%**	**(5.5)%**	**-----**	**-----**
Subtotal			**$744.1**	**7.4%**				
Grand total			**$1,249.6**	**12.4%**				
Index Returns:								
S&P 500 (Equities)					**(18.0)%**	**(21.2)%**	**(10.3)%**	**.2%**
Lehman Brothers Aggregate (Fixed Income)					**8.1%**	**10.2%**	**9.3%**	**7.1%**

Future Hedge Fund Plans

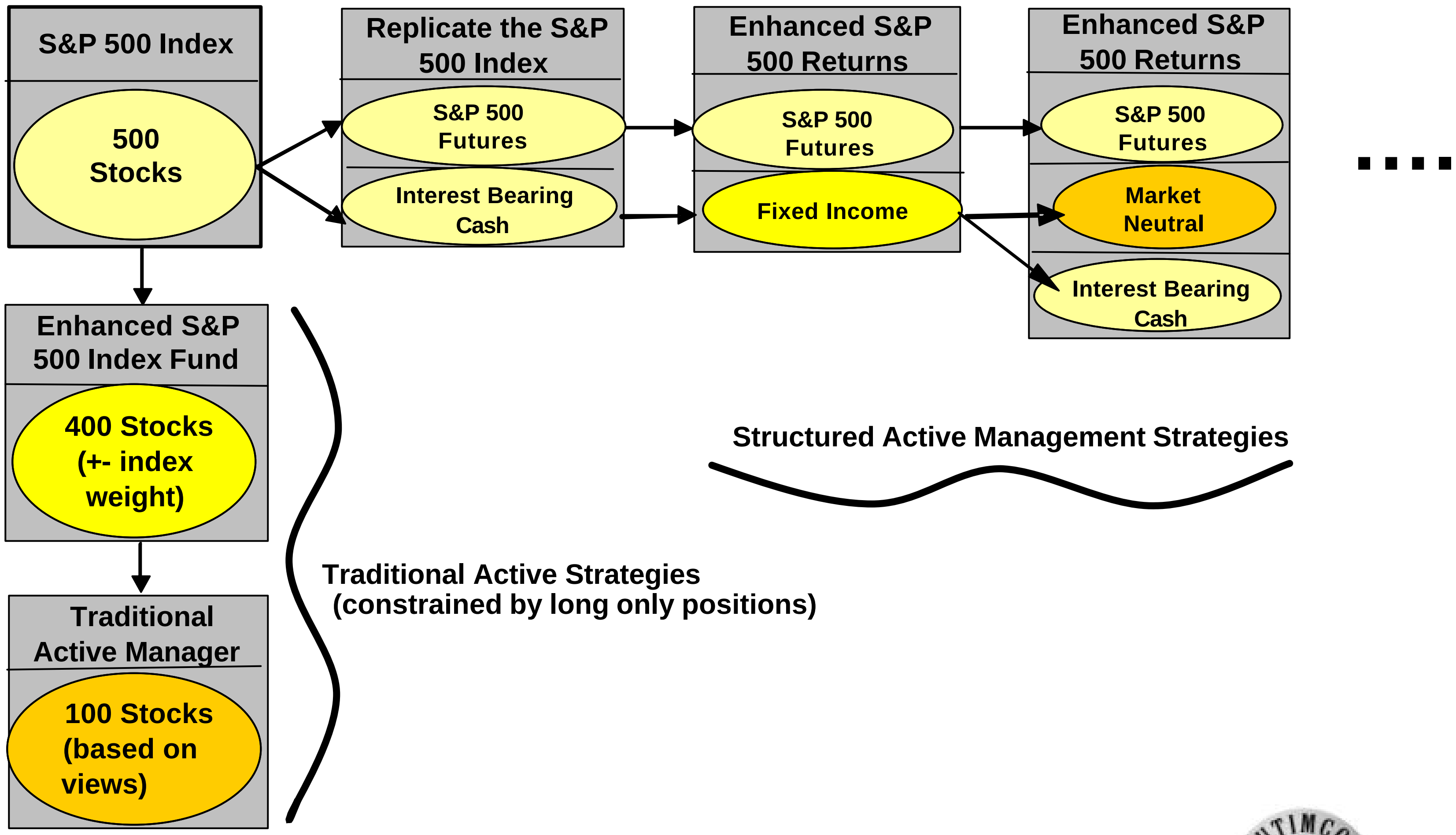
- Increase hedge fund target to 20% of total assets from current 10% target
- Broaden range of strategies employed to gain additional diversification
- Use creative fund of funds strategies to mitigate capacity problems
- Use staff risk management and derivatives management skills to complement hedge fund managers in order to create Structured Active Management alternatives to traditional active and passive management

UTIMCO Use of Hedge Fund Strategies

Multi-Strategy (Rotational)

Relative Value	Event Driven	Long/Short Equity	Global Macro
Equity Market Neutral Long/Short (or ß neutral)	Merger Arbitrage	Global/International	Discretionary Trading
Fixed Income Arbitrage	Distressed Debt	Opportunistic	Systematic Trend Following
Statistical Arbitrage (Trading)	Corporate Reorg/Restr/Spin-off	Sector Specific	Tactical Asset Allocation
Convertible Arbitrage	Special Situations	Short Biased	

Traditional vs Structured Active Management



Factors Important to Future Success in our Hedge Funds Allocations

- Assessing manager skill
- Thoroughly understanding and monitoring hedge fund strategies
- Ensuring adequate transparency
- Monitoring and controlling individual and aggregate hedge fund risk levels
- Controlling asset growth so that size of each fund complements the particular strategy
- Monitoring risk management and internal controls at each hedge fund
- Maintaining alignment of interests
- Moving assets when warning signs appear

UTIMCO

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THE UNIVERSITY OF TEXAS
INVESTMENT MANAGEMENT COMPANY

Appendix

Alternative Marketable Investments

Category Definitions

Categories of Alternative Marketable Investments
Relative Value

- Relative Value managers look to take advantage of pricing inefficiencies among individual securities, focusing on the value of one security relative to another. They seek to profit from their view via an arbitrage, or market-neutral, position in which they are long the undervalued security and short the one they believe is overvalued. There are four basic relative value strategies: Market Neutral, Fixed Income Arbitrage, Statistical Arbitrage, and Convertible Arbitrage.

  - **Equity Market Neutral** – Managers take both long and short positions in matched equity portfolios of the same size within a country. Market neutral portfolios are designed to be either beta or currency neutral, or both. Well-designed portfolios typically control for industry, sector, market capitalization, and other exposures.

  - **Fixed Income Arbitrage** – Managers attempt to identify pricing anomalies in various fixed income markets, ranging from government bonds to mortgage-backed securities. If, for example, the US Treasury announced a cutback on the future issuance of 30-year Treasuries, the 30-year might rally in absolute terms and in relation to the 10-year. A manager believing prices would revert to prior levels might buy the (cheaper) 10-year and short the 30-year.

  - **Statistical Arbitrage** – Managers, believing that equity behavior is mathematically describable, perform a low risk, market neutral analytical equity strategy. This approach captures momentary pricing aberrations in the stocks being monitored and seeks to exploit them at the lowest level of risk. Managers employ a variety of techniques: classical times series, statistical pattern recognition, extreme time theory, etc., to determine misevaluation.

  - **Convertible Arbitrage** – Managers seek to identify convertible bonds that they view as undervalued. They establish arbitrage positions in which they buy the convertible bond and short the stock of the same issuer to eliminate the stock price risk embedded in the convertible bond. Hedging strategies seek to profit from increased volatility.

  - **Multi-Strategy** – Managers can use multiple Relative Value and Event Driven strategies to seek their objectives.

Categories of Alternative Marketable Investments
Event Driven

- Event Driven managers typically invest based on the anticipated outcomes of company-specific or transaction-specific situations, such as merger, acquisition, or emergence from bankruptcy. Performance depends on how well the managers analyze event-specific situations, rather than on the direction of the stock or bond markets. There are four main Event Driven strategies: Merger Arbitrage, Distressed Debt, Corporate Reorganization/Restructuring/Spin-off, and Special Situations.

  - **Merger Arbitrage** – Managers consider buying the stock of an acquisition target after an acquirer has publicly made a bid. Before buying, the managers analyze the probability of the deal closing, the likelihood of it closing at or above the bid price, and the timeframe to the closing date. If the deal involves a regulated industry (such as banking), they factor in regulatory risk. Most merger arb managers look at both cash and stock deals. In stock-for-stock deals, they often buy the stock of the target company and simultaneously short the stock of the acquirer (giving the position deal exposure but no 'net market exposure').

  - **Distressed Debt** – Managers consider the situations of companies in bankruptcy or near-bankruptcy. In a typical situation, a financial institution makes a loan to a borrower at full value or '100 cents on the dollar'. Then the company gets into trouble; it is in bankruptcy or close to it and the value of the loan falls to 30 cents on the dollar. A Distressed Debt specialist analyzes the situation: does the business have value? Is the company in trouble because of problems, such as over-leveraging, that can be rectified? What is the inter-creditor situation? Are there legal issues? What class of debt will have the most power in the restructuring? Or conversely, is this company in such bad shape that even at 30 cents on the dollar, it is overvalued?

  - **Corporate Reorg/Restr/Spin-off** – Managers seek to profit from a spin-off or reorganization of a company. In spin-offs, a subsidiary or division becomes an independent company and the shares of the new entity are often mispriced to the intrinsic value of the company. By buying the stocks of the parent company, often the stocks of the residual company can be created at a discount. To hedge the market risk the manager often shorts related companies to the residual company that do not trade at a discount.

  - **Special Situations** – Managers seek to invest in opportunities where stock or bond prices are expected to change in a short period of time due to special situations such as stock buyback, spin-off, bond upgrade, earnings surprise, etc. Managers take long positions in positive situations and short positions in negative situations. They tend to be interested in specific companies and do not try to forecast economic or market trends.

Categories of Alternative Marketable Investments
Long/Short Equity

- Long/Short Equity managers take long and short stock positions. The manager may attempt to profit from "alpha" generation on both long and short stock positions independently, or profit from the relative outperformance of long positions against short positions. The stock picking and portfolio construction process is usually based on bottom-up fundamental stock analysis, but may also include top-down macro-based views, market trends, and sentiment factor.
  - **Global/International** –Managers take both long and short positions, but do so on a global basis, depending on their market outlook.
  - **Opportunistic** – Managers employ a variety of approaches for capital appreciation. Managers "opportunistically" move to asset classes or strategies that give what they feel are the best possible returns. An opportunistic manager could also be invested in many different strategies, like value, special situations, and distressed securities, at one time.
  - **Sector Specific** – Managers take both long and short stock positions, but primarily concentrate on a specific sector such as healthcare, technology, financials, etc.
  - **Short-Biased** – Managers maintain a net short bias against the market. That is, managers look for securities that they perceive to be overvalued and short those stocks or use derivatives to profit from a declining share price. They tend to achieve better results in bearish markets.

Categories of Alternative Marketable Investments
Global Macro

- Global Macro managers focus on macro-economic opportunities in the global equity, fixed income, currency and commodity markets. The manager tries to exploit perceived divergence between and within these various asset classes.
  - **Discretionary Trading** – Managers tend to be the least constrained as they can be long or short equities, currencies, fixed income securities, and even commodities. They tend to make concentrated bets on market moves based on their own fundamental analysis. In general, this risk tends to be the highest risk and highest return strategy within the universe of hedge funds.
  - **Systematic Trend Following** – Managers use proprietary, quantitative models to identify market opportunities and establish positions. They seek to identify a trend and position themselves to stay invested as long as it persists. The managers tend to specialize in either the equity, fixed income, commodity, or currency markets.
  - **Tactical Asset Allocation** – Managers use proprietary, quantitative models to identify market opportunities across equity, bonds, and currency markets and tactically overweight undervalued markets and underweight overvalued markets.

Request for Approval to Amend the Permanent University Fund and General Endowment Fund Investment Policy Statements

The amendments to the PUF and GEF Investment Policy Statements are proposed following a review of asset allocation for the PUF and the GEF by Cambridge Associates and UTIMCO, in addition to other amendments clarifying provisions in the investment policies. The proposed amendments are summarized below:

- *[Reference – page 3 for PUF]* For the PUF only, eliminating the word "person" in reference to the prudent person investment standard. The standard is defined as prudent investor.
- [*Reference – Page 3 for PUF and Page 1 for GEF*] Replacement of the language for hiring unaffiliated investment managers to language referring to the UTIMCO Board of Directors' approved Delegation of Authority Guidelines for the selection and termination of managers. These guidelines were approved by the UTIMCO Board of Directors in September 2000. (Approved Delegation of Authority Guidelines included as an Exhibit for reference purposes)
- [*Reference - Page 4 for PUF and Page 3 for GEF*] Amendment to clarify the definition of alternative marketable investments and their use in implementing the asset allocation policy.
- [*Reference - Page 5 for PUF and Page 4 for GEF*] Inclusion of language to provide clarification to Exhibit A (Specific Asset Allocation Expected Return and Risk, Neutral Allocations, Ranges and Performance Objectives).
- [*Reference - Page 6 for PUF and Page 4 for GEF*] Amendment of range for broadly defined equity from 68% - 90% to 65% - 90%.
- [*Reference - Page 6 for PUF and Page 4 for GEF*] Amendment of the provision for the allocation to deflation hedging and other fixed income to not exceed 35% of the Fund instead of 32% of the Fund.
- [*Reference - Page 6 for PUF and Page 4 for GEF*] Amendment of performance measurement to clarify that investment performance is routinely measured by the Fund's custodian, who is an unaffiliated organization.
- [*Reference - Page 7 for PUF and Page 5 for GEF*] Modification of derivatives language to reference the Derivatives Policy due to be approved by the UTIMCO Board of Directors on October 31, 2002. (Derivative Investment Policy included as an Exhibit for reference purposes)

- [*Reference – Page 11 for PUF and Page 10 for* GEF] Amendment eliminating the descriptive language for investments in alternative and inflation hedging assets since it is addressed in the Delegation of Authority Guidelines for the selection and termination of managers approved by the UTIMCO Board of Directors.
  (Approved Delegation of Authority Guidelines included as an Exhibit for reference purposes)

The UTIMCO Board of Directors approved the proposed amendments to the Investment Policy Statements for the PUF and GEF on September 18, 2002. No changes are proposed for the Investment Policy Statements of the Long Term Fund, the Permanent Health Fund, the Short Term Fund, the Short Intermediate Term Fund, or the Separately Invested Funds.

THE UNIVERSITY OF TEXAS SYSTEM
PERMANENT UNIVERSITY FUND
INVESTMENT POLICY STATEMENT

Purpose

The Permanent University Fund (the "Fund") is a public endowment contributing to the support of institutions of The University of Texas System (other than The University of Texas-Pan American and The University of Texas at Brownsville) and institutions of The Texas A&M University System (other than Texas A&M University-Corpus Christi, Texas A&M International University, Texas A&M University-Kingsville, West Texas A&M University, Texas A&M University-Commerce, Texas A&M University-Texarkana, and Baylor College of Dentistry).

Fund Organization

The Permanent University Fund was established in the Texas Constitution of 1876 through the appropriation of land grants previously given to The University of Texas at Austin plus one million acres. The land grants to the Permanent University Fund were completed in 1883 with the contribution of an additional one million acres of land. Today, the Permanent University Fund contains 2,109,190 acres of land (the "PUF Lands") located in 24 counties primarily in West Texas.

The 2.1 million acres comprising the PUF Lands produce two streams of income: a) mineral income, primarily in the form of oil and gas royalties and b) surface income, in the form of surface leases and easements. Under the Texas Constitution, mineral income, as a non-renewable source of income, remains a non-distributable part of PUF corpus, and is invested in securities. Surface income, as a renewable source of income, is distributed to the Available University Fund (the "AUF"), as received.

The Constitution prohibits the distribution and expenditure of mineral income contributed to the Fund. The Constitution also requires that all surface income and investment distributions paid to the AUF be expended for certain authorized purposes.

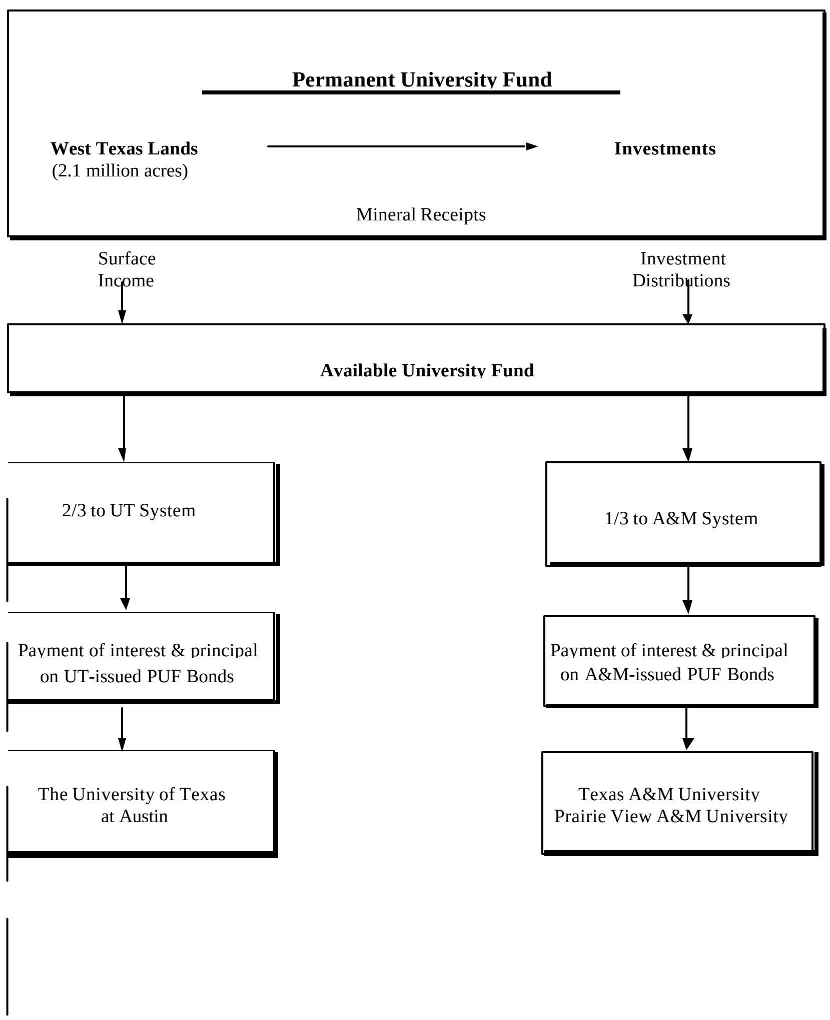
The expenditure of the AUF is subject to a prescribed order of priority:

First, following a 2/3rds and 1/3rd allocation of AUF receipts to the U. T. System and Texas A&M University System, respectively, expenditures for debt service on PUF bonds. Article VII of the Texas Constitution authorizes the U. T. Board and the Texas A&M University System Board (the "TAMUS Board") to issue bonds payable from their respective interests in AUF receipts to finance permanent improvements and to refinance outstanding PUF obligations. The Constitution limits the amount of bonds and notes secured by each System's interest in divisible PUF income to 20% and 10% of the book value of PUF investment securities, respectively. Bond resolutions adopted by both Boards also prohibit the issuance of additional PUF parity obligations unless the projected interest in AUF receipts for each System covers projected debt service at least 1.5 times.

Second, expenditures to fund a) excellence programs specifically at U. T. Austin, Texas A&M University and Prairie View A&M University and b) the administration of the university systems.

The payment of surface income and investment distributions from the PUF to the AUF and the associated expenditures is depicted below in Exhibit 1:

Exhibit 1



Fund Management

Article VII of the Texas Constitution assigns fiduciary responsibility for managing and investing the Fund to the U. T. Board. Article VII authorizes the U. T. Board, subject to procedures and restrictions it establishes, to invest the Fund in any kind of investments and in amounts it considers appropriate, provided that it adheres to the prudent investor [~~person investment~~] standard. This standard provides that the U. T. Board, in making investments, may acquire, exchange sell, supervise, manage, or retain, through procedures and subject to restrictions it establishes and in amounts it considers appropriate, any kind of investment that prudent investors, exercising reasonable care, skill, and caution, would acquire or retain in light of the purposes, terms, distribution requirements, and other circumstances of the fund then prevailing, taking into consideration the investment of all the assets of the fund rather than a single investment.

Ultimate fiduciary responsibility for the Fund rests with the Board. Section 66.08 of the Texas Education Code authorizes the U. T. Board to delegate to its committees, officers or employees of the U. T. System and other agents the authority to act for the U. T. Board in investment of the PUF. The Fund shall be managed through The University of Texas Investment Management Company ("UTIMCO") which shall a) recommend investment policy for the Fund, b) determine specific asset allocation targets, ranges and performance benchmarks consistent with Fund objectives, and c) monitor Fund performance against Fund objectives. UTIMCO shall invest the Fund's assets in conformity with investment policy.

UTIMCO may select and terminate unaffiliated investment managers subject to Delegation of Authority Guidelines approved by the UTIMCO Board. These guidelines are intended to ensure that the appropriate managers are retained to pursue a defined investment strategy within the Fund's portfolio structure and to define the general conditions under which a portfolio manager may be placed on a watch list or terminated. Such managers shall have complete investment discretion unless restricted by the terms of their management contracts. [~~Unaffiliated investment managers may be hired by UTIMCO to improve the Fund's return and risk characteristics. Such managers shall have complete investment discretion unless restricted by the terms of their management contracts.~~] Managers shall be monitored for performance and adherence to investment disciplines.

Fund Administration

UTIMCO shall employ an administrative staff to ensure that all transaction and accounting records are complete and prepared on a timely basis. Internal controls shall be emphasized so as to provide for responsible separation of duties and adequacy of an audit trail. Custody of Fund assets shall comply with applicable law and be structured so as to provide essential safekeeping and trading efficiency.

Fund Investment Objectives

The primary investment objective shall be to preserve the purchasing power of Fund assets and annual distributions by earning an average annual total return after inflation of 5.5% over rolling ten-year periods or longer. The Fund's success in meeting its objectives depends upon its ability to generate high returns in periods of low inflation that will offset lower returns generated in years when the capital markets underperform the rate of inflation.

The secondary fund objective is to generate a fund return in excess of the Policy Portfolio benchmark over rolling five-year periods or longer. The Policy Portfolio benchmark will be established by UTIMCO and will be comprised of a blend of asset class indices weighted to reflect Fund asset allocation policy targets.

Asset Allocation

Asset allocation is the primary determinant of the volatility of investment return and, subject to the asset allocation ranges specified herein is the responsibility of UTIMCO. Specific asset allocation targets may be changed from time to time based on the economic and investment outlook.

Fund assets shall be allocated among the following broad asset classes based upon their individual return/risk characteristics and relationships to other asset classes:

A. Cash Equivalents - are highly reliable in protecting the purchasing power of current income streams but historically have not provided a reliable return in excess of inflation. Cash equivalents provide good liquidity under both deflation and inflation conditions.

B. Fixed Income Investments - Intermediate to long-term investment grade bonds offer the best protection for hedging against the threat of deflation by providing a dependable and predictable source of Fund income. Below investment grade bonds including high yield bonds usually behave more like equities than high-quality bonds such as Treasuries. In the recovery phase of the market such bonds frequently outperform high-quality bonds.

C. Equities - provide both current income and growth of income, but their principal purpose is to provide appreciation of the Fund. Historically, returns for equities have been higher than for bonds over all extended periods. As such, equities represent the best chance of preserving the purchasing power of the Fund.

D. [~~Alternative Investments - generally consist of alternative marketable investments and alternative nonmarketable investments.~~]

[-] Alternative Marketable Investments - These investments are broadly defined to include hedge funds, arbitrage and special situation funds, distressed debt, market neutral, and other nontraditional investment strategies whereby the majority of the [~~whose~~] underlying securities are traded on public exchanges or are otherwise readily marketable. These investments shall be used as implementation strategies within the Absolute Return, Opportunistic Fixed Income, Domestic and International Public Equity asset types. Alternative marketable investments may be made directly by UTIMCO or through investments in partnerships or corporate vehicles. [~~If these investments are made through partnerships they offer faster drawdown of committed capital and earlier realization potential than alternative nonmarketable investments.~~] Alternative marketable investments made through partnerships or corporate vehicles have various redemption options [~~will generally provide investors with liquidity at least annually~~].

E.[-] Alternative Non-marketable Investments - Alternative Non-marketable investments shall be expected to earn superior equity type returns over extended periods. The advantages of alternative non-marketable investments are that they enhance long-term returns through investment in inefficient, complex markets. They offer reduced volatility of Fund asset values through their characteristics of low correlation with listed equities and fixed income instruments. The disadvantages of this asset class are that they may be illiquid, require higher and more complex fees, and are frequently dependent on the quality of external managers. In addition, they possess a limited return history versus traditional stocks and bonds. The risk of alternative non-marketable investments shall be controlled with extensive due diligence and diversification. These investments are held either through limited partnership or as direct ownership interests. They include special equity, mezzanine venture capital, and other investments that are privately held and which are not registered for sale on public exchanges. In partnership form, these investments require a commitment of capital for extended periods of time with no liquidity.

F [~~E~~]. Inflation Hedging Assets - generally consist of assets with a higher correlation of returns with inflation than other eligible asset classes. They include direct real estate, REITs, oil and gas interests, commodities, inflation-linked bonds, timberland and other hard assets. These investments may be held through limited partnership, other commingled funds or as direct ownership interests.

Asset Allocation Policy

The asset allocation policy and ranges herein recognize that the Fund's return/risk profile can be enhanced by diversifying the Fund's investments across different types of assets whose returns are not closely correlated. Asset allocation policies have become increasingly complex requiring the need to disclose the function or purpose of an asset type within the Fund's investment portfolio, in addition to disclosing the underlying implementation strategies within each asset type. The targets and ranges seek to protect the Fund against both routine illiquidity in normal markets and extraordinary illiquidity during a period of extended deflation.

The long-term asset allocation policy for the Fund must recognize that the 5.5% real return objective requires a high allocation to broadly defined equities, including domestic, international stocks, alternative [~~equity~~] investments, and inflation hedging assets of 65[~~8~~]% to 90%. The allocation to deflation hedging and other f[~~F~~]ixed i[~~I~~]ncome investments should therefore not exceed 35[~~2~~]% of the Fund.

The Board delegates authority to UTIMCO to establish specific neutral asset allocations and ranges within the broad policy guidelines described above. UTIMCO may establish specific asset allocation targets and ranges for large and small capitalization U. S. stocks, established and emerging market international stocks, marketable and non-marketable alternative equity investments, and other asset classes as well as the specific performance objectives for each asset class. Specific asset allocation policies shall be decided by UTIMCO and reported to the U. T. Board.

Performance Measurement

The investment performance of the Fund will be measured by the Fund's custodian, an unaffiliated organization, with recognized expertise in this field and reporting responsibility to the UTIMCO Board, and compared against the stated investment benchmarks of the Fund. Such measurement will occur at least annually, and evaluate the results of the total Fund, major classes of investment assets, and individual portfolios.

Investment Guidelines

The Fund must be invested at all times in strict compliance with applicable law. Investment guidelines include the following:

General

- Investment guidelines for index and other commingled funds managed externally shall be governed by the terms and conditions of the Investment Management Contract.

- All investments will be U. S. dollar denominated assets unless held by an internal or external portfolio manager with discretion to invest in foreign currency denominated securities.

- Investment policies of any unaffiliated liquid investment fund must be reviewed and approved by the chief investment officer prior to investment of Fund assets in such liquid investment fund.

- No securities may be purchased or held which would jeopardize the Fund's tax-exempt status.

- No investment strategy or program may purchase securities on margin or use leverage unless specifically authorized by the UTIMCO Board.

- No investment strategy or program employing short sales may be made unless specifically authorized by the UTIMCO Board.

- The Fund's investments in warrants shall not exceed more than 5% of the Fund's net assets or 2% with respect to warrants not listed on the New York or American Stock Exchanges.

- The Fund may utilize Derivative Securities [~~with the approval of the UTIMCO Board~~] to: a) simulate the purchase or sale of an underlying market index while retaining a cash balance for fund management purposes; b) facilitate trading; c) reduce transaction costs; d) seek higher investment returns when a Derivative Security is priced more attractively than the underlying security; e) index or to hedge risks associated with Fund investments; or f) adjust the market exposure of the asset allocation, including long and short strategies and other strategies provided that the Fund's use of derivatives complies with the Derivatives Policy approved by the UTIMCO Board. The Derivatives Policy shall serve the purpose of defining the permitted applications under which derivative securities can be used, which applications are prohibited, and the requirements for the reporting and oversight of their use. The objective of the Derivatives Policy is to facilitate risk management and provide efficiency in the implementation of the investment strategies using derivatives.[~~; provided that leverage is not employed in the implementation of such Derivative purchases or sales. Leverage occurs when the notional value of the futures contracts exceeds the value of cash assets allocated to those contracts by more than 2%. The cash assets allocated to futures contracts is the sum of the value of the initial margin deposit, the daily variation margin and dedicated cash balances. This prohibition against leverage shall not apply where cash is received within 1 business day following the day the leverage occurs. UTIMCO's Derivative Guidelines shall be used to monitor compliance with this policy. Notwithstanding the above, leverage strategies are permissible within the alternative equities investment class with the approval of the UTIMCO Board, if the investment strategy is uncorrelated to~~

~~the Fund as a whole, the manager has demonstrated skill in the strategy, and the strategy implements systematic risk control techniques, value at risk measures, and pre-defined risk parameters.~~

- ~~Such Derivative Securities shall be defined to be those instruments whose value is derived, in whole or part, from the value of any one or more underlying assets, or index of assets (such as stocks, bonds, commodities, interest rates, and currencies) and evidenced by forward, futures, swap, option, and other applicable contracts.~~

  ~~UTIMCO shall attempt to minimize the risk of an imperfect correlation between the change in market value of the securities held by the Fund and the prices of Derivative Security investments by investing in only those contracts whose behavior is expected to resemble that of the Fund's underlying securities. UTIMCO also shall attempt to minimize the risk of an illiquid secondary market for a Derivative Security contract and the resulting inability to close a position prior to its maturity date by entering into such transactions on an exchange with an active and liquid secondary market. The net market value of exposure of Derivative Securities purchased or sold over the counter may not represent more than 15% of the net assets of the Fund.~~

  ~~In the event that there are no Derivative Securities traded on a particular market index such as MSCI EAFE, the Fund may utilize a composite of other Derivative Security contracts to simulate the performance of such index. UTIMCO shall attempt to reduce any tracking error from the low correlation of the selected Derivative Securities with its index by investing in contracts whose behavior is expected to resemble that of the underlying securities.~~

  ~~UTIMCO shall minimize the risk that a party will default on its payment obligation under a Derivative Security agreement by entering into agreements that mark to market no less frequently than monthly and where the counterparty is an investment grade credit. UTIMCO also shall attempt to mitigate the risk that the Fund will not be able to meet its obligation to the counterparty by investing the Fund in the specific asset for which it is obligated to pay a return or by holding adequate short-term investments.~~

  ~~The Fund may be invested in foreign currency forward and foreign currency futures contracts in order to maintain the same currency exposure as its respective index or to protect against anticipated adverse changes in exchange rates among foreign currencies and between foreign currencies and the U. S. dollar.~~]

<u>Cash and Cash Equivalents</u>

- Holdings of cash and cash equivalents may include internal short term pooled investment funds managed by UTIMCO.

- Unaffiliated liquid investment funds as approved by the chief investment officer.

- Deposits of the Texas State Treasury.

- The Fund's custodian late deposit interest bearing liquid investment fund.

- Commercial paper must be rated in the two highest quality classes by Moody's Investors Service, Inc. (P1 or P2) or Standard & Poor's Corporation (A1 or A2).

- Negotiable certificates of deposit must be with a bank that is associated with a holding company meeting the commercial paper rating criteria specified above or that has a certificate of deposit rating of 1 or better by Duff & Phelps.

- Bankers' Acceptances must be guaranteed by an accepting bank with a minimum certificate of deposit rating of 1 by Duff & Phelps.

- Repurchase Agreements and Reverse Repurchase Agreements must be transacted with a dealer that is approved by UTIMCO and selected by the Federal Reserve Bank as a Primary Dealer in U. S. Treasury securities and rated A-1 or P-1 or the equivalent.

    - Each approved counterparty shall execute the Standard Public Securities Association (PSA) Master Repurchase Agreement with UTIMCO.

    - Eligible Collateral Securities for Repurchase Agreements are limited to U. S. Treasury securities and U. S. Government Agency securities with a maturity of not more than 10 years.

    - The maturity for a Repurchase Agreement may be from one day to two weeks.

    - The value of all collateral shall be maintained at 102% of the notional value of the Repurchase Agreement, valued daily.

    - All collateral shall be delivered to the PUF custodian bank. Tri-party collateral arrangements are not permitted.

- The aggregate amount of Repurchase Agreements with maturities greater than seven calendar days may not exceed 10% of the Fund's fixed income assets.

- Overnight Repurchase Agreements may not exceed 25% of the Fund's fixed income assets.

- Mortgage Backed Securities (MBS) Dollar Rolls shall be executed as matched book transactions in the same manner as Reverse Repurchase Agreements above. As above, the rules for trading MBS Dollar Rolls shall follow the Public Securities Association standard industry terms.

<u>Fixed Income</u>

<u>Domestic Fixed Income</u>

Holdings of domestic fixed income securities shall be limited to those securities a) issued by or fully guaranteed by the U. S. Treasury, U. S. Government-Sponsored Enterprises, or U. S. Government Agencies, and b) issued by corporations and municipalities. Within this overall limitation:

- Permissible securities for investment include the components of the Lehman Brothers Aggregate Bond Index (LBAGG): investment grade government and corporate securities, agency mortgage pass-through securities, and asset-backed securities. These sectors are divided into more specific subindices 1) Government: Treasury and Agency; 2) Corporate: Industrial, Finance, Utility, and Yankee; 3) Mortgage-backed securities: GNMA, FHLMC, and FNMA; and 4) Asset-backed securities. In addition to the permissible securities listed above, the following securities shall be permissible: a) floating rate securities with periodic coupon changes in market rates issued by the same entities that are included in the LBAGG as issuers of fixed rate securities; b) medium term notes issued by investment grade corporations; c) zero coupon bonds and stripped Treasury and Agency securities created from coupon securities; and d) structured notes issued by LBAGG qualified entities.

- U. S. Domestic Bonds must be rated investment grade, Baa3 or better by Moody's Investors Services, BBB- by Standard & Poor's Corporation, or an equivalent rating by a nationally recognized rating agency at the time of acquisition. This provision does not apply to an investment manager that is authorized by the terms of an investment advisory agreement to invest in below investment grade bonds.

- Not more than 5% of the market value of domestic fixed income securities may be invested in corporate and municipal bonds of a single issuer provided that such bonds, at the time of purchase, are rated, not less than Baa3 or BBB-, or the equivalent, by any two nationally-recognized rating services, such as Moody's Investors Service, Standard & Poor's Corporation, or Fitch Investors Service.

Non-U. S. Fixed Income

- Not more than 35% of the Fund's fixed income portfolio may be invested in non-U. S. dollar bonds. Not more than 15% of the Fund's fixed income portfolio may be invested in bonds denominated in any one currency.

- Non-dollar bond investments shall be restricted to bonds rated equivalent to the same credit standard as the U. S. Fixed Income Portfolio.

- Not more than 7.5% of the Fund's fixed income portfolio may be invested in Emerging Market debt.

- International currency exposure may be hedged or unhedged at UTIMCO's discretion or delegated by UTIMCO to an external investment manager.

Equities

The Fund shall:

A. hold no more than 25% of its equity securities in any one industry or industries (as defined by the standard industry classification code and supplemented by other reliable data sources) at market

B. hold no more than 5% of its equity securities in the securities of one corporation at cost unless authorized by the chief investment officer.

Alternative Investments and Inflation Hedging Assets

Investments in alternative assets and inflation hedging assets may be made through management contracts with unaffiliated organizations (including but not limited to limited partnerships, trusts, and joint ventures). [~~so long as such organizations:~~

~~A. possess specialized investment skills~~

~~B. possess full investment discretion subject to the management agreement~~

~~C. are managed by principals with a demonstrated record of accomplishment and performance in the investment strategy being undertaken~~

~~D. align the interests of the investor group with the management as closely as possible~~

~~E. charge fees and performance compensation which do not exceed prevailing industry norms at the time the terms are negotiated.~~

~~Investments in alternative nonmarketable assets and inflation hedging assets also may be made directly by UTIMCO in co-investment transactions sponsored by and invested in by a management firm or partnership in which the Fund has invested prior to the co-investment or in transactions sponsored by investment firms well known to UTIMCO management, provided that such direct investments shall not exceed 25% of the market value of the alternative nonmarketable assets portfolio or the inflation hedging assets portfolio at the time of the direct investment.~~]

Members of UTIMCO management, with the approval of the UTIMCO Board, may serve as directors of companies in which UTIMCO has directly invested Fund assets. In such event, any and all compensation paid to UTIMCO management for their services as directors shall be endorsed over to UTIMCO and applied against UTIMCO management fees. Furthermore, UTIMCO Board approval of UTIMCO management's service as a director of an investee company shall be conditioned upon the extension of UTIMCO's Directors and Officers Insurance Policy coverage to UTIMCO management's service as a director of an investee company.

Fund Distributions

The Fund shall balance the needs and interests of present beneficiaries with those of the future. Fund spending policy objectives shall be to:

A. provide a predictable, stable stream of distributions over time

B. ensure that the inflation adjusted value of distributions is maintained over the long term

C. ensure that the inflation adjusted value of Fund assets after distributions is maintained over the long term.

The goal is for the Fund's average spending rate over time not to exceed the Fund's average annual investment return after inflation and expenses in order to preserve the purchasing power of Fund distributions and underlying assets.

The Texas Constitution states that "The amount of any distributions to the available university fund shall be determined by the board of regents of The University of Texas System in a manner intended to provide the available university fund with a stable and predictable stream of annual distributions and to maintain over time the purchasing power of permanent university fund investments and annual distributions to the available university fund. The amount distributed to the available university fund in a fiscal year must be not less than the amount needed to pay the principal and interest due and owing in that fiscal year on bonds and notes issued under this section. If the purchasing power of permanent university fund investments for any rolling 10-year period is not preserved, the board may not increase annual distributions to the available university fund until the purchasing power of the permanent university fund investments is restored, except as necessary to pay the principal and interest due and owing on bonds and notes issued under this section. An annual distribution made by the board to the available university fund during any fiscal year may not exceed an amount equal to seven percent of the average net fair market value of permanent university fund investment assets as determined by the board, except as necessary to pay any principal and interest due and owing on bonds issued under this section. The expenses of managing permanent university fund land and investments shall be paid by the permanent university fund."

Annually, the U. T. Board of Regents will approve a distribution amount to the AUF.

In conjunction with the annual U. T. System budget process, UTIMCO shall recommend to the U. T. Board in May of each year an amount to be distributed to the AUF during the next fiscal year. UTIMCO's recommendation on the annual distribution shall be an amount equal to 4.75% of the trailing twelve quarter average of the net asset value of the Fund for the quarter ending February of each year.

Following approval of the distribution amount, distributions from the Fund to the AUF may be quarterly or annually at the discretion of UTIMCO Management.

Fund Accounting

The fiscal year of the Fund shall begin on September 1st and end on August 31st. Market value of the Fund shall be maintained on an accrual basis in compliance with Financial Accounting Standards Board Statements, Government Accounting Standards Board Statements, industry guidelines, and state statutes, whichever is applicable. Significant asset write-offs or write-downs shall be approved by the chief investment officer and reported to the UTIMCO Board of Directors. The Fund's financial statements shall be audited each year by an independent accounting firm selected by UTIMCO's Board.

Valuation of Assets

As of the close of business on the last business day of each month, UTIMCO shall determine the fair market value of all Fund net assets. Valuation of Fund assets shall be based on the books and records of the custodian for the valuation date. Valuation of alternative assets shall be determined in accordance with the UTIMCO Valuation Criteria for Alternative Assets.

The fair market value of the Fund's net assets shall include all related receivables and payables of the Fund on the valuation. Such valuation shall be final and conclusive.

Securities Lending

The Fund may participate in a securities lending contract with a bank or nonbank security lending agent for either short-term or long-term purposes of realizing additional income. Loans of securities by the Fund shall be collateralized by cash, letters of credit or securities issued or guaranteed by the U. S. Government or its agencies. The collateral will equal at least 100% of the current market value of the loaned securities. The contract shall state acceptable collateral for securities loaned, duties of the borrower, delivery of loaned securities and collateral, acceptable investment of collateral and indemnification provisions. The contract may include other provisions as appropriate. The securities lending program will be evaluated from time to time as deemed necessary by the UTIMCO Board. Monthly reports issued by the agent shall be reviewed by UTIMCO to insure compliance with contract provisions.

Investor Responsibility

As a shareholder, the Fund has the right to a voice in corporate affairs consistent with those of any shareholder. These include the right and obligation to vote proxies in a manner consistent with the unique role and mission of higher education as well as for the economic benefit of the Fund. Notwithstanding the above, the UTIMCO Board shall discharge its fiduciary duties with respect to the Fund solely in the interest of Fund unitholders and shall not invest the Fund so as to achieve temporal benefits for any purpose including use of its economic power to advance social or political purposes.

Amendment of Policy Statement

The Board of Regents reserves the right to amend the Investment Policy Statement as it deems necessary or advisable.

Effective Date

The effective date of this policy shall be February 13, 2003 [~~September 1, 2001~~].

REVISED Exhibit A

ENDOWMENT FUNDS
(5 to 7 Year Time Horizon)
EXPECTED RETURN AND RISK, NEUTRAL ALLOCATIONS, RANGES AND PERFORMANCE OBJECTIVES

Function	Asset Category	Implementation Strategies	Expected Nominal Return	Expected Risk	Target Allocation	Range	Investment Policy Benchmark Return
Drivers of Return:							
	Domestic Public Equity	Passive Management Active Management Hedge and Alpha Transport	7.50%	16.50%	31.00%	25%-45%	Wilshire 5000
	International Public Equity	Passive Developed and Emerging Active Developed and Emerging Hedge and Alpha Transport	7.50%	21.00%	19.00%	10%-30%	Morgan Stanley Capital International-All Country World Free ex U.S.
	Private Capital	Venture Capital Private Equity Private Debt Opportunistic Special Situations	9.75%	24.50%	15.00%	10% -20%	Wilshire 5000 + 4%
	Subtotal Drivers of Return				65.00%	50%-80%	(Sum of Target Weighted Benchmarks)
Risk Reducing Assets:							
	Absolute Return	Market Neutral Hedge Funds	7.00%	8.25%	10.00%	5%-15%	91 day T-Bills Average Yield + 4%
	Inflation Hedging	Financial Exposure to Commodities (GSCI futures) Oil and Gas, Timber and Other Physical Commodities Public Real Estate (REITS) Private Real Estate Treasury Inflation Protected Securities (TIPS)	6.15%	9.25%	10.00%	5%-15%	(25% Goldman Sachs Commodity Index minus 100 basis points) +(25% Treasury Inflation Protected Securities) +(25% National Commercial Real Estate Index Fund) + (25% Wilshire Associates Real Estate Securities Index)
	Opportunistic Fixed Income	Domestic Public Debt (Investment Grade) High Yield Bonds (Below Investment Grade) International Developed Markets Public Debt Emerging Markets Public Debt Hedge and Alpha Transport	7.00%	11.75%	5.00%	2.5%-15%	Lehman Brothers Aggregate Bond Index (ex- U.S. Governments)
	Deflation Hedging	U.S. Government Bonds and Agencies	5.50%	9.25%	10.00%	5.0%-15%	Lehman Brothers Government Bond Index
	Cash and Equivalents	Money Markets	3.50%	3.50%	0.00%	0%-5%	91 day T-Bills Average Yield
	Subtotal Risk Reducing Assets				35.00%	20%-50%	(Sum of Target Weighted Benchmarks)
	Total				100.00%		(Sum of Target Weighted Benchmarks)
		Expected Nominal Return			7.40%		
		Expected Risk			9.70%		
		Return/Risk Ratio			0.76		

Risk is defined in annualized standard deviation terms.
The neutral policy portfolio is the sum of the neutrally weighted benchmark returns.

THE UNIVERSITY OF TEXAS SYSTEM
GENERAL ENDOWMENT FUND
INVESTMENT POLICY STATEMENT

Purpose

The General Endowment Fund (the "Fund"), established by the Board of Regents of The University of Texas System (the "Board") to be effective on March 1, 2001, is a pooled fund for the collective investment of long-term funds under the control and management of the Board. The Fund provides for greater diversification of investments than would be possible if each account were managed separately.

Fund Organization

The Fund is organized as a mutual fund in which each eligible account purchases and redeems Fund units as provided herein. The ownership of Fund assets shall at all times be vested in the Board. Such assets shall be deemed to be held by the Board, as a fiduciary, regardless of the name in which the assets may be registered.

Fund Management

Ultimate fiduciary responsibility for the Fund rests with the Board. Section 66.08, Texas Education Code, as amended, authorizes the U. T. Board, subject to certain conditions, to enter into a contract with a nonprofit Corporation to invest funds under the control and management of the U. T. Board.

The Fund shall be governed through The University of Texas Investment Management Company ("UTIMCO"), a nonprofit Corporation organized for the express purpose of investing funds under the control and management of the Board. UTIMCO shall a) recommend investment policy for the Fund, b) determine specific asset allocation targets, ranges, and performance benchmarks consistent with Fund objectives, and c) monitor Fund performance against Fund objectives. UTIMCO shall invest the Fund assets in conformity with investment policy.

UTIMCO may select and terminate unaffiliated investment managers subject to Delegation of Authority Guidelines approved by the UTIMCO Board. These guidelines are intended to ensure that the appropriate managers are retained to pursue a defined investment strategy within the Fund's portfolio structure and to define the general conditions under which a portfolio manager may be placed on a watch list or terminated. Such managers shall have complete investment discretion unless restricted by the terms of their management contracts. [~~Unaffiliated investment managers may be hired by UTIMCO to improve the Fund's return and risk characteristics. Such managers shall have complete investment discretion unless restricted by the terms of their management contracts.~~] Managers shall be monitored for performance and adherence to investment disciplines.

Fund Administration

UTIMCO shall employ an administrative staff to ensure that all transaction and accounting records are complete and prepared on a timely basis. Internal controls shall be emphasized so as to provide for responsible separation of duties and adequacy of an audit trail. Custody of Fund assets shall comply with applicable law and be structured so as to provide essential safekeeping and trading efficiency.

Funds Eligible to Purchase Fund Units

No fund shall be eligible to purchase units of the Fund unless it is under the sole control, with full discretion as to investments, by the Board and/or UTIMCO.

Any fund whose governing instrument contains provisions which conflict with this Policy Statement, whether initially or as a result of amendments to either document, shall not be eligible to purchase or hold units of the Fund.

Fund Investment Objectives

The primary investment objective shall be to preserve the purchasing power of Fund assets by earning an average annual total return after inflation of 5.5% over rolling ten-year periods or longer. The Fund's success in meeting its objectives depends upon its ability to generate high returns in periods of low inflation that will offset lower returns generated in years when the capital markets underperform the rate of inflation.

The secondary fund objectives are to generate a fund return in excess of the Policy Portfolio benchmark and the average median return of the universe of the college and university endowments as reported annually by Cambridge Associates and NACUBO over rolling five-year periods or longer. The Policy Portfolio benchmark will be established by UTIMCO and will be comprised of a blend of asset class indices weighted to reflect Fund's asset allocation policy targets.

Asset Allocation

Asset allocation is the primary determinant of the volatility of investment return and, subject to the asset allocation ranges specified herein, is the responsibility of UTIMCO. Specific asset allocation targets may be changed from time to time based on the economic and investment outlook. Fund assets shall be allocated among the following broad asset classes based upon their individual return/risk characteristics and relationships to other asset classes:

A. Cash Equivalents - are highly reliable in protecting the purchasing power of current income streams but historically have not provided a reliable return in excess of inflation. Cash equivalents provide good liquidity under both deflation and inflation conditions.

B. Fixed Income Investments - Intermediate to long-term investment grade bonds offer the best protection for hedging against the threat of deflation by providing a dependable and predictable source of Fund income. Below investment grade bonds including high yield bonds usually behave more like equities than high-quality bonds such as Treasuries. In the recovery phase of the market such bonds frequently outperform high-quality bonds.

C. Equities - provide both current income and growth of income, but their principal purpose is to provide appreciation of the Fund. Historically, returns for equities have been higher than for bonds over all extended periods. Therefore, equities represent the best chance of preserving the purchasing power of the Fund.

D. [~~Alternative Investments – generally consist of alternative marketable investments and alternative nonmarketable investments.~~]

[•] Alternative Marketable Investments - These investments are broadly defined to include hedge funds, arbitrage and special situation funds, distressed debt, market neutral, and other nontraditional investment strategies whereby the majority of the [~~whose~~] underlying securities are traded on public exchanges or are otherwise readily marketable. These investments shall be used as implementation strategies within the Absolute Return, Opportunistic Fixed Income, Domestic and International Public Equity asset types. Alternative marketable investments may be made directly by UTIMCO or through investments in partnerships or corporate vehicles. [~~If these investments are made through partnerships they offer faster drawdown of committed capital and earlier realization potential than alternative nonmarketable investments.~~] Alternative marketable investments made through partnerships or corporate vehicles have various redemption options [~~will generally provide investors with liquidity at least annually~~].

E.[•] Alternative Non-marketable Investments - Alternative Non-marketable investments shall be expected to earn superior equity type returns over extended periods. The advantages of alternative non-marketable investments are that they enhance long-term returns through investment in inefficient, complex markets. They offer reduced volatility of Fund asset values through their characteristics of low correlation with listed equities and fixed income instruments. The disadvantages of this asset class are that they may be illiquid, require higher and more complex fees, and are frequently dependent on the quality of external managers. In addition, they possess a limited return history versus traditional stocks and bonds. The risk of alternative non-marketable investments shall be controlled with extensive due diligence and diversification. These investments are held through either limited partnership or as direct ownership interests. They include special equity, mezzanine venture capital, oil and gas, real estate and other investments that are privately held and which are not registered for sale on public exchanges. In partnership form, these investments require a commitment of capital for extended periods of time with no liquidity. They also generally require an extended period of time to achieve targeted investment levels.

F[~~E~~]. Inflation Hedging Assets - generally consist of assets with a higher correlation of returns with inflation than other eligible asset classes. They include direct real estate, REITs, oil and gas interests, commodities, inflation-linked bonds, timberland and other hard assets. These investments may be held through limited partnership, other commingled funds or as direct ownership interests.

Asset Allocation Policy

The asset allocation policy and ranges herein recognize that the Fund's return/risk profile can be enhanced by diversifying the Fund's investments across different types of assets whose returns are not closely correlated. Asset allocation policies have become increasingly complex requiring the need to disclose the function or purpose of an asset type within the Fund's investment portfolio, in addition to disclosing the underlying implementation strategies within each asset type. The targets and ranges seek to protect the Fund against both routine illiquidity in normal markets and extraordinary illiquidity during a period of extended deflation.

The long-term asset allocation policy for the Fund must recognize that the 5.5% real return objective requires a high allocation to broadly defined equities, including domestic, international stocks, alternative [~~equity~~] investments, and inflation hedging assets of 65[~~8~~]% to 90%. The allocation to deflation hedging and other f[~~F~~]ixed i[~~I~~]ncome investments should therefore not exceed 35[~~2~~]% of the Fund.

The Board delegates authority to UTIMCO to establish specific neutral asset allocations and ranges within the broad policy guidelines described above. UTIMCO may establish specific asset allocation targets and ranges for large and small capitalization U. S. stocks, established and emerging market international stocks, marketable and non-marketable alternative equity investments, and other asset classes as well as the specific performance objectives for each asset class. Specific asset allocation policies shall be decided by UTIMCO and reported to the U. T. Board.

Performance Measurement

The investment performance of the Fund will be measured by the Fund's custodian, an unaffiliated organization, with recognized expertise in this field and reporting responsibility to the UTIMCO Board, and compared against the stated investment benchmarks of the Fund. Such measurement will occur at least annually, and evaluate the results of the total Fund, major classes of investment assets, and individual portfolios.

Investment Guidelines

The Fund must be invested at all times in strict compliance with applicable law.

Investment guidelines include the following:

General

- Investment guidelines for index and other commingled funds managed externally shall be governed by the terms and conditions of the Investment Management Contract.
- All investments will be U. S. dollar denominated assets unless held by an internal or external portfolio manager with discretion to invest in foreign currency denominated securities.
- Investment policies of any unaffiliated liquid investment fund must be reviewed and approved by the chief investment officer prior to investment of Fund assets in such liquid investment fund.

- No securities may be purchased or held which jeopardize the Fund's tax exempt status.

- No investment strategy or program may purchase securities on margin or use leverage unless specifically authorized by the UTIMCO Board.

- No investment strategy or program employing short sales may be made unless specifically authorized by the UTIMCO Board.

- The Fund's investments in warrants shall not exceed more than 5% of the Fund's net assets or 2% with respect to warrants not listed on the New York or American Stock Exchanges.

- The Fund may utilize Derivative Securities [~~with the approval of the UTIMCO Board~~] to: a) simulate the purchase or sale of an underlying market index while retaining a cash balance for fund management purposes; b) facilitate trading; c) reduce transaction costs; d) seek higher investment returns when a Derivative Security is priced more attractively than the underlying security; e) index or to hedge risks associated with Fund investments; or f) adjust the market exposure of the asset allocation, including long and short strategies and other strategies provided that the Fund's use of derivatives complies with the Derivatives Policy approved by the UTIMCO Board. The Derivatives Policy shall serve the purpose of defining the permitted applications under which derivative securities can be used, which applications are prohibited, and the requirements for the reporting and oversight of their use. The objective of the Derivatives Policy is to facilitate risk management and provide efficiency in the implementation of the investment strategies using derivatives.[~~; provided that leverage is not employed in the implementation of such Derivative purchases or sales. Leverage occurs when the notional value of the futures contracts exceeds the value of cash assets allocated to those contracts by more than 2%. The cash assets allocated to futures contracts is the sum of the value of the initial margin deposit, the daily variation margin and dedicated cash balances. This prohibition against leverage shall not apply where cash is received within 1 business day following the day the leverage occurs. UTIMCO's Derivatives Guidelines shall be used to monitor compliance with this policy. Notwithstanding the above, leverage strategies are permissible within the alternative equities investment class with the approval of the UTIMCO Board, if the investment strategy is uncorrelated to the Fund as a whole, the manager has demonstrated skill in the strategy, and the strategy implements systematic risk control techniques, value at risk measures, and predefined risk parameters.~~

- ~~Such Derivative Securities shall be defined to be those instruments whose value is derived, in whole or part, from the value of any one or more underlying assets, or index of assets (such as stocks, bonds, commodities, interest rates, and currencies) and evidenced by forward, futures, swap, option, and other applicable contracts.~~

  ~~UTIMCO shall attempt to minimize the risk of an imperfect correlation between the change in market value of the securities held by the Fund and the prices of Derivative Security investments by investing in only those contracts whose behavior is expected to resemble that of the Fund's underlying securities. UTIMCO also shall attempt to minimize the risk of an illiquid secondary market for a Derivative Security contract and the resulting inability to close a position prior to its maturity date by entering into such transactions on an exchange with an active and liquid secondary market. The net market value of exposure of Derivative Securities purchased or sold over the counter may not represent more than 15% of the net assets of the Fund.~~

  ~~In the event that there are no Derivative Securities traded on a particular market index such as MSCI EAFE, the Fund may utilize a composite of other Derivative Security contracts to simulate the performance of such index. UTIMCO shall attempt to reduce any tracking error from the low correlation of the selected Derivative Securities with its index by investing in contracts whose behavior is expected to resemble that of the underlying securities.~~

  ~~UTIMCO shall minimize the risk that a party will default on its payment obligation under a Derivative Security agreement by entering into agreements that mark to market no less frequently than monthly and where the counterparty is an investment grade credit. UTIMCO also shall attempt to mitigate the risk that the Fund will not be able to meet its obligation to the counterparty by investing the Fund in the~~

~~specific asset for which it is obligated to pay a return or by holding adequate short-term investments.~~

~~The Fund may be invested in foreign currency forward and foreign currency futures contracts in order to maintain the same currency exposure as its respective index or to protect against anticipated adverse changes in exchange rates among foreign currencies and between foreign currencies and the U. S. dollar.~~]

Cash and Cash Equivalents

- Holdings of cash and cash equivalents may include internal short-term pooled investment funds managed by UTIMCO.
- Unaffiliated liquid investment funds as approved by the chief investment officer.
- The Fund's custodian late deposit interest bearing liquid investment fund.
- Commercial paper must be rated in the two highest quality classes by Moody's Investors Service, Inc. (P1 or P2) or Standard & Poor's Corporation (A1 or A2).
- Negotiable certificates of deposit must be with a bank that is associated with a holding company meeting the commercial paper rating criteria specified above or that has a certificate of deposit rating of 1 or better by Duff & Phelps.
- Bankers' Acceptances must be guaranteed by an accepting bank with a minimum certificate of deposit rating of 1 by Duff & Phelps.
- Repurchase Agreements and Reverse Repurchase Agreements must be transacted with a dealer that is approved by UTIMCO and selected by the Federal Reserve Bank as a Primary Dealer in U. S. Treasury securities and rated A-1 or P-1 or the equivalent.
  - Each approved counterparty shall execute the Standard Public Securities Association (PSA) Master Repurchase Agreement with UTIMCO.
  - Eligible Collateral Securities for Repurchase Agreements are limited to U. S. Treasury securities and U. S. Government Agency securities with a maturity of not more than 10 years.
  - The maturity for a Repurchase Agreement may be from one day to two weeks.
  - The value of all collateral shall be maintained at 102% of the notional value of the Repurchase Agreement, valued daily.
  - All collateral shall be delivered to the GEF custodian bank. Tri-party collateral arrangements are not permitted.
- The aggregate amount of repurchase agreements with maturities greater than seven calendar days may not exceed 10% of the Fund's fixed income assets.
- Overnight Repurchase Agreements may not exceed 25% of the Fund's fixed income assets.
- Mortgage Backed Securities (MBS) Dollar Rolls shall be executed as matched book transactions in the same manner as Reverse Repurchase Agreements above. As above, the rules for trading MBS Dollar Rolls shall follow the Public Securities Association standard industry terms.

Fixed Income

Domestic Fixed Income

Holdings of domestic fixed income securities shall be limited to those securities a) issued by or fully guaranteed by the U. S. Treasury, U. S. Government-Sponsored Enterprises, or U. S. Government Agencies, and b) issued by corporations and municipalities. Within this overall limitation:

- Permissible securities for investment include the components of the Lehman Brothers Aggregate Bond Index (LBAGG): investment grade government and corporate securities, agency mortgage pass-through securities, and asset-backed securities. These sectors are divided into more specific subindices 1) Government: Treasury and Agency; 2) Corporate: Industrial, Finance, Utility, and Yankee; 3) Mortgage-backed securities: GNMA, FHLMC, and FNMA; and 4) Asset-backed securities. In addition to the permissible securities listed above, the following securities shall be permissible: a) floating rate securities with periodic coupon changes in market rates issued by the same entities that are included in the LBAGG as issuers of fixed rate securities; b) medium term notes issued by investment grade corporations; c) zero coupon bonds and stripped Treasury and Agency securities created from coupon securities; and d) structured notes issued by LBAGG qualified entities.

- U. S. Domestic Bonds must be rated investment grade, Baa3 or better by Moody's Investors Services, BBB- by Standard & Poor's Corporation, or an equivalent rating by a nationally recognized rating agency at the time of acquisition. This provision does not apply to an investment manager that is authorized by the terms of an investment advisory agreement to invest in below investment grade bonds.

- Not more than 5% of the market value of domestic fixed income securities may be invested in corporate and municipal bonds of a single issuer provided that such bonds, at the time of purchase, are rated, not less than Baa3 or BBB-, or the equivalent, by any two nationally-recognized rating services, such as Moody's Investors Service, Standard & Poor's Corporation, or Fitch Investors Service.

Non-U. S. Fixed Income

- Not more than 35% of the Fund's fixed income portfolio may be invested in non-U. S. dollar bonds. Not more than 15% of the Fund's fixed income portfolio may be invested in bonds denominated in any one currency.

- Non-dollar bond investments shall be restricted to bonds rated equivalent to the same credit standard as the U. S. Fixed Income Portfolio.

- Not more than 7.5% of the Fund's fixed income portfolio may be invested in Emerging Market debt.

- International currency exposure may be hedged or unhedged at UTIMCO's discretion or delegated by UTIMCO to an external investment manager.

Equities

The Fund shall:

A. hold no more than 25% of its equity securities in any one industry or industries (as defined by the standard industry classification code and supplemented by other reliable data sources) at market

B. hold no more than 5% of its equity securities in the securities of one corporation at cost unless authorized by the chief investment officer.

Alternative Investments and Inflation Hedging Assets

Investments in alternative assets and inflation hedging assets may be made through management contracts with unaffiliated organizations (including but not limited to limited partnerships, trusts, and joint ventures). [~~so long as such organizations:~~

~~A. possess specialized investment skills~~

~~B. possess full investment discretion subject to the management agreement~~

~~C. are managed by principals with a demonstrated record of accomplishment and performance in the investment strategy being undertaken~~

~~D. align the interests of the investor group with the management as closely as possible~~

~~E. charge fees and performance compensation which do not exceed prevailing industry norms at the time the terms are negotiated.~~

~~Investments in alternative nonmarketable assets and inflation hedging assets also may be made directly by UTIMCO in co-investment transactions sponsored by and invested in by a management firm or partnership in which the Fund has invested prior to the co-investment or in transactions sponsored by investment firms well known to UTIMCO management, provided that such direct investments shall not exceed 25% of the market value of the alternative nonmarketable assets portfolio or the inflation hedging assets portfolio at the time of the direct investment.~~]

Members of UTIMCO management, with the approval of the UTIMCO Board, may serve as directors of companies in which UTIMCO has directly invested Fund assets. In such event, any and all compensation paid to UTIMCO management for their services as directors shall be endorsed over to UTIMCO and applied against UTIMCO management fees. Furthermore, UTIMCO Board approval of UTIMCO management's service as a director of an investee company shall be conditioned upon the extension of UTIMCO's Directors and Officers Insurance Policy coverage to UTIMCO management's service as a director of an investee company.

Fund Accounting

The fiscal year of the Fund shall begin on September 1st and end on August 31st. Market value of the Fund shall be maintained on an accrual basis in compliance with Financial Accounting Standards Board Statements, Government Accounting Standards Board Statements, or industry guidelines, whichever is applicable. Significant asset write-offs or write-downs shall be approved by the chief investment officer and reported to the UTIMCO Board of Directors. The Fund's financial statements shall be audited each year by an independent accounting firm selected by UTIMCO's Board.

Valuation of Assets

As of the close of business on the last business day of each month, UTIMCO shall determine the fair market value of all Fund net assets and the net asset value per unit of the Fund. Valuation of Fund assets shall be based on the books and records of the custodian for the valuation date. Valuation of alternative assets shall be determined in accordance with the UTIMCO Valuation Criteria for Alternative Assets.

The fair market value of the Fund's net assets shall include all related receivables and payables of the Fund on the valuation date and the value of each unit thereof shall be its proportionate part of such net value. Such valuation shall be final and conclusive.

Purchase of Fund Units

Purchase of Fund units may be made on any quarterly purchase date (September 1, December 1, March 1, and June 1 of each fiscal year or the first business day subsequent thereto) upon payment of cash to the Fund or contribution of assets approved by the chief investment officer, at the net asset value per unit of the Fund as of the most recent quarterly valuation date. Each fund whose monies are invested in the Fund shall own an undivided interest in the Fund in the proportion that the number of units invested therein bears to the total number of all units comprising the Fund.

Redemption of Fund Units

Redemption of Units shall be paid in cash as soon as practicable after the quarterly valuation date of the Fund. Withdrawals from the Fund shall be at the market value price per unit determined for the period of the withdrawal.

Securities Lending

The Fund may participate in a securities lending contract with a bank or nonbank security lending agent for either short-term or long-term purposes of realizing additional income. Loans of securities by the Fund shall be collateralized by cash, letters of credit, or securities issued or guaranteed by the U. S. Government or its agencies. The collateral will equal at least 100% of the current market value of the loaned securities. The contract shall state acceptable collateral for securities loaned, duties of the borrower, delivery of loaned securities and collateral, acceptable investment of collateral and indemnification provisions. The contract may include other provisions as appropriate.

The securities lending program will be evaluated from time-to-time as deemed necessary by the UTIMCO Board. Monthly reports issued by the agent shall be reviewed by UTIMCO to insure compliance with contract provisions.

Investor Responsibility

As a shareholder, the Fund has the right to a voice in corporate affairs consistent with those of any shareholder. These include the right and obligation to vote proxies in a manner consistent with the unique role and mission of higher education as well as for the economic benefit of the Fund. Notwithstanding the above, the UTIMCO Board shall discharge its fiduciary duties with respect to the Fund solely in the interest of Fund unitholders and shall not invest the Fund so as to achieve temporal benefits for any purpose including use of its economic power to advance social or political purposes.

Amendment of Policy Statement

The Board of Regents reserves the right to amend the Investment Policy Statement as it deems necessary or advisable.

Effective Date

The effective date of this policy shall be February 13, 2003 [~~March 1, 2001~~].

REVISED Exhibit A

ENDOWMENT FUNDS
(5 to 7 Year Time Horizon)
EXPECTED RETURN AND RISK, NEUTRAL ALLOCATIONS, RANGES AND PERFORMANCE OBJECTIVES

Function	Asset Category	Implementation Strategies	Expected Nominal Return	Expected Risk	Target Allocation	Range	Investment Policy Benchmark Return
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	International Public Equity	Passive Developed and Emerging Active Developed and Emerging Hedge and Alpha Transport	7.50%	21.00%	19.00%	10%-30%	Morgan Stanley Capital International-All Country World Free ex U.S.
	Private Capital	Venture Capital Private Equity Private Debt Opportunistic Special Situations	9.75%	24.50%	15.00%	10% -20%	Wilshire 5000 + 4%
	Subtotal Drivers of Return				65.00%	50%-80%	(Sum of Target Weighted Benchmarks)
Risk Reducing Assets:							
	Absolute Return	Market Neutral Hedge Funds	7.00%	8.25%	10.00%	5%-15%	91 day T-Bills Average Yield + 4%
	Inflation Hedging	Financial Exposure to Commodities (GSCI futures) Oil and Gas, Timber and Other Physical Commodities Public Real Estate (REITS) Private Real Estate Treasury Inflation Protected Securities (TIPS)	6.15%	9.25%	10.00%	5%-15%	(25% Goldman Sachs Commodity Index minus 100 basis points) +(25% Treasury Inflation Protected Securities) +(25% National Commercial Real Estate Index Fund) + (25% Wilshire Associates Real Estate Securities Index)
	Opportunistic Fixed Income	Domestic Public Debt (Investment Grade) High Yield Bonds (Below Investment Grade) International Developed Markets Public Debt Emerging Markets Public Debt Hedge and Alpha Transport	7.00%	11.75%	5.00%	2.5%-15%	Lehman Brothers Aggregate Bond Index (ex- U.S. Governments)
	Deflation Hedging	U.S. Government Bonds and Agencies	5.50%	9.25%	10.00%	5.0%-15%	Lehman Brothers Government Bond Index
	Cash and Equivalents	Money Markets	3.50%	3.50%	0.00%	0%-5%	91 day T-Bills Average Yield
	Subtotal Risk Reducing Assets				35.00%	20%-50%	(Sum of Target Weighted Benchmarks)
	Total				100.00%		(Sum of Target Weighted Benchmarks)
		Expected Nominal Return			7.40%		
		Expected Risk			9.70%		
		Return/Risk Ratio			0.76		

Risk is defined in annualized standard deviation terms.
The neutral policy portfolio is the sum of the neutrally weighted benchmark returns.

Delegation of Investment Approval Authority

Approved by UTIMCO Board: September 26, 2000
Amended: January 23, 2001

Delegation of Investment Approval Authority to UTIMCO management and approved by the CEO as listed below are a means to:

- improve operational efficiency by institutionalizing the investment process and thereby insulating it from employee turnover
- define and concentrate accountability for investment performance and policy compliance on UTIMCO management
- ensure a transparent policy and investment decision making process.

- **Continue board decision making at the policy level**
  - Appointment/evaluation/compensation/termination of chief executive officer
  - Approval of investment policy (investment objectives, asset allocation, manager selection/termination policy, performance objectives, use of derivatives, etc.)
  - Evaluate and confirm compliance with investment policies
  - Evaluate investment results against performance objectives

- **Delegate approval authority to UTIMCO management for:**
  - tactical asset allocation (within approved ranges)
  - manager selection/termination subject to the following limits:

Manager Type	Manager Exposure	($ Millions) UTIMCO Management Authority Limit (1)	Authority Limit as % of Total Assets (2)
Public - Passive	Portfolio value + New commitment	$ 502	5.00%
Public - Active	Portfolio value + New commitment	$ 251	2.50%
Private - Partnership	New commitment	$ 25	0.25%
Private - Direct	Portfolio value + New commitment	$ -	0.00%
Private - Relationship Total	Sum of portfolio values + Undrawn capital + New commitment	$ 100	1.00%

(1) At time of award based on 8/31/02 endowment values
(2) $10,031,468,633 endowment asset base (PUF and GEF) as of 8/31/02 (adjusted annually)
(3) Subject to concurring recommendation from private equity advisor

- Management shall notify the UTIMCO Board of its intent to enter into an agreement with a business entity to manage a portfolio asset of a type and in an amount within its delegated approval limit.

- Management's approval of said agreement or transaction shall become effective upon the receipt of an executed certificate of compliance from each Director certifying that the Director does not have a personal or private interest in the transaction or business entity, *unless* a Director requests further review of the business entity or transaction by the full Board of Directors.

- In exercising its delegated authority, Management shall adhere to Board-approved Investment Manager Selection And Termination Guidelines (see Exhibit A) including receipt of a concurring recommendation based on due diligence performed by a non-discretionary advisor when selecting private equity managers (see Exhibit B).

- Annual verification of compliance with the Investment Manager Selection and Termination Guidelines by UTIMCO Compliance Officer and Audit and Ethics Committee.

- All investment transactions and award of accounts to portfolio managers in amounts that exceed the approval limits specified above shall be submitted to the Board for approval.
    - Presentations by portfolio managers to the Board at the time of approval shall be required upon request by one or more members of the Board of Directors.

- **Establish a formal portfolio manager monitoring system consisting of periodic reports and manager presentations to allow the Board to evaluate UTIMCO's manager selection process (see Exhibit C).**

- **Subject to concurrence of Compensation Committee, establish a uniform performance compensation plan for UTIMCO management that recognizes:**
- UTIMCO's compensation should be competitive with private endowments and foundations
- The lack of internal mobility in UTIMCO's organizational structure creates a significant retention risk
- Performance based compensation cannot be unlimited on the upside
    - For example: cap at 100% of salary
- A significant portion of performance based compensation should be tied to achievement of corporate wide objectives
- commitment to the UTIMCO investment team is paramount

EXHIBIT A

INVESTMENT MANAGER SELECTION AND TERMINATION GUIDELINES

UTIMCO Management shall be responsible for the selection and termination of internal and external portfolio managers entrusted to invest U. T. System PUF, PHF, and other funds. While this delegation of authority recognizes that the manager selection and termination process is inherently subjective, it is subject to compliance with the guidelines below. These guidelines are intended to:

- ensure that the appropriate managers are retained to pursue a defined investment strategy within each fund's portfolio structure, and

- define the general conditions under which a portfolio manager may be placed on a watch list or be terminated.

These guidelines shall be reviewed at least annually by the UTIMCO Board to ensure their continued effectiveness.

MANAGER SELECTION

The selection of portfolio managers shall be based upon an evaluation of the following due diligence factors:

- **General Overview of Firm**

- History: date of formation, historical focus of firm, etc.
- Ownership: identify the distribution of ownership, capital adequacy, use of firm capital as management incentive tool, etc.
- Number of Portfolio Products/Growth in Number of Products: identify firm resources that are dedicated to portfolio product under review
- Assets Under Management: what is historical growth pattern, what are firm's plans to manage growth, percentage of firm's assets represented by UTIMCO portfolio
- Client Profile: distribution and size of accounts, high net worth individuals vs. institutional
- Stability of Client Base: recent history of client additions and losses, reasons for losses
- Participation of Manager's Capital in the Firm's Portfolios
- Compensation of Firm's Investment Professionals

- **Personnel**

- Interviews: meet with key decision makers on-site, check references
- Evaluation of Experience: verify that portfolio managers have a meaningful and proven historical record of success with their current or prior firms
- Approach to Staffing: Portfolio management by single manager or multi-manager, years staff has worked together, identify relationship manager for account, determine compatibility with UTIMCO staff and process
- Dedication of Firm's Resources: compatibility of firm's organizational size with portfolio management
- Education and Background of Investment Professionals: appropriateness for level of responsibility required by the mandate
- Turnover of Investment Professionals: historical record, reasons for departures, succession plans
- Client Service: through marketing representative vs. portfolio manager, firm interest in establishing relationship

- **Investment Philosophy and Process**

- Competitive Advantage/Sustainability of Advantage
- Style Discipline
- Interaction of Macro Research with Security Level Research
- Quantitative vs. Fundamental Investment Approach: reliance on quantitative screens
- Country vs. Security Selection/Use of Hedging: (non-U.S. managers)
- Use of Cash
- Decision Making Process within Firm
- Research and Due Diligence: idea generation, depth of research
- Portfolio Construction/Diversification: by sector, industry, position size, country, value vs. equal weighting
- Buy/sell Discipline: definition and consistency of process
- Monitoring/Controls: evidence of effective compliance programs to monitor, control and administer the portfolio account
- Operations: adequacy of administrative, operating and trading capacities relative to the number and complexity of accounts under management
- Portfolio Risk: analyze historical and expected volatility of the portfolio vs. its benchmark, review firm's written policies concerning risk management
- Liquidity: daily volume of portfolio securities, can the account be liquidated without a large market impact

- **Historical Investment Performance**

- Comparison Against Relevant Passive Benchmarks:
- Comparison Against Relevant Universe Benchmarks:
- Cyclicality of Excess Returns; Information Ratio

- **Fees**

- Reasonableness Given the Portfolio Mandate
- Asset Based vs. Performance Based

In addition to the factors listed above, the selection of managers for alternative asset partnerships shall include the following considerations:

- **Marketable Alternative Assets**:

- Investment Strategy: identify the unique strategy and pattern of expected returns that is not achievable with traditional strategies at a lower cost. Identify the source of expected value added – stock selection, shorting, leverage, event drivers, distressed investing, etc.

- Net Exposure: identify the manager's process for determining the portfolio's net exposure (long positions less short positions), determine the historical range of net exposure

- Fees: determine the carried interest and whether it is subject to a preferred return or high water mark/loss carry forward provision

- Use of Leverage: determine the firm's use of leverage at the partnership level, determine the historical range of leverage used

- Tax Status: determine the potential that the partnership's activities will create taxable income, representation from firm re: best efforts avoidance of UBTI

- Liquidity: determine the redemption and notice provisions governing the withdrawal of capital

- Transparency: determine the availability of individual portfolio transactions, i.e., ability to see through the partnership

- **Non - Marketable Alternative Assets:**

- Deal Flow: identify the proprietary nature of the firm's deal flow and distribution of deal generation among partners

- Key Man Provisions: determine the meaningfulness of provisions allowing for dissolution of the partnership in the event of the departure of certain key individuals from the firm

- Fees: determine the carried interest and whether it is subject to a preferred return and a clawback

- Use of Leverage: determine the firm's use of leverage at the partnership level (assumed to be zero and limited to 5%), determine use of leverage at the portfolio company level

- Tax Status; determine the potential that the partnership's activities will create taxable income, representation from firm re: best efforts avoidance of UBTI

- Valuation Policy: determine the firm's methodology for valuing illiquid investments and the method's reasonableness

- Realization Strategies: determine the expected strategies to be employed by the firm in realizing its investments and the degree of the firm's experience in executing such strategies

TERMINATION OF MANAGERS

Portfolio managers (with the exception of index managers) shall be selected with the expectation of generating returns in excess of the returns for a relevant index or universe of peer managers. Managers whose performance is below expectations shall be placed on a watch list to determine whether termination is advisable or justified. Portfolio managers shall be notified when they have been placed on a watch list. Reasons for portfolio managers to be placed on a watch list include:

- Under performance against its benchmark return or universe median return
- Significant change in portfolio composition or style
- Tracking error in excess of designated limits
- Significant changes in the manager's organization
- Turnover of personnel
- Ownership structure
- Growth of firm's assets under management to a level believed to inhibit effective implementation of portfolio strategy
- Unpredictable performance

If performance does not improve in a manner sufficient to justify manager retention, manager may be terminated. Termination of portfolio managers is expected to be infrequent but may be necessitated by the following factors:

- Fraud
- Violation of Investment Policy or Other Terms of Advisory Agreement
- Sustained Under Performance vs. Benchmarks
- Unethical Acts
- Turnover of Key Investment Professionals
- Significant Change in Ownership Structure or Control
- Assumption of Imprudent Risks
- Non Adherence to Assigned Portfolio Strategy
- Restructuring of Portfolio Mandates

EXHIBIT B

USE OF A PRIVATE EQUITIES CONSULTANT

UTIMCO's ability to execute a private equity investment program has been compromised by the departure of its private investment staff. The major impact from staff departures is on the development of investment strategy, identification of investment opportunities, and the due diligence process. The rebuilding of UTIMCO's private equity staff is not considered an attractive option at this time given the over heated demand for private equity professionals. Instead UTIMCO should contract with a private equity consultant (approved by the UTIMCO board and reporting to the CEO) to assist Management in performing the various tasks involved in managing private equities. The use of a consultant will also allow UTIMCO to a) institutionalize the manager selection process against board and staff turnover, b) demonstrate the use of an objective review process and, c) provide assistance in the rebuilding of an internal staff, if and when deemed desirable.

Management has recommended and the Board has approved the engagement of Cambridge Associates based on a review of four institutions by the Strategic Review Committee: Commonfund Capital, Harbourvest, Pacific Corporate Group and Cambridge Associates. Following this review, the Committee selected Pacific Corporate Group and Cambridge Associates as finalists.

EXHIBIT C

PORTFOLIO MANAGER MONITORING GUIDELINES

UTIMCO's asset allocation consists of nine distinct asset classes encompassing both cash and futures based investments traded on securities markets around the world. Under its current operating structure, UTIMCO management concentrates primarily on asset allocation, risk management and manager selection. Security selection is delegated to 18 managers managing 36 conventional public market portfolios and 57 managers managing 97 alternative asset portfolios. Given the high degree of delegation of portfolio management to external agents, it is critically important that the UTIMCO Board of Directors have the ability to monitor and evaluate the Corporation's ability to select value-added managers. The Guidelines below are designed to ensure that the Board receives the necessary written reports and presentations with which to monitor the performance of portfolio managers.

Reports:
Within 45 days following the end of each fiscal quarter, Management shall submit to the UTIMCO Board:

- A schedule presenting the market value of assets under management by fund group, asset allocation, portfolio strategy, portfolio manager, nature of relationship (i.e. internal vs. external), portfolio market value as a percentage of the market value of both the relevant asset class and fund, as of the end of the fiscal quarter.

- A schedule presenting the investment performance of each portfolio manager as of the end of each fiscal quarter:
    - trailing three month, six month, one year, two year, three year, five year, seven year, and ten year, fiscal year to date, and calendar year to date periods against the benchmarks established for each portfolio manager
    - an analysis attributing the performance of global asset allocation comparing the performance of each portfolio against assigned benchmarks and UTIMCO managed portfolios

- A schedule of the changes in the market value of assets for each fund and by portfolio manager presenting beginning asset value, net contributions, investment return, expenses, distributions, net transfers and ending asset value for the most recent quarter and the fiscal year to date.

- A schedule of portfolio managers hired, placed on the watch list or terminated and presenting the asset value of the respective portfolio at the time the action was taken during the quarter and fiscal year to date.

Manager Presentations:
Management shall schedule presentations by various portfolio managers for each meeting of the Board. The selection of portfolio managers shall be based on the following factors:

- Portfolio assets as a percentage of total assets under management
- Portfolio strategy
  - Active vs. passive
  - Return/risk profile
- Performance below expectations
- Significant changes in firm ownership or employees
- Length of time since last presentation

U. T. System: Request for Approval of Amendments to the Regental Policy entitled U. T. System Environmental Review Policy for Acquisition of Real Property Assets

RECOMMENDATION

The Chancellor concurs in the recommendation of the Executive Vice Chancellor for Business Affairs and the Executive Director of Real Estate that the Regental Policy entitled U. T. System Environmental Review Policy for Acquisitions of Real Property Assets be amended to include examination of improvements for the presence of mold as part of the inspection process for assets to be leased or acquired in the Scope of the Policy and Paragraph 4 of the Environmental Review Process as set forth below in congressional style:

U. T. SYSTEM ENVIRONMENTAL REVIEW POLICY FOR ACQUISITIONS OF REAL PROPERTY ASSETS

Statement of Policy

It is the policy of The University of Texas System to minimize its potential for exposure to claims made under the applicable laws governing the environment and hazardous substances by making all appropriate inquiry with regard to the environmental condition of real property assets, including leaseholds, prior to acquisition.

Scope of the Policy

To reduce the risk of liability, the U. T. System will complete an environmental site assessment (ESA) prior to acquisition of any real property asset, except as specifically provided in this policy. For purposes of this policy, the term "real property asset" means any interest in real property except a mineral interest severed from the surface estate, a leasehold in improvements only, or a leasehold less than five years in duration that does not contemplate any improvements to be constructed by U. T. System or other activities that would result in disturbance of the soil. The term specifically includes without limitation any acquisition in fee simple of real property, any leasehold on which U. T. System will construct improvements, and any leasehold where an underground storage tank, water wells, or monitoring wells exist. Federal and State statutes impose certain liabilities on owners of real property, including public institutions of higher education, when hazardous or other regulated substances have been deposited, stored, or released on the property. Hazardous and other regulated substances include not only the most dangerous or toxic substances, but also a wide array of chemicals and compounds, many of which are components of household trash or are found in raw materials and wastes. Environmental hazards may also include the presence of molds in or on improvements. Liabilities related to hazardous and other regulated substances may include costs associated with removal of these substances from the property, including overhead and enforcement expenses. If environmental hazards are identified, the U. T. System should then weigh the risks that may arise with respect to such hazards in determining whether the acquisition is beneficial and appropriate. If no risks are identified, the U. T. System may, under certain circumstances, be able to assert a defense to liability if contamination that was unknown at the time of acquisition is later discovered.

The Environmental Review Process

1. At a minimum, prior to acquisition of any real estate asset, the benefited component, with respect to purchases of land or leaseholds to be used for campus purposes, or the Real Estate Office with respect to all other real property assets, will conduct an initial ESA using the American Society for Testing and Materials (ASTM) transaction screen process E1528. For purposes of the policy, "benefited component" means the component that will use and have control over land acquired by purchase, gift or bequest, or lease. The benefited component will determine the scope of further assessment based on the property's location and history, and findings of the transaction screen.

2. The chief business officer of the benefited component or the chief business officer's delegate, will coordinate the review process for purchase of real property assets to be used for campus purposes.

    a. No component of the U. T. System will add property to the inventory of campus real property assets until a qualified university employee or a qualified outside professional retained by the component, performs an ESA in accordance with this policy.

    b. The benefited component will pay all costs of the ESA that are not paid by a donor or an external entity whether the acquisition is by purchase, gift, bequest, or other means.

    c. Any office or component of the U. T. System will notify the Real Estate Office immediately upon identification of a real property asset, which may be donated or bequeathed to the U. T. System or any component institution.

    d. No component will make a commitment to accept a donation or bequest of a real property asset until the appropriate office has complied with this policy with respect to such asset.

3. All ESAs will comply with the appropriate standards established by ASTM, unless otherwise specifically provided for in this policy.

4. The Real Estate Office may require, when appropriate, an investigation of other environmental issues or conditions beyond the scope of the ASTM guidelines, such as mold, lead, biological, radiation contamination, endangered species, or wetlands.

5. If the initial transaction screen indicates areas of concern, the "Responsible Officer" (Real Estate Office or Chief Business Officer of the benefited component with respect to real property assets to be used for campus purposes, as appropriate) may (i) reject the real property asset, (ii) accept the real property asset with the identified risks, or (iii) require further investigation in the form of a Phase I, II, or III ESA.

6. If the Responsible Officer requests a Phase I ESA, a qualified outside professional will perform the ESA unless the component or the U. T. System has a qualified employee to complete the review.

    a. All contracts for Phase I ESAs must be in a form acceptable to the Office of General Counsel.

    b. The Office of General Counsel and the Responsible Officer shall review the ESA report.

    c. If the Phase I ESA indicates areas of concern, the Responsible Officer may (i) reject the property asset, (ii) accept the real property asset with the identified risks, or (iii) require additional investigation in the form of a Phase II or III ESA.

7. A qualified outside professional must conduct any Phase II ESA, unless the component receives express written permission from the Executive Director, Real Estate Office to conduct all or part of the Phase II ESA in-house based on the institution's expertise. The Phase II ESA should include an extensive review of prior uses of the land and records pertaining to those uses, an examination and sampling of the property, and testing of all samples collected.

    a. All contracts for Phase II ESAs must be in a form acceptable to the Office of General Counsel.

    b. The Office of General Counsel and the Responsible Officer will review the Phase II ESA report. If the Phase II ESA indicates areas of concern, the Responsible Officer may (i) reject the real property asset, (ii) accept the real property asset with identified risks, or (iii) require additional investigation in the form of a supplemental Phase II or a Phase III ESA.

8. A qualified outside professional must conduct any Phase III ESA. The ESA should include extensive physical sampling of the site, testing of all samples, estimates of the extent of contamination, and estimates of the total cost to clean up the site.

    a. All contracts for Phase III ESAs must be in a form acceptable to the Office of General Counsel.

    b. The Office of General Counsel and the Responsible Officer will review the Phase III ESA report. If the Phase III ESA identifies unacceptable contamination or cleanup estimates, the real property asset will be rejected and will not be acquired.

9. The Real Estate Office will maintain complete ASTM guidelines for the ESA transaction screen process, as revised from time to time. The Real Estate Office will distribute the guidelines at cost to any component business and development offices upon request.

10. When the U. T. System or a benefited component conducts an ESA either in-house or using a qualified outside professional and elects, based on the results of the ESA, not to acquire the real property asset under review, it is the System's policy to provide a copy of the ESA, with an appropriate disclaimer to the seller/current landowner or landlord, if requested.

Recommended Environmental Review by Property Type

The level of screening will vary according to type of real property asset, history and location.

1. Residential:

    a. Have a qualified in-house individual or outside professional conduct an inspection.

    b. Conduct a site visit and a review of aerial photos for the past 50 years if such photos are readily available from libraries or archives. If there is concern about past land uses (i.e., the property was vacant and in a remote or formerly industrial/commercial area, the site visit indicates distressed vegetation, or there is other evidence of contamination), then a 50-year title search may be warranted.

2. Vacant/Unoccupied Lands: Step 1.b above. The site visit should include (a) asking neighbors about prior uses such as dumping, and (b) inspecting along on-site roadways or fence lines where historical dumping would be more likely to have occurred. Aerial photos may be particularly useful in evaluating historical dumping on vacant lands.

   In geographical areas where endangered species might be present, a review of U. S. Fish and Wildlife Service maps might be appropriate in determining if further investigation on this issue is warranted.

   Visual inspection of the site for topographical, hydrological, and vegetative indicators of wetlands may also be appropriate, depending on the geographical location of the property.

3. Commercial Sites: Steps 1.a and 1.b above. A 50-year title search will be useful in evaluating former uses of commercial property. Every attempt should be made to obtain from the current or past owners, operators and/or tenants the nature of business conducted at the site including a review of copies of any permits, licenses, notices of violation or consent agreements issued to owners, operators or tenants of the site.

4. Industrial Sites: Engage a qualified outside professional to conduct a Phase I ESA in accordance with ASTM Phase I Standard E1527, including a review of copies of any permits, licenses, notices of violation or consent agreements issued to current or past owners, operators or tenants of the site.

BACKGROUND INFORMATION

The U. T. System Environmental Review Policy for Acquisitions of Real Property Assets was first approved in 1991 and last amended on November 11, 1999. Since that date much attention has been devoted to the risks associated with presence of mold in improvements and the impact of mold on the insurability of contaminated properties. The U. T. System Administration Compliance Committee considered these risks significant. These amendments to the Regental Policy are intended to make inspection for mold on or in improvements a required step in the evaluation of the risks associated with leasing or acquiring real property assets.

U. T. System: Request to Approve an Amendment to the Aggregate Amount of Equipment Financing for Fiscal Year 2003 and Approve the Use of Revenue Financing System Parity Debt, Receipt of Certificate, and Finding of Fact with Regard to Financial Capacity

RECOMMENDATION

The Chancellor concurs in the recommendation of the Executive Vice Chancellor for Business Affairs that the U. T. Board of Regents approve an amendment to the aggregate amount of equipment to be purchased in Fiscal Year 2003 under the Revenue Financing System Equipment Financing Program from $49,368,000 to $50,066,000, an increase of $698,000 to be allocated as follows:

U. T. El Paso	$ 198,000
U. T. Health Center – Tyler	$ 500,000

The Chancellor also concurs in the recommendation of the Executive Vice Chancellor for Business Affairs that, in compliance with Section 5 of the Amended and Restated Master Resolution Establishing The University of Texas System Revenue Financing System adopted by the U. T. Board of Regents on February 14, 1991, amended on October 8, 1993, and August 14, 1997, and based in part upon the delivery of the Certificate of an Authorized Representative as required by Section 5 of the Master Resolution, the U. T. Board of Regents resolves that:

a. Parity Debt shall be issued to pay the cost of equipment including costs incurred prior to the issuance of such Parity Debt

b. Sufficient funds will be available to meet the financial obligations of the U. T. System, including sufficient Pledged Revenues as defined in the Master Resolution to satisfy the Annual Debt Service Requirements of the Financing System, and to meet all financial obligations of the Board relating to the Financing System

c. The component institutions and U. T. System Administration, which are “Members” as such term is used in the Master Resolution, possess the financial capacity to satisfy their direct obligation as defined in the Master Resolution relating to the issuance by the U. T. Board of Regents of tax-exempt Parity Debt in the aggregate amount of $698,000 for the purchase of equipment

d. This resolution satisfies the official intent requirements set forth in Section 1.150-2 of the U. S. Treasury Regulations.

BACKGROUND INFORMATION

At the August 2002 meeting, the U. T. Board of Regents approved the use of debt under the Revenue Financing System Equipment Financing Program in the aggregate amount of $49,368,000 for equipment purchases in Fiscal Year 2003 at U. T. Arlington, U. T. Austin, U. T. El Paso, U. T. Southwestern Medical Center - Dallas, U. T. Medical Branch - Galveston, U. T. Health Science Center - San Antonio, U. T. M. D. Anderson Cancer Center, U. T. Health Center - Tyler, and U. T. System Administration.

Approval of this item would increase the aggregate amount approved for equipment financing by $698,000 to $50,066,000. Of the increase, $500,000 is for U. T. Health Center - Tyler to finance medical research equipment and $198,000 is for U.T. El Paso for equipment purchases for grant proposals that require a matching contribution. With the issuance of all approved equipment financing debt, the debt service coverage for the U. T. System is projected to range from 2.01 times to 2.98 times for the next six years. Further details on the equipment, source of funds for financing, and debt coverage ratios for each component can be found in the table on Page _3_.

Equipment Financing Requests for FY 2003

- On behalf of two component institutions, the Office of Finance is requesting $698,000 of additional equipment financing for purchases to be completed in FY 2003. The Board approved $49,368,000 of equipment financing in August.
- In 1994, the Board of Regents approved the use of Revenue Financing System (RFS) debt as an alternative to vendor lease purchase financing. The equipment is purchased using RFS commercial paper.
- To qualify, the equipment must have an aggregate value of $100,000 or more and have a useful life of at least three years.

U. T. El Paso	$198,000	Equipment purchases for grant proposals that require a matching contribution. Current requests are $35,000 for National Science Foundation Biology Research; $58,000 for Department of Defense Chemistry; $65,000 for National Cooperative Highway Research Programs, in the Civil Engineering Department; and $40,000 for other programs.	Designated Tuition
U. T. Health Center Tyler	$500,000	Most equipment is targeted for use in the new BSL-3 Facility: $99,000 for a flow cytometer; $56,000 for a pass through autoclave; and $345,000 for centrifuges, rotors, incubators and freezers.	Patient income
Total	$698,000		

The University of Texas System
Office of Finance

Interest Rate Swap Overview

Finance and Planning Committee

January 7, 2003

Purpose

- The Office of Finance would like to have the flexibility to use interest rate swaps as a means to reduce the System's cost of debt and more efficiently manage its interest rate risk.

- Although the Board of Regents did approve the use of interest rate swaps as part of an RFS bond transaction in 1999, the Office of Finance believes that an <u>interest rate swap policy</u> is needed to better define the parameters under which interest rate swaps can be used.

Interest Rate Swap Overview

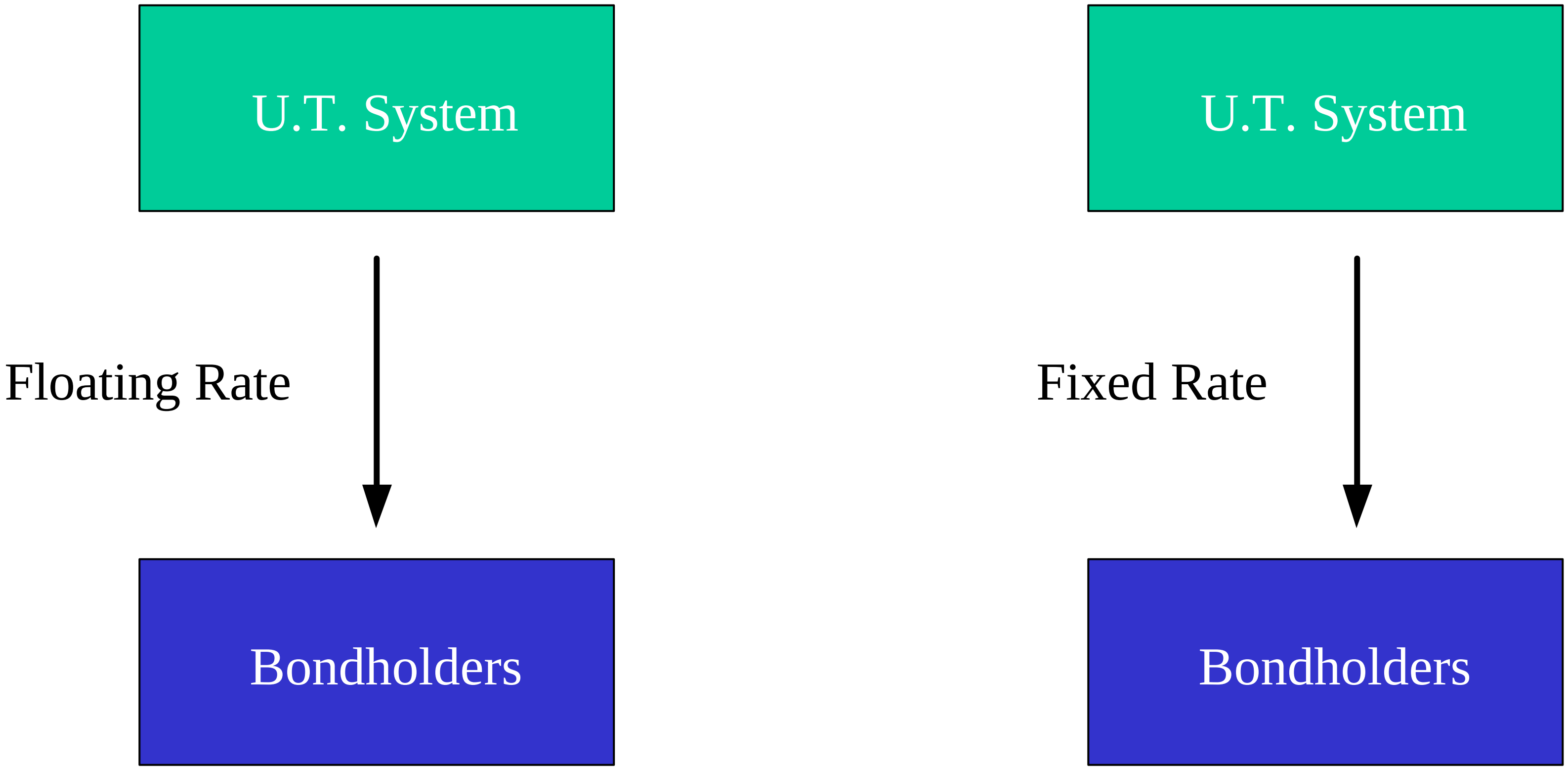
- The simplest and most widely used derivative product in the public sector is the interest rate swap.

- An interest rate swap is a contract in which two parties agree to exchange a stream of interest payments based on predetermined indices and an agreed notional amount.

- A swap is not a debt instrument, a security or an insurance policy. There is no exchange of principal in a swap transaction.

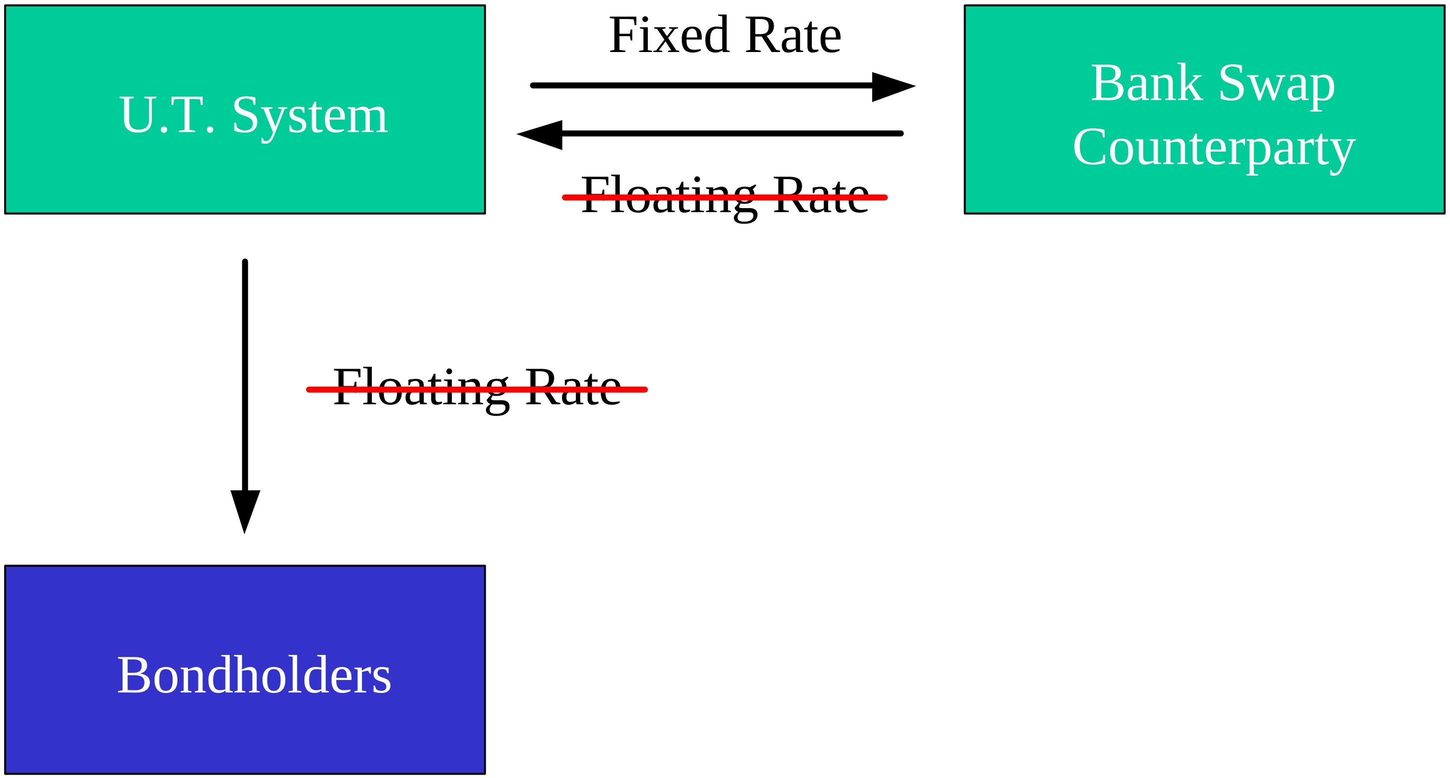
- Interest rate swaps have been an integral part of most large public debt programs, including dozens of higher education issuers, dating back to 1986.

The U.T. System Typically Issues "Natural" Floating Rate Debt or Fixed Rate Debt



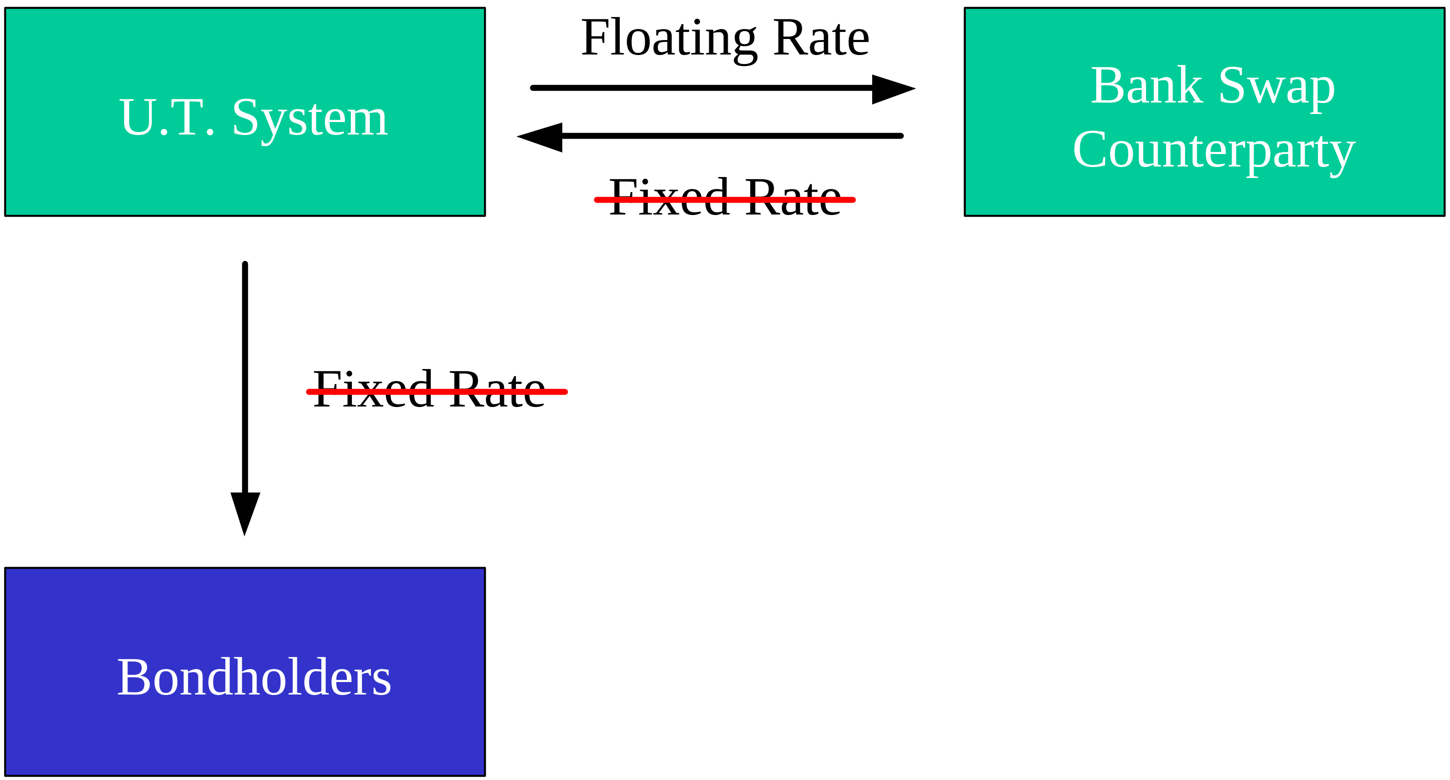
“Synthetic” Fixed Rate Debt

(Issue “natural” floating rate debt and swap to a fixed rate)



“Synthetic” Floating Rate Debt

(Issue “natural” fixed rate debt and swap to a floating rate)



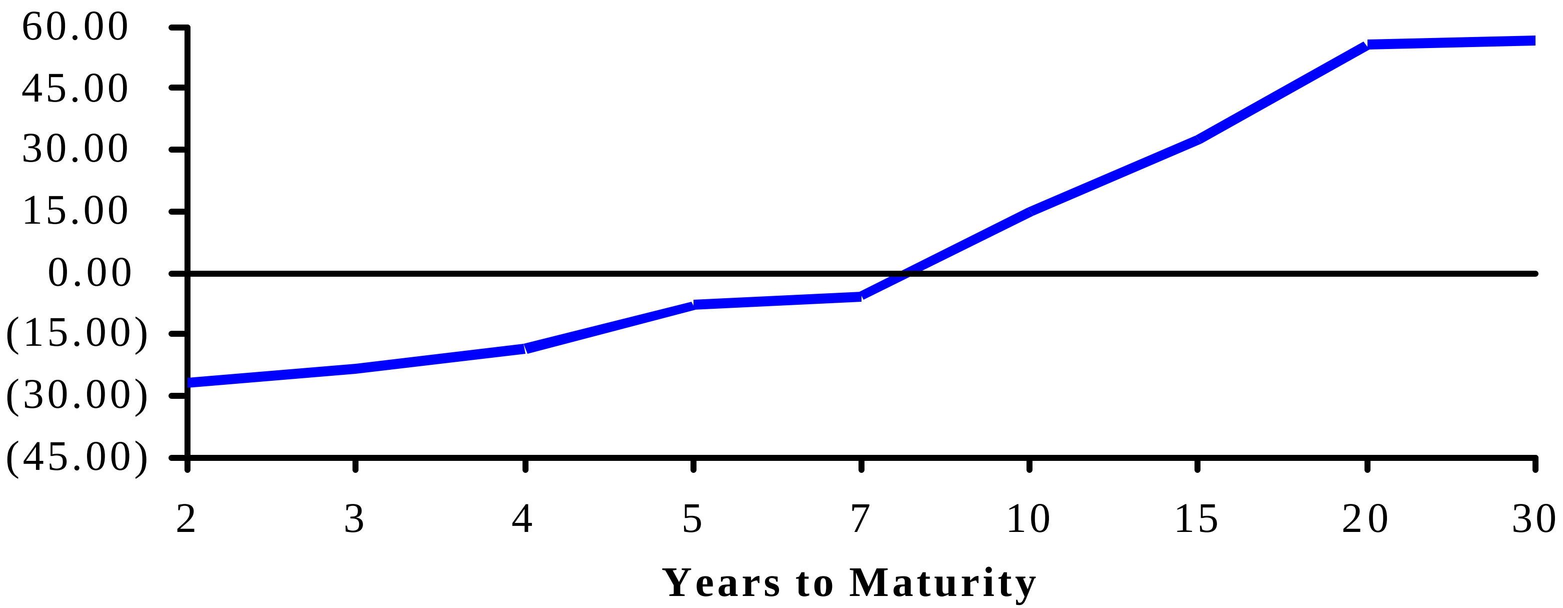
Two Primary Advantages of Interest Rate Swaps

- "Synthetic debt" accomplished through the use of interest rate swaps can be less costly than "natural" debt.

- Swaps can be used to lock-in a fixed rate well in advance of the issuance of debt. This is referred to as a forward starting swap.

“Natural” Tax-Exempt Curve vs. BMA Swap Curve

(in basis points)



Source: UBS Paine Webber Inc.; Muni Cash versus Muni Swap; AA Munis — Mid-Market Swap Rate *as of 11/29/02*.

Comparison of "Natural" and "Synthetic" Fixed Rate Debt

- Option 1: Issue 20-year fixed rate debt ("Natural")

Bond Yield	4.40%

- Option 2: Issue floating rate debt and swap to 20-year fixed rate debt ("Synthetic")

20-year Fixed Swap Rate	3.96%
Remarketing and Liquidity	0.15%
All-in Cost	4.11%

Swap Risks and Mitigation Strategies

Primary Swap Risks		Mitigation Strategy (per the Swap Policy)
1. Counterparty Risk	>	Swap exposure is limited to a maximum of $30 million; counterparties must maintain a minimum credit rating of "A / A2" or better.
2. Termination Risk	>	Swap termination provisions will be negotiated to maximize flexibility and price competitiveness.
3. Amortization Risk	>	The swap maturity date cannot exceed the bond maturity date; the swap amortization schedule must be matched to the bond amortization schedule.
4. Basis (Index) Risk	>	Only recognized market indices can be used.
5. Tax Risk	>	Tax risk must be accounted for as part of the approval process.

Conclusions

- The Office of Finance believes that interest rate swaps should be an integral part of the System's debt management program.

- Therefore, the Office of Finance would like to have the flexibility to use interest rate swaps as a means to reduce the System's cost of debt and more efficiently manage interest rate risk.

- The Office of Finance also believes that an <u>interest rate swap policy</u> is needed to better define the parameters under which interest rate swaps can be used.

U. T. System: Recommended Adoption of Revenue Financing System Interest Rate Swap Policy

RECOMMENDATION

The Chancellor concurs in the recommendation of the Executive Vice Chancellor for Business Affairs and the Vice Chancellor and General Counsel that the U. T. Board of Regents adopt the U. T. System Interest Rate Swap Policy, substantially in the form immediately following this item.

BACKGROUND INFORMATION

This recommended policy will govern the use by U. T. System of interest rate swap transactions for the purpose of either reducing the cost of existing or planned Revenue Financing U. T. System debt, or to hedge the interest rate of existing or planned Revenue Financing U. T. System debt. By using swaps in a prudent manner, the U. T. System can take advantage of market opportunities to reduce costs and reduce interest rate risk. The use of swaps must be tied directly to U. T. System debt instruments. The U. T. System shall not enter into swap transactions for speculative purposes.

To enter into a Master Swap Agreement (which governs each swap transaction), the System must receive: (1) approval from the Board, (2) approval by the Texas Attorney General, (3) approval from the Texas Bond Review Board, and (4) an opinion acceptable to the Authorized Representative from bond counsel that the agreement relating to the swap transaction is a legal, valid, and binding obligation of the System and that entering into the transaction complies with applicable State and federal laws.

U.T. System Interest Rate Swap Policy

I. Authority

State law authorizes the U.T. System ("System") to enter into interest rate swap transactions and related agreements (Chapter 55 of the Texas Education Code and Chapter 1371 of the Texas Government Code). Pursuant to this authority, the U.T. System Board of Regents ("Board") approved the Eighth Supplemental Resolution to the Master Resolution, authorizing the System to enter into Master Swap Agreements with certain counterparties, in 1999.

II. Purpose

This policy will govern the use by the System of interest rate swap transactions for the purpose of either reducing the cost of existing or planned Revenue Financing System debt, or to hedge the interest rate of existing or planned Revenue Financing System debt. By using swaps in a prudent manner, the System can take advantage of market opportunities to reduce costs and reduce interest rate risk. The use of swaps must be tied directly to System debt instruments. The System shall not enter into swap transactions for speculative purposes.

III. Legality/Approval

To enter into a Master Swap Agreement (which governs each swap transaction), the System must receive: 1) approval from the Board; 2) approval by the Texas Attorney General, 3) approval from the Texas Bond Review Board, and 4) an opinion acceptable to the Authorized Representative from bond counsel that the agreement relating to the swap transaction is a legal, valid and binding obligation of the System and that entering into the transaction complies with applicable Texas and Federal laws.

IV. Form of Swap Agreements

Each new Master Swap Agreement shall contain terms and conditions as set forth in the International Swap and Derivatives Association, Inc. ("ISDA") Master Agreement, as amended, and such other terms and conditions including schedules and confirmations as deemed necessary by an Authorized Representative.

V. Methods of Soliciting and Procuring Swaps

Swaps can be procured via competitive bids or on a negotiated basis. The competitive bid should include a minimum of three firms with counterparty credit ratings of 'A' or 'A2' or better from Standard & Poor's or Moody's, respectively. An Authorized Representative may allow a firm or firms not submitting the bid that produces the lowest cost to match the lowest bid and be awarded up to 40% of the notional amount of the swap transaction.

An Authorized Representative may procure swaps by negotiated methods in the following situations:

1. A determination is made by an Authorized Representative that due to the complexity of a particular transaction, a negotiated bid would result in the most favorable pricing.

2. An Authorized Representative makes a determination that, in light of the facts and circumstances, doing so will promote the System's interests by encouraging and rewarding innovation.

VI. Management of Swap Transaction Risk

Certain risks are created when the System enters into any swap transaction. In order to manage the associated risks, guidelines and parameters for each risk category are as follows:

Counterparty Credit Risk

To limit and diversify the System's counterparty risk and to monitor credit exposure to each counterparty, the System may not enter into a swap transaction with an otherwise qualified counterparty unless the cumulative mark-to-market value owed by the counterparty (and its unconditional guarantor, if applicable) to the System shall be less than or equal to $30 million.

The $30 million limitation shall be the sum of all mark-to-market values between the subject counterparty and the System regardless of the type of swap transaction, net of collateral posted by the counterparty. Collateral will consist of cash, U.S. Treasury securities and Federal Agency securities guaranteed unconditionally by the full faith and credit of the U.S. Government. Collateral shall be deposited with a third party trustee acceptable to System, or as mutually agreed upon between System and each counterparty.

Specific limits by counterparty are based on the cumulative mark-to-market value of the swap(s) and the credit rating of the counterparty. The limits are as follows:

Counterparty Long-Term Debt Rating (lowest prevailing rating from Standard & Poor's / Moody's)	**Maximum Cumulative Mark-to-Market Value of Swaps Owed to System by Counterparty (net of collateral posted)**
AAA / Aaa	$30 million
AA+ / Aa1	$25 million
AA / Aa2	$20 million
AA- / Aa3	$15 million
A+/A1	$10 million
A / A2	$5 million

If a counterparty's credit rating is downgraded such that the cumulative mark-to-market value of all swaps between a counterparty and the System exceeds the maximum permitted by this policy, the counterparty must either terminate a portion of the swap, post collateral or provide other credit enhancement that is satisfactory to the System and ensures compliance with this policy.

Termination Risk

The System shall consider the merits of including a provision that permits it to optionally terminate a swap agreement at anytime over the term of the agreement (elective termination right). In general, exercising the right to optionally terminate an agreement should produce a benefit to the System, either through receipt of a payment from a termination, or if a termination payment is made by the System, a conversion to a more beneficial debt instrument or credit relationship. If no other remedies are available, it's possible that a termination payment by the

System may be required in the event of termination of a swap agreement due to a counterparty default or following a decrease in credit rating.

Amortization Risk

The amortization schedules of the debt and associated swap transaction should be closely matched for the duration of the swap. Mismatched amortization schedules can result in a less than satisfactory hedge and create unnecessary risk. In no circumstance may the term of a swap transaction extend beyond the final maturity date of the affected debt instrument, or in the case of a refunding transaction, beyond the final maturity date of the refunding bonds.

Basis (Index) Risk

Basis risk arises as a result of movement in the underlying variable rate indices that may not be in tandem, creating a cost differential that could result in a net cash outflow from the System. Basis risk can also result from the use of floating, but different, indices. To mitigate basis risk, any index used as part of an interest rate swap agreement shall be a recognized market index, including but not limited to, the Bond Market Association Municipal Swap Index (BMA) or the London Interbank Offered Rate (LIBOR).

Tax Risk

Tax risk is the risk that tax laws will change, resulting in a change in the marginal tax rates on swaps and their underlying assets. Tax risk is also present in all tax-exempt debt issuances. The Office of Finance will need to understand and document tax risk for a contemplated swap transaction as part of the approval process.

VII. Reporting Requirements

The Annual Financial Report prepared by the System and presented to the Board will discuss the status of all interest rate swaps. The report shall include a list of all swaps with notional value and interest rates, a list of counterparties and their respective credit ratings, and other key terms.

VIII. Definitions

Authorized Representative: For purposes of this policy, an Authorized Representative includes the Executive Vice Chancellor for Business Affairs, the Vice Chancellor and General Counsel, the Assistant Vice Chancellor for Finance, and the Director of Finance.

BMA Index: The Bond Market Association Municipal Swap Index, the principal benchmark for the floating rate payments for tax-exempt issuers. The index is a national rate based on a market basket of high-grade, seven-day, tax-exempt variable rate bond issues.

Counterparty: A participant in a swap or other derivatives agreement who exchanges payments based on interest rates or other criteria with another counterparty.

Hedge: A transaction entered into to reduce exposure to market fluctuations.

Interest Rate Swap (or "Swap"): A transaction in which two parties agree to exchange future net cash flows based on predetermined interest rate indices calculated on an agreed notional amount. The swap is not a debt instrument and there is no exchange of principal.

ISDA Master Agreement: The International Swaps and Derivatives Association is the global trade association for the derivatives industry. The ISDA Master Agreement is the basic governing document that serves as a framework for all interest rate swap, swap enhancement and derivative transactions between two counterparties. It is a standard form used throughout the industry. It is typically negotiated once, prior to the first transaction and remains in force for all subsequent transactions.

LIBOR: The London Interbank Offered Rate. The rate of interest at which banks borrow funds from other banks in the London interbank market. It is a commonly used benchmark for interest rate transactions ranging from one month to one year.

Mark-to-Market: Calculation of the value of a financial instrument (like an interest rate swap) based on the current market rates or prices of the underlying indices.

Master Resolution: The First Amended and Restated Master Resolution establishing the University of Texas System Revenue Financing System adopted on February 14, 1991, as amended on October 8, 1993 and August 14, 1997 and each supplemental resolution thereto authorizing parity debt.

Notional Amount: The size of the interest rate swap and the dollar amount used to calculate interest payments.

U. T. System: Recommended Approval of Appointment of Carrier for Vision Plan to be Effective September 1, 2003

RECOMMENDATION

The Chancellor concurs in the recommendation of the Executive Vice Chancellor for Business Affairs that the U. T. Board of Regents approve the appointment of Superior Vision Services, Inc., Rancho Cordova, California, as the vision plan carrier for the employees and retirees of the U. T. System to be effective September 1, 2003.

It is further recommended that the U. T. System Board of Regents approve the monthly premium rates as shown in the following table.

Superior Vision Services, Inc. Monthly Premium Rates		
Coverage Level	FY 2003-2004 Proposed Rates	FY 2002-2003 Current Rates
Subscriber Only	$7.22	$7.22
Subscriber and Spouse	$11.20	$11.20
Subscriber and Children	$11.46	$11.46
Subscriber and Family	$18.48	$18.48
Spouse Only*	$7.22	$7.22
Child Only*	$7.22	$7.22
Family Only*	$11.46	$11.46
*These categories represent monthly premiums for families of employees who have either been called to active military duty or who are survivors of an employee who at the time of death had 5 or more years of service.		

BACKGROUND INFORMATION

On September 27, 2002, the U. T. System Employee Group Insurance (EGI) office issued a Request for Proposal (RFP) for a fully-insured vision plan to serve employees and retirees. Since September 1, 1997, Superior Vision Services, Inc., Rancho Cordova, California, has served as the carrier of the vision plan. Proposals were sought based on the requirement of the Texas Insurance Code, Article 3.50-3, which states U. T. submit the plan(s) to competitive bidding at least once every six years. The RFP was distributed to 39 interested organizations. Seven proposals were received from the following organizations:

Cole Managed Vision, a subsidiary of Cole Vision Corporation, Twinsburg, Ohio
CompBenefits Corporation, Roswell, Georgia
EyeMed Vision Care, LLC, a subsidiary of Luxottica Group, S.P.A., Mason, Ohio
National Vision Administrators, Inc., Clifton, New Jersey
SafeGuard Health Enterprises, Dallas, Texas
Spectera, Inc., is a division of Specialized Care Services, Inc., a wholly-owned subsidiary of UnitedHealth Group, Baltimore, Maryland
Superior Vision Services, Inc., Rancho Cordova, California

The RFP specified that carriers prepare proposals and monthly premiums based on the current plan design offered to employees and retirees. The current plan design is outlined in the following table and it is recommended the design continue to be the benefits offered in FY 2003-2004.

Summary of Vision Benefits		
Benefit	**In-Network Provider**	**Out-of-Network Provider**
Exam MD	100% after $35 copayment	Up to $42 after $35 copayment
Exam OD	100% after $35 copayment	Up to $37 after $35 copayment
Lenses		
Single Vision	100%	Up to $32
Bifocal	100%	Up to $46
Trifocal	100%	Up to $61
Lenticular	100%	Up to $84
Contacts		
Medically Necessary	100%	Up to $210
Elective	Up to $95*	Up to $95
Frames	Up to $140	Up to $53
Materials Discounts		
Lens Upgrades	10% off Retail	Not Available
Contact Cost (over Allowance)	10% off Retail	Not Available
Additional Contact Purchase or Pair of Lens/Frames	20% off Retail	Not Available
Non-Rx Sunglasses	20% off Retail	Not Available
Miscellaneous Items	20% off Retail	Not Available
Refractive Surgery	10% off Usual & Customary	Not Available
Blepharoplasty	10% off Usual & Customary	Not Available
*Superior Vision Services, Inc., has increased this benefit to a $130 maximum for FY 2003-2004.		

After extensive review of the responses by the RFP review committee, which consisted of ten EGI staff members, the Director of the EGI office recommended to the Executive Director for Employment and Benefit Services and the Executive Vice

Chancellor for Business Affairs that the U. T. System vision plan contract be awarded to Superior Vision Services, Inc., Rancho Cordova, California, on the basis of its proven customer service and the excellent six year history of serving the needs of the U. T. employee and retiree population. Further, Superior Vision Services, Inc., is also recommended based on their extensive provider network, which meets and/or exceeds the needs for members residing both in and outside of Texas and due to current network participation of the U. T. Schools of Ophthalmology which provide the employees and retirees access to the U. T. ophthalmology providers.

U. T. System: Recommended Approval of Appointment of Carrier for Long Term Disability and Short Term Disability Plans to be Effective September 1, 2003.

RECOMMENDATION

Recommended appointment of a carrier for the long term disability and short term disability plan to be effective September 1, 2003, for U. T. System employees are being negotiated. Recommendations to approve the appointment of one or more carriers will be distributed in the Agenda Book for the February 2003 meeting of the U. T. Board of Regents.

BACKGROUND INFORMATION

The Employee Group Insurance (EGI) office created a Request for Proposal (RFP) for a long term disability plan based on the Texas Insurance Code, Article 3.50-3 requirement, which states that The University of Texas System will submit the plan(s) to competitive bidding at least once every six years. Additionally, EGI has received numerous requests for offering a short term disability policy for employees of the U. T. System; therefore, the System Wide Insurance Advisory Committee recommended and approved that EGI seek short term disability proposals in conjunction with the long term disability proposal.

EGI issued an RFP for long term and short term disability on November 5, 2002 to 48 interested organizations. Proposals were due and received on December 6, 2002, from six organizations. Evaluations of the six proposals received are currently being performed in preparation for the February 2003 meeting of the U. T. Board of Regents. CNA Group Benefits, a division of CNA Financial Corporation, Chicago, Illinois, currently administers the benefits for group long term disability and has held the contract since September 1, 1997.

U. T. Board of Regents: Request to Amend Regents' Rules and Regulations for The University of Texas Governmental Retirement Arrangement Effective March 1, 2003

RECOMMENDATION

The Chancellor concurs in the recommendation of the Acting Executive Vice Chancellor for Health Affairs, the Executive Vice Chancellor for Business Affairs, the Executive Vice Chancellor for Academic Affairs, and the Vice Chancellor and General Counsel that the U. T. System Board of Regents authorize amendment of the Regents' Rules and Regulations for The University of Texas Governmental Retirement Arrangement (UTGRA) effective March 1, 2003, to provide for de minimus distributions and distributions arising from qualified domestic relations orders.

BACKGROUND INFORMATION

On August 14, 1997, the U. T. System Board of Regents established UTGRA, effective October 1, 1997. UTGRA was created under Section 415(m) of the Internal Revenue Code of 1986, as amended, for governmental employees and allows eligible employees participating in the Optional Retirement Program to place retirement contributions in excess of $40,000 into a tax-deferred account. On June 19, 2001, the Internal Revenue Service issued a favorable Private Letter Ruling approving the structure of the UTGRA plan as a qualified governmental excess benefit arrangement.

The U. T. M.D. Anderson Physicians Referral Service Retirement Board (PRS Retirement Board) has served as the UTGRA trustee since September 1, 2001. The PRS Retirement Board also provides necessary UTGRA administrative services.

At the request of the PRS Retirement Board, the recommended amendments to the Regents' Rules and Regulations, Part Two, Chapter VI, are:

Sec. 3 University of Texas Governmental Arrangement

3.1 Governmental Excess Benefits Plan
The Board of Regents of The University of Texas System has authorized the establishment of a "governmental excess benefits plan" for the Optional Retirement Program, authorized

under Internal Revenue Code Section 415(m) and Texas Government Code Section 830.004 and designated as The University of Texas Governmental Retirement Arrangement (UTGRA).

3.2 Eligibility for Participation
Eligibility for participation shall be based on an employee's date of initial participation in the Optional Retirement Program and the employee's level of earnings. Participation in the program and all subsequent distributions shall be in accordance with the plan documents.

3.3 Operation and Administration
The Board delegates to the Executive Vice Chancellor for Business Affairs the power and authority to amend the plan document consistent with applicable law and to take all actions and make all decisions and interpretations necessary or appropriate to administer and operate UTGRA consistent with the plan documents.

3.4 Funds Are Property of the Board of Regents Until Authorized Distribution
All funds participating in UTGRA including the monthly State contribution, amounts reduced from each participant's salary, any subsequent investment earnings are the property of the Board of Regents until such time as an authorized distribution is executed in accordance with the plan document.

3.5 External Organizations as Trustee
The University of Texas M. D. Anderson Cancer Center Physicians Referral Service Retirement Board (PRS Retirement Board) shall serve as trustee and record keeper for UTGRA.

U. T. System: Recommended Approval of Appointment of Carrier for Long Term Disability and Short Term Disability Plans to be Effective September 1, 2003.

RECOMMENDATION

Recommended appointment of a carrier for the long term disability and short term disability plan to be effective September 1, 2003, for U. T. System employees are being negotiated. Recommendations to approve the appointment of one or more carriers will be distributed in the Agenda Book for the February 2003 meeting of the U. T. Board of Regents.

BACKGROUND INFORMATION

The Employee Group Insurance (EGI) office created a Request for Proposal (RFP) for a long term disability plan based on the Texas Insurance Code, Article 3.50-3 requirement, which states that The University of Texas System will submit the plan(s) to competitive bidding at least once every six years. Additionally, EGI has received numerous requests for offering a short term disability policy for employees of the U. T. System; therefore, the System Wide Insurance Advisory Committee recommended and approved that EGI seek short term disability proposals in conjunction with the long term disability proposal.

EGI issued an RFP for long term and short term disability on November 5, 2002 to 48 interested organizations. Proposals were due and received on December 6, 2002, from six organizations. Evaluations of the six proposals received are currently being performed in preparation for the February 2003 meeting of the U. T. Board of Regents. CNA Group Benefits, a division of CNA Financial Corporation, Chicago, Illinois, currently administers the benefits for group long term disability and has held the contract since September 1, 1997.

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THE UNIVERSITY OF TEXAS SYSTEM
Management's Discussion and Analysis (Unaudited)
For the Year Ended August 31, 2002

INTRODUCTION

The following discussion and analysis provides an overview of the financial position and activities of The University of Texas System (the System) for the year ended August 31, 2002. This discussion has been prepared by management and should be read in conjunction with the accompanying financial statements and notes. The System has elected not to restate prior periods for purposes of providing the comparative data for this Management's Discussion and Analysis. A comparative analysis will be presented in future years.

The System was established pursuant to the Texas Constitution of 1876. In 1881, Austin was designated the site of the main academic campus and Galveston as the location of the medical branch. The University of Texas at Austin opened in 1883, and eight years later, the John Sealy Hospital in Galveston (now a part of the System's Medical Branch at Galveston) established a program for university-trained medical professionals. In addition to the original academic campus located in Austin, the System now includes eight additional academic campuses in Arlington, Dallas, El Paso, Odessa, San Antonio, Tyler, Brownsville and Edinburg. Health institutions for medical education and research have expanded beyond the original Galveston medical campus to include: M.D. Anderson Cancer Center, Southwestern Medical Center at Dallas, Health Science Centers at Houston and San Antonio and the Health Center at Tyler. The System's fifteen component institutions and System Administration have emerged among the nation's premier educational enterprises. Many of the System's programs in natural science, engineering, business, medicine, law, liberal arts and humanities rank among the very best in the country.

USING THE FINANCIAL STATEMENTS

The System's combined financial report includes three financial statements: The Balance Sheet, the Statement of Revenues, Expenses and Changes in Net Assets and the Statement of Cash Flows. The financial statements are prepared in accordance with Government Accounting Standards Board (GASB) principles. During 2002, the System adopted GASB Statement No. 35, *Basic Financial Statements – Management's Discussion and Analysis – for Public Colleges and Universities*, as amended by GASB Statements No. 37, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments: Omnibus*, and GASB Statement No. 38, *Certain Financial Statement Note Disclosures*. These statements establish standards for external financial reporting for public colleges and universities and require that financial statements be presented on a consolidated basis to focus on the System as a whole. Previously, financial statements focused on the accountability of individual fund groups rather than on the System as a whole.

Other significant changes to the financial statements are as follows:

- The measurement focus and basis of accounting is presented in full accrual, consistent with the accounting method used by private-sector institutions. All current year's revenues and expenses are recognized when earned or incurred, regardless of when cash is received or disbursed.

- Resources are classified for accounting and reporting purposes into the following four net asset categories: invested in capital assets -- net of related debt, restricted nonexpendable, restricted expendable, and unrestricted.
- Revenues and expenses are categorized as operating or nonoperating. Previously, a measure of operations was not presented. Significant recurring sources of the System's revenues, including state appropriations, gift contributions and investment income (loss) are considered nonoperating, as required by GASB Statement No. 35.
- Depreciation of capital assets is now recognized. Previously, the historical costs of capital assets were not systematically reduced to reflect use of these assets over time. Accumulated depreciation for prior periods is reflected as a restatement to net assets and current year's depreciation expense is shown as an operating expense on the Statement of Revenues, Expenses and Changes in Net Assets.
- Receivables, cash advances and unearned revenues for sponsored programs and student tuition and fees are now recorded as deferred revenue. Previously, only unearned cash receipts were recognized as deferred revenue.
- Scholarships and fellowships applied to student accounts are now shown as a reduction of student tuition and residence fee revenues, while stipends and other payments made directly to students continue to be presented as scholarship and fellowship expenses. Previously, all scholarships and fellowships were presented as expenditures.

FINANCIAL HIGHLIGHTS

- The current economic downturn has had both positive and negative impacts on the System. Weak labor market conditions contributed to an increase in student enrollment, evidenced by a 6.6% increase in the academic institutions' semester credit hours in 2002, as student retention increased and more individuals returned for retraining. Increased enrollment numbers and higher fees resulted in increased tuition and fees and other student-related revenues and expenses. However, declines in the financial markets have resulted in realized and unrealized endowment investment losses, largely contributing to the System's overall decrease in net assets of $657.4 million during 2002.
- The first-time recognition of accumulated depreciation of capital assets under GASB Statement No. 35, the implementation of higher State-wide capitalization threshold levels for capital assets and losses on endowment investments account for the $4 billion reduction in total assets to $22 billion in 2002. Approximately $3.6 billion of the $4 billion reduction in total assets is attributable to the restatements related to reducing depreciable capital asset values.
- Investments in capital asset additions totaled approximately $863.2 million in 2002, excluding $269.5 million in construction in progress that was completed during the year.

CONDENSED FINANCIAL INFORMATION

The Balance Sheet

The System's net assets are the difference between its assets and liabilities. Over time, increases or decreases in net assets are one indicator of the improvement or decline of the System's financial health when considered with non-financial factors such as enrollment, patient levels and the condition of facilities. Assets and liabilities are generally measured using current values.

One notable exception is capital assets, which are stated at historical cost less an allowance for depreciation. The following table reflects the condensed balance sheet at August 31, 2002:

($ in millions)	2002
Assets:	
Current Assets	$3,310.4
Noncurrent Investments	13,427.7
Other Noncurrent Assets	277.0
Capital Assets, net	4,960.3
Total Assets	21,975.4
Liabilities:	
Current Liabilities	2,663.5
Noncurrent Liabilities	2,192.3
Total Liabilities	4,855.8
Net Assets:	
Invested in Capital Assets, Net of Related Debt	3,044.1
Restricted	11,489.2
Unrestricted	2,586.3
Net Assets	17,119.6
Liabilities and Net Assets	$21,975.4

For more detailed information, see the accompanying Combined Balance Sheet and Notes to the Combined Financial Statements.

Assets declined approximately $4 billion since 2001, primarily due to the recognition of depreciation under GASB Statement No. 35 of $3.1 billion, and losses incurred due to unfavorable financial market fluctuations in the System's endowment investments. Liabilities increased $287.7 million, due to debt issuances needed to fund construction and renovation of facilities. Despite the net reduction in the balance sheet, the System continues to build upon its strong financial foundation. This financial health reflects the prudent utilization of its financial resources, including cost controls, management of its endowments and adherence to its long range capital plan for the maintenance and replacement of its facilities.

Current Assets and Current Liabilities

Current assets consist primarily of cash and cash equivalents, securities lending collateral, various student, patient and gift receivables and student notes receivable. Current liabilities consist primarily of trade accounts payable and accrued liabilities, securities lending obligations, deferred revenues, commercial paper notes and the current portion of bonds payable. The System's current ratio (current assets to current liabilities) of 1.24 times, reflects adequate liquidity and sufficient short-term ability to meets its upcoming obligations.

Noncurrent Investments

Noncurrent investments include permanent endowments, funds functioning as endowments, life income funds and other investments. A $1.5 billion decline was experienced in these assets in 2002 as follows:

($ in millions)	
Beginning of the Year	$14,942.3
Realized Losses	(463.1)
Fair Value Unrealized Losses	(446.2)
Income Distributions	(248.2)
Transfer to State Comptroller	(88.2)
Additions to Endowments	87.7
Other (Withdrawals and Changes in Receivables and Payables)	(356.6)
End of the Year	$13,427.7

The decrease is attributable to declines in the financial markets, resulting in realized and unrealized net investment losses of $909.3 million and income distributions of $248.2 million, offset by $87.7 million of gifts received to establish new endowment funds. During the fiscal year, funds totaling $88.2 million that were previously invested in the Permanent Health Fund by The University of North Texas System and the Texas Comptroller of Public Accounts were transferred to the Texas Safekeeping Trust Company, which will act as the new investment agent for these funds.

Capital Assets and Related Debt Activities

One of the critical factors in continuing the quality and meeting the demand of the System's academic, medical and research programs, and residential life is the development and renewal of its capital assets. The System continues to implement its $3.8 billion capital improvement program, planned for fiscal years 2002 through 2007, for the purpose of upgrading its facilities and addressing fire and life safety needs. This capital improvement program is balanced between new construction to deal with space deficiencies and planned growth in patient care and student enrollment. Capital additions totaled approximately $863.2 million in 2002, excluding $269.5 million in construction in progress that was completed during the year. These capital additions are primarily comprised of replacement, renovation and new construction of academic, research and health care facilities, as well as significant investments in equipment. Current year capital asset additions were funded with debt proceeds of $359.8 million, gifts of $56.5 million, with the balance funded by unrestricted and restricted net assets, designated for capital purposes.

The System continues to utilize short-term notes from its two available financing programs: the Revenue Financing System and the Permanent University Fund. Both programs provide interim financing for the System's eligible institutions' capital improvement programs. At August 31, 2002, current liabilities included notes outstanding for these financing programs of $498 million, an increase of $79.2 million since 2001. The System typically converts these outstanding notes to long-term debt financing, as appropriate, within the normal course of business.

Bonds payable relating to financing of current and prior years' construction needs totaled approximately $1.8 billion and $1.4 billion at August 31, 2002 and 2001, respectively. All long-term bonds continued to reflect the highest uninsured "Aaa" and "AAA" credit ratings from the three major bond-rating agencies.

Net Assets

Net assets represent the residual interest in the System's assets, after liabilities are deducted. The following table summarizes the composition of net assets at August 31, 2002:

($ in millions)	2002
Net Assets:	
Invested in Capital Assets, Net of Related Debt	$3,044.1
Restricted:	
Nonexpendable	10,064.2
Expendable	1,425.0
Unrestricted	2,586.3
Total Net Assets	$17,119.6

For more detailed information, see the accompanying Combined Balance Sheet and Notes to the Combined Financial Statements.

Net assets invested in capital assets, net of related debt represents the System's capital assets net of accumulated depreciation and outstanding debt obligations attributable to the acquisition, construction or improvement of those assets. The $3.1 billion decrease in capital assets, net of related debt since August 31, 2001 resulted from the restatement for initial recognition of accumulated depreciation, restatements for increases in capitalization thresholds, and the disposal of equipment assets, offset by additions to capital assets and debt levels during 2002.

Restricted nonexpendable net assets primarily include the System's permanent endowment funds and are subject to externally imposed restrictions governing their use. These net assets decreased a net of $1.6 billion to $10.1 billion in 2002. The decrease resulted from realized losses, decreases in fair value of investments, and income distributions, offset by new gifts. This category of restricted net assets also includes $188.7 million of funds functioning as endowments.

Although unrestricted net assets are not subject to externally imposed stipulations, substantially all of the System's unrestricted net assets have been committed for various future operating budgets related to academic, patient and research programs and initiatives, as well as capital projects. In addition, unrestricted net assets include Permanent Health Fund Endowments of $698.2 million established in 1999 from tobacco-related litigation funds received from the State. The corpus of these funds is restricted by State statute to remain intact and the earnings from the funds are required to be utilized for public health activities such as medical research, health education and treatment programs. Additionally, unrestricted net assets include funds functioning as endowment of $77.4 million.

The Statement of Revenues, Expenses and Changes in Net Assets

The Statement of Revenues, Expenses and Changes in Net Assets presents the System's results of operations. The following table summarizes the System's revenues, expenses and changes in net assets for the year ending August 31, 2002:

THE UNIVERSITY OF TEXAS SYSTEM
Management's Discussion and Analysis (Unaudited)
For the Year Ended August 31, 2002

($ in millions)	2002
Operating Revenues:	
Net Student Tuition and Fees	$526.8
Sponsored Programs	1,643.0
Patient Care Revenues	2,113.5
Net Auxiliary Enterprises	217.4
Other	305.1
Total Operating Revenues	4,805.8
Total Operating Expenses	(6,757.7)
Operating Loss	(1,951.9)
Nonoperating Revenues (Expenses):	
State Appropriations	1,622.5
Gift Contributions	197.1
Net Investment Income (Loss)	(54.7)
Net Decrease in Fair Value of Investments	(458.5)
Interest Expense and Other, Net	(90.6)
Net Other Nonoperating Revenues	13.4
Loss Before Other Revenues, Expenses, Gains or Losses	(722.7)
Capital Gift Contributions and Additions to Permanent Endowments	177.0
Special and Extraordinary Items	(13.6)
Transfers to Other State Entities	(98.1)
Change in Net Assets	(657.4)
Net Assets, Beginning of the Year	21,397.0
Restatements	(3,620.0)
Restated Net Assets, Beginning of the Year	17,777.0
Net Assets, End of the Year	$17,119.6

For more detailed information, see the accompanying Combined Statement of Revenues, Expenses and Changes in Net Assets and Notes to the Combined Financial Statements.

Operating Revenues

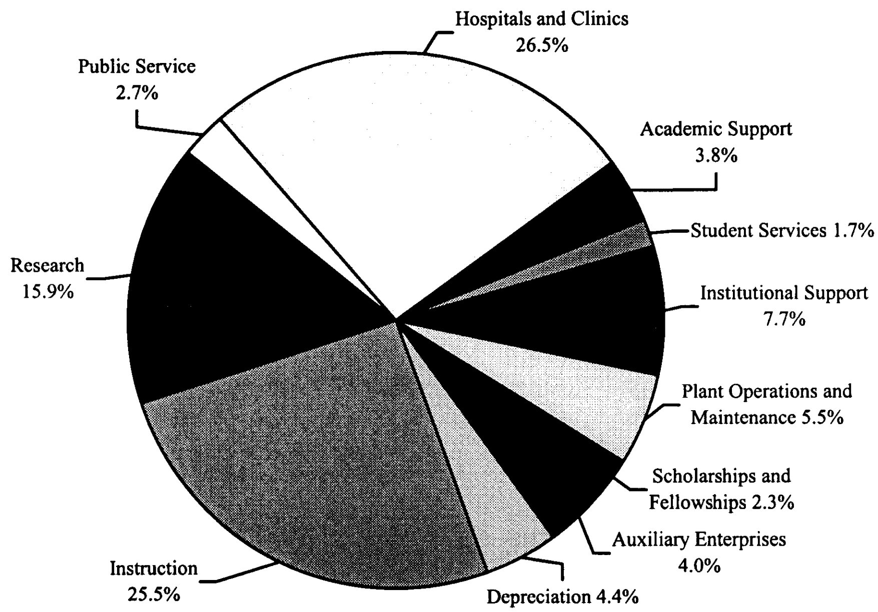
Student tuition and fees, a primary source of funding for the System's academic programs, are reflected net of associated discounts and allowances. Student-related revenues generally increased for 2002, caused by fee increases and a 6.6% increase in student semester credit hours at the academic institutions from approximately 3.3 million in 2001 to 3.5 million in 2002. Enrollment levels at the health institutions remained relatively stable. A weak labor market contributed to student retention and caused individuals to return to education for retraining. Recruitment efforts also continue to contribute to enrollment growth at many academic institutions in response to the State's Uniform Recruitment and Retention Act and the "*Closing the Gaps*" initiative by the Texas Higher Education Coordinating Board. Sponsored program revenues are primarily from governmental and private sources and related to research programs that normally provide for the recovery of direct and indirect costs. Other sponsored programs include student financial aid and contracts with affiliated hospitals for clinical activities. These revenues increased in 2002 due to higher participation by the academic institutions in the TEXAS Grant Program, a State-based financial aid program. Additionally, growth in contractual income resulted from renegotiations with various health institutions' affiliated teaching hospitals for improved cost recoveries of administration, training and providing for indigent care. Patient care revenues are principally generated within the System's hospitals and physicians' practice plans under contractual arrangements with governmental payers and private insurers. Auxiliary enterprise revenues were earned from a host of activities such as athletics, housing and food service, bookstores, parking and traffic, student health and other activities.

Operating Expenses

The following data summarizes the composition of operating expenses by programmatic function for the year ending August 31, 2002:

($ in millions)	2002
Functional Classification of Operating Expenses:	
Instruction	$1,723.4
Research	1,074.9
Public Service	185.6
Hospitals and Clinics	1,788.4
Academic Support	259.9
Student Services	113.8
Institutional Support	521.2
Operations and Maintenance of Plant	368.5
Scholarships and Fellowships	156.3
Auxiliary Enterprises	268.2
Depreciation and Amortization	297.5
Total Operating Expenses	$6,757.7

Functional Classification of Operating Expenses ($6,757.7 million)

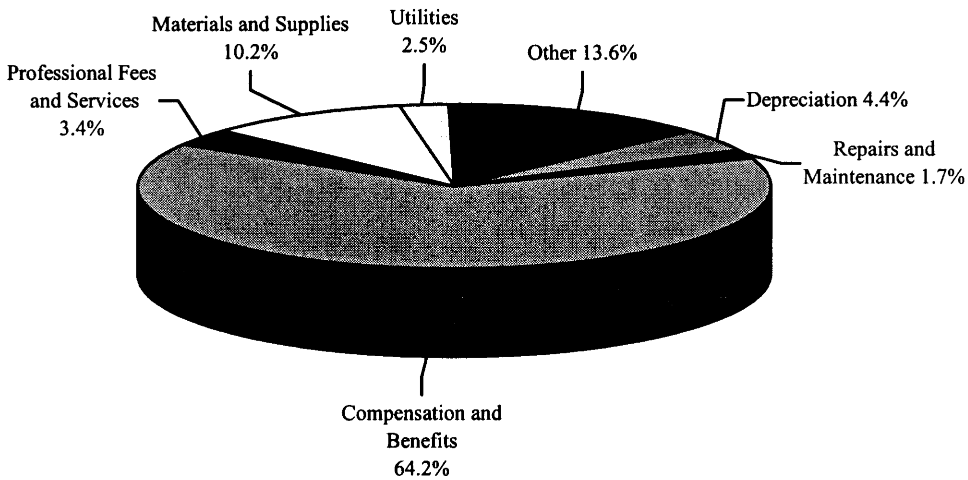


The above functional presentation of operating expenses reflects the System's commitments in promoting instruction, research, patient care, public service and student support. Previous capital asset expenditures were replaced by the recognition of depreciation expense. Total expenses generally increased in 2002, in response to growing student enrollment, research, and patient care activities. The System's full-time equivalent employees increased 4.2% from 63,054 in 2001 to 65,689 in 2002. Employee related costs generally increased due to state-mandated salary increases and higher medical insurance premium costs.

In addition to programmatic (functional) classification of operating expenses, a summary of the System's expenses by natural classification for the year ending August 31, 2002 follows:

($ in millions)	2002
Natural Classification of Operating Expenses:	
Compensation and Benefits	$4,336.5
Materials and Supplies	689.6
Professional Fees and Services	230.4
Utilities and Communications	171.7
Repairs and Maintenance	113.4
Depreciation and Amortization	297.5
Other (Travel, Scholarships and Fellowships, etc.)	918.6
Total Operating Expenses	$6,757.7

Natural Classification of Operating Expenses ($6,757.7 million)



Nonoperating Revenues and Expenses

Significant recurring revenues are considered nonoperating, as required by GASB Statement No. 35. State appropriations increased $107.9 million or 7.1%, primarily due to health insurance premiums, merit increases and special item funding for various academic excellence and medical and biotechnology initiatives. Gift contributions for operations were received from private sources and used to further research and support student education. Interest and investment income net losses totaled $54.7 million, which include dividends and interest receipts offset by realized losses on endowment investments. The unfavorable financial market also resulted in unrealized losses on the System's investment portfolios. The System's endowment investment polices are designed to maximize long-term total return while income distribution policies are designed to preserve the value of the endowments and to generate a predictable stream of distributable income. Interest expense on capital asset financings increased 7% from $84.7 million in 2001 to $90.6 million in 2002, primarily due to $437.6 million in additional debt issuance.

Loss Before Other Revenues, Expenses, Gains or Losses

Loss Before Other Revenues, Expenses, Gains or Losses, is the computation resulting from operating loss and nonoperating revenues and expenses. It is an indication of recurring revenues and expenses for the System and does not take into account capital and endowment related additions, special or extraordinary items and transfers to other entities. The Loss Before Other Revenues, Expenses, Gains or Losses totaled $722.7 million in 2002. The loss reflects realized and unrealized investment losses of valuing investments to their fair values. The System measures its operating results by considering operating activities, including certain significant recurring nonoperating revenues, expenses and endowment distribution transfers. The following table summarizes the System's view on its operating results for 2002:

($ in millions)	2002
Operating Results:	
Operating Loss	$(1,951.9)
State Appropriations	1,622.5
Gift Contributions for Operations	197.1
Net Investment Income (Loss)	(54.7)
Interest Expense on Debt Financings	(90.6)
P.U.F. and Other Endowment Distributions	257.5
Net Operating Results	$(20.1)

Various corpus distributions from the State endowment, known as the Permanent University Fund (P.U.F.), and other endowment funds are recorded operationally as transfers instead of revenue. Therefore, these transfers must be considered in the analysis in order to properly match associated operating expenses and P.U.F. debt interest expense. The System's operating results were negative due to realized losses on investments caused by market conditions.

Capital Gift Contributions and Additions to Permanent Endowments
Capital gifts and additions to permanent endowments totaled $177.1 million for the period ending August 31, 2002 and resulted primarily from capital campaign efforts to address facilities expansion and renovation and establishment of endowments for instruction, research and patient care activities. The institutions with large, multi-year fund raising campaigns underway include: Austin of $1 billion, Southwestern Medical Center at Dallas of $450 million, and Health Science Center at Houston of $200 million.

Special and Extraordinary Items
Special and extraordinary items result from unusual and infrequent events. Net expenses totaling $13.6 million were realized during fiscal year 2002 as a result of the Health Science Center at Houston's continued costs associated with debris removal, emergency protective measures and replacement supplies relating to property and equipment damage sustained during Tropical Storm *Allison* in June 2001. Since *Allison*, receipts have been realized from commercial insurance coverage and from the United States Federal Emergency Management Agency (FEMA). Additional insurance and FEMA proceeds are anticipated; however, the amount and timing of such receipts cannot reasonably be predicted due to on-going settlement negotiations and numerous variables that preclude estimation.

Transfers and Others
Transfers to and from other state agencies include $112.8 million in Available University Funds distributed to Texas A&M University System for their annual one-third participation in the Permanent University Fund endowment. Additionally, $14.7 million was received from the State for new legislative initiatives promoting advancements in research and academic excellence. Such funding will continue and is expected to increase in future years.

Change in Net Assets
The change in net assets results from all revenues, expenses, gains, losses, gifts and transfers that occurred during the accounting period. It is an overall indication of the improvement or decline

of the System's financial health and relates the change in net asset information between the prior and current year's balance sheet. Net assets decreased $657.4 million for the year ending August 31, 2002, primarily due to net investment losses and distributions of $112.8 million made to Texas A&M University System for their annual one-third participation in the Permanent University Fund.

Restatements

Various restatements totaling $3.6 billion caused beginning net asset values to decrease. The majority of these restatements impacted capital assets and resulted from implementation of the new accounting standards. The following table summarizes these restatements for 2002:

($ in millions)	2002
Restatements to Beginning Net Assets:	
Accumulated Depreciation	$(2,967.6)
Increased Capitalization Thresholds	(585.5)
GASB Statement No. 35 Accruals	(116.5)
Equipment Held In Trust	82.2
Other Adjustments (Gift Pledges and Technology Stock)	(32.6)
Net Restatements	$(3,620.0)

For more detailed information, see the accompanying Note 14 to the Combined Financial Statements.

The Statement of Cash Flows

The Statement of Cash Flows provides additional information about the System's financial results by reporting the major sources and uses of cash. The statement provides an assessment of the System's financial flexibility and liquidity to meet obligations as they come due and the need for external financing. The following table summarizes cash flows for the year ending August 31, 2002:

($ in millions)	2002
Cash Flows:	
Cash received from operations	$4,887.9
Cash expended for operations	(6,524.2)
Net cash used in operating activities	(1,636.3)
Net cash provided by noncapital financing activities	1,860.9
Net cash used in capital and related financing activities	(360.0)
Net cash provided by investing activities	546.3
Net increase in cash and cash equivalents	410.9
Cash and cash equivalents, beginning of the year	1,161.3
Cash and cash equivalents, end of the year	$1,572.2

For more detailed information, see the accompanying Combined Statement of Cash Flows and Notes to the Combined Financial Statements.

Net cash used in operating activities should be viewed in conjunction with net cash provided by noncapital financing activities. State appropriations and gift contributions for operations are significant sources of recurring revenues in support of operating expenses, but required to be classified as noncapital financing activities under GASB Statement No. 35. Therefore when considering cash flows related to operating activities, it is important to also consider these noncapital financing activities which support operating expenses. Net cash flow used by these two activities amounted to $224.6 million. Net cash used in capital and related financing activities totaled $360 million and reflected the System's commitments to expand and renovate facilities and make significant investments in equipment. Net cash provided by investing activities of $546.3 million reflected receipts from sales and maturities of investments compared to purchases of investments. The unrealized losses from the decrease in fair value of investments is considered a non-cash transaction for valuation purposes only, and does not affect cash flows from investing activities. The System's cash and cash equivalents increased $410.9 million during 2002 due to positive flow of funds provided by noncapital financing and investing activities.

Economic Outlook

Management regards the System as well positioned to continue its strong financial condition and service to students, patients, the research community, citizens of Texas and our country. Future successes are largely dependent upon cost containment, the ability to recruit and retain the highest quality students, faculty and staff, and ongoing financial and political support from state government.

Private gift contributions are an important supplement to the fundamental support from the state, revenues from students and patients, and a significant factor in the growth of academic, research, and patient care units. Economic pressures affecting donors may also affect the future level of support afforded the System from corporate and individual giving.

The System will continue to employ its long-term investment strategy to maximize total returns, at an appropriate level of risk, while utilizing a spending rate policy to insulate the System's operations from temporary market volatility.

Finally, while it is not possible to predict the ultimate results, management believes that the System's financial condition has historically reflected strength and is capable of withstanding and adjusting to future economic uncertainties.

THE UNIVERSITY OF TEXAS SYSTEM
EXHIBIT A - COMBINED BALANCE SHEET
As of August 31, 2002

	Primary University	Component Units
ASSETS		
Current Assets:		
Cash & Cash Equivalents (Notes 1 & 2)	$ 1,347,979,275	14,187,593
Restricted Cash & Cash Equivalents (Notes 1 & 2)	224,183,935	93,355
Balance in State Appropriations	83,526,788	
Securities Lending Collateral (Notes 1 & 2)	202,552,782	
Accounts Receivable, Net:		
Federal Receivables	141,712,977	
Other Intergovernmental Receivables	18,098,255	
Student Receivables	55,107,112	
Patient Receivables	382,843,860	884,501
Interest and Dividends	104,186,545	13,041
Contributions Receivable	53,864,749	442,664
Other Receivables	407,004,291	5,151,764
Due From Other Funds	107,878,453	
Due From Other Agencies	6,559,270	
Inventories	41,794,631	
Loans and Contracts	39,668,854	
Other Current Assets	93,378,982	188,097
Total Current Assets	3,310,340,759	20,961,015
Non-Current Assets:		
Restricted:		
Cash & Cash Equivalents (Notes 1 & 2)	81,198	
Investments (Note 2)	11,336,976,501	665,282
Loans, Contracts and Other	81,605,742	
Funds Held by Sealy & Smith Foundation	64,608,525	
Contributions Receivable	129,555,640	
Investments (Note 2)	2,090,700,212	
Other Non-Current Assets	1,247,372	330,150
Capital Assets (Note 4)	8,082,245,459	22,448,944
Less Accumulated Depreciation	(3,121,981,400)	(6,011,454)
Total Non-Current Assets	18,665,039,249	17,432,922
TOTAL ASSETS	$ 21,975,380,008	38,393,937
LIABILITIES		
Current Liabilities:		
Accounts Payable and Accrued Liabilities	$ 409,950,446	5,384,386
Federal Payables	23,825,612	
Other Intergovernmental Payables	1,982,257	
Self-Insurance Claims IBNR (Note 5)	161,813,541	
Securities Lending Obligations (Note 2)	202,552,782	
Due to Other Funds	107,878,453	
Due to Other Agencies	7,616,276	
Deferred Revenue	554,709,057	2,872
Employees' Compensable Leave-Curr Portion (Note 10)	20,901,406	127,947
Notes, Loans & Leases Payable-Curr Portion (Notes 8, 9 & 10)	499,054,777	25,231
Payable From Restricted Assets-Current Portion	538,688,067	
Bonds Payable-Current Portion (Notes 7 & 10)	83,860,000	
Funds Held for Others	20,504,956	
Other Current Liabilities	30,116,223	
Total Current Liabilities	2,663,453,853	5,540,436
Non-Current Liabilities:		
Employees' Compensable Leave (Note 10)	206,826,246	100,378
Assets Held for Others	294,586,588	
Notes, Loans and Leases Payable (Notes 8, 9 & 10)	3,201,892	1,860
Bonds Payable (Notes 7 & 10)	1,686,735,000	
Other Non-Current Liabilities	990,317	152,760
Total Non-Current Liabilities	2,192,340,043	254,998
TOTAL LIABILITIES	4,855,793,896	5,795,434
NET ASSETS		
Invested in Capital Assets, Net of Related Debt	3,044,050,654	16,410,399
Restricted for:		
Nonexpendable		
Permanent University Fund Endowment (Note 3)	7,539,176,009	
True and Term Endowments, and Annuities (Note 3)	2,525,055,435	
Expendable		
Capital Projects	153,974,493	507,546
Debt Service	4,459,204	
Funds Functioning as Endowment - Restricted	188,678,479	
Other Expendable	1,077,858,300	28,473
Unrestricted (Note 11)	2,586,333,538	15,652,085
TOTAL NET ASSETS	17,119,586,112	32,598,503
TOTAL LIABILITIES AND NET ASSETS	$ 21,975,380,008	38,393,937

The accompanying Notes to the Combined Financial Statements are an integral part of the financial stateme

THE UNIVERSITY OF TEXAS SYSTEM
EXHIBIT B - COMBINED STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS
For the Year Ended August 31, 2002

	Primary University	Component Units
Operating Revenues:		
Net Student Tuition and Fees (Note 12)	$ 526,797,774	
Federal Sponsored Programs	992,413,749	
Federal Sponsored Programs Pass-Through from Other St. Agencies	26,516,878	
State Sponsored Programs	71,921,435	28,173,812
State Sponsored Programs Pass-Through from Other St. Agencies	97,582,551	
Local Sponsored Programs	207,699,434	
Private Sponsored Programs	246,854,089	
Net Sales and Services of Educational Activities (Note 12)	175,801,905	
Net Sales and Services of Hospitals (Note 12)	1,525,987,837	9,327,460
Net Professional Fees (Note 12)	587,509,555	926,414
Net Auxiliary Enterprises (Note 12)	217,379,370	
Other Operating Revenues	129,358,376	485,162
Total Operating Revenues	4,805,822,953	38,912,848
Operating Expenses: (Note 13 for Natural Classification of Expenses)		
Instruction	1,723,387,682	
Research	1,074,874,600	
Public Service	185,570,069	
Hospitals and Clinics	1,788,348,960	37,017,029
Academic Support	259,880,116	
Student Services	113,848,077	
Institutional Support	521,215,696	
Operations and Maintenance of Plant	368,512,756	241,997
Scholarships and Fellowships	156,300,728	
Auxiliary Enterprises	268,219,817	
Depreciation and Amortization	297,507,694	2,490,883
Total Operating Expenses	6,757,666,195	39,749,909
Operating Loss	(1,951,843,242)	(837,061)
Nonoperating Revenues (Expenses):		
State Appropriations	1,615,398,320	
HEAF Appropriations	7,131,692	
Gift Contributions for Operations	197,089,606	920,678
Net Investment Income (Note 12)	(54,688,371)	211,704
Net Increase (Decrease) in Fair Value of Investments	(458,524,437)	
Interest Expense on Capital Asset Financings	(90,644,496)	(3,137)
Gain/(Loss) on Sale of Capital Assets	(10,384,593)	
Other Nonoperating Revenues	110,203,638	101,390
Other Nonoperating Expenses	(86,453,272)	
Net Nonoperating Revenues (Expenses)	1,229,128,087	1,230,635
Income/(Loss) Before Other Rev., Exp., Gains/(Losses) & Transfers	(722,715,155)	393,574
Gifts and Sponsored Programs for Capital Acquisitions	89,395,282	2,500,000
Additions to Permanent Endowments	87,678,590	
Extraordinary Items	(13,634,457)	
Transfers to/from Other State Agencies	(98,095,514)	
Change in Net Assets	(657,371,254)	2,893,574
Net Assets - September 1, 2001 - As Previously Reported	21,397,004,622	29,346,466
Restatements (Note 14)	(3,620,047,256)	358,463
Net Assets - September 1, 2001 - As Restated	17,776,957,366	29,704,929
Net Assets - August 31, 2002	$ 17,119,586,112	32,598,503

The accompanying Notes to the Combined Financial Statements are an integral part of the financial statements.

UNAUDITED

THE UNIVERSITY OF TEXAS SYSTEM
EXHIBIT C - COMBINED STATEMENT OF CASH FLOWS
For the Year Ended August 31, 2002

	Primary University	Component Units
Cash Flows from Operating Activities:		
Proceeds Received from Students	$ 729,497,852	
Proceeds Received from Patients and Customers	2,092,359,664	34,608,537
Proceeds for Sponsored Programs	1,620,622,835	
Auxiliary Enterprise Charges	214,885,060	
Proceeds from Other Revenues	184,712,210	1,053,443
Payments to Suppliers	(2,075,367,188)	(28,935,157)
Payments to Employees	(4,337,571,764)	(5,289,864)
Loans Issued to Students	(49,951,214)	
Collections of Loans to Students	45,795,179	
Payments for Other Expenses	(61,280,598)	
Net Cash Provided (Used) by Operating Activities	(1,636,297,964)	1,436,959
Cash Flows from Noncapital Financing Activities:		
Proceeds from State Appropriations	1,611,465,567	
Operating Gifts	219,761,221	1,241,105
Private Gifts for Endowment and Annuity Life Purposes	87,678,590	
Other Nonoperating Revenues	94,776,256	99,949
Payments/Receipts for Transfers to/from Other Agencies	164,908,051	
Payments for Other Uses	(317,670,019)	
Net Cash Provided (Used) by Noncapital Financing Activities	1,860,919,666	1,341,054
Cash Flows from Capital and Related Financing Activities:		
Proceeds from Issuance of Capital Debt	582,194,387	
Capital Grants and Gifts	43,801,609	4,178,643
Proceeds from Sale of Capital Assets	388,443	
Purchase of Capital Assets	(782,230,662)	(1,646,802)
Principal Paid on Capital Related Debt	(122,155,643)	(36,531)
Interest Paid on Capital Related Debt	(82,016,589)	(3,137)
Net Cash Provided (Used) by Related Financing Activities	(360,018,455)	2,492,173
Cash Flows from Investing Activities:		
Proceeds from Sales and Maturities of Investments	15,574,966,543	500,000
Proceeds from Interest and Investment Income	170,481,749	198,663
Purchases of Investments	(15,199,083,006)	(15,380)
Net Cash Provided (Used) by Investing Activities	546,365,286	683,283
Net Increase (Decrease) in Cash	410,968,533	5,953,469
Cash & Cash Equivalents - Beginning of the Year	1,161,275,875	8,327,479
Cash & Cash Equivalents - End of the Year	$ 1,572,244,408	14,280,948
Reconciliation of Net Operating Revenues (Expenses) to Net Cash Provided (Used) by Operating Activities:		
Operating Loss	$ (1,951,843,242)	(837,061)
Adjustments to Reconcile Operating Loss to Net Cash:		
Depreciation and Amortization Expense	297,507,694	2,490,883
Loss on Asset Disposition		11,729
Changes in Assets and Liabilities:		
Accounts Receivable, net	(205,781,715)	(3,264,351)
Inventory	(3,007,781)	
Loans to Students	(923,544)	
Other Assets	(3,582,842)	(66,087)
Accounts Payable	56,648,281	3,219,297
Deferred Revenue	190,583,366	(1,161)
Deposits Held for Others	(38,398,515)	3,000
Compensated Absences & Notes Payable	22,414,081	42,919
Other Liabilities	86,253	(162,209)
Total Adjustments	315,545,278	2,274,020
Net Cash Provided (Used) by Operating Activities:	$ (1,636,297,964)	1,436,959
Non Cash Transactions		
Net Increase (Decrease) in Fair Value of Investments	(458,524,437)	
Loss on Disposal of Capital Assets	(72,250,882)	
Accumulated Depreciation on Disposal of Capital Assets	(17,466,724)	
Miscellaneous Non Cash Transactions	5,005,031	

The accompanying Notes to the Combined Financial Statements are an integral part of the financial statements.

2002 Analysis of Financial Condition

The University of Texas System

January 2003

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The University of Texas System
2002 Analysis of Financial Condition

Executive Summary

The U. T. System has prepared the Analysis of Financial Condition (AFC) since 1995. Since that time, the same basic ratios relying on trends for rating purposes have been used. With the implementation of Governmental Accounting Standards Board (GASB) 34/35 in 2002, the basis of accounting and presentation of the financial statements has changed, making comparable information unavailable for prior periods. The financial statements are also now presented with an entity wide approach, removing the focus from current funds. In past years, we have rated institutions as unsatisfactory, watch, or satisfactory based on five-year trends. Since there are no trends available upon which to base our conclusions, we will not be rating institutions this year.

It is also not appropriate to compare a large research institution to a smaller academic institution or to compare a large indigent care hospital to a premier cancer hospital; therefore, no comparisons are made among institutions. We have taken the next logical step and asked the institutions chief business officers, Academic Affairs, and Health Affairs to determine the nationwide peers for each institution. We attempted to obtain the information to benchmark each institution to its own peers for this report; however, the financial statement information is not available until mid-January. Once the information is available, we will prepare a new report benchmarking each institution to their true peers. We hope to have the updated version of the Analysis of Financial Condition available for discussion at the April Finance and Planning Committee of the Board.

With the changes mentioned above, it was a logical time to change focus and begin presenting ratios that are commonly used by bond rating agencies, public accounting firms and consulting firms. The focus was placed on three core ratios:

- Primary Reserve Ratio – measures the financial strength of the institution by comparing expendable net assets to total expenses less depreciation. This ratio provides a snapshot of financial strength and flexibility by indicating how long the institution could function by using its expendable reserves without relying on additional net assets generated by operations. Prior to 2002, a similar ratio was employed using Available Unrestricted Fund Balances to Budgeted Expenditures. Balances and activity related to bond proceeds and endowments/annuities were excluded from this ratio.
- Annual Operating Margin Ratio – indicates whether the institution has balanced annual operating expenses with revenues. Activities related to bond proceeds and endowments/annuities were excluded since these are not operating activities. Depreciation expense is included, as it is believed that inclusion of depreciation reflects a more complete picture of operating performance as it reflects use of physical assets. This ratio has been in existence since 1995.
- Return on Net Assets Ratio – determines whether the institution is financially better off than in previous years by measuring economic return. Once again, balances related to bond proceeds and endowment/annuities were excluded since these are not operating activities. A temporary decline in this ratio may be appropriate and even warranted if it reflects a strategy to better fulfill the institution's mission. On the other hand, an improving trend in this ratio indicates that the institution is increasing its net assets and is likely to be able to set aside financial resources to strengthen its future financial flexibility. This is a new ratio for 2002.

Please note that these core ratios only deal with the financial aspects of the institution and must be considered with key performance indicators in academics, infrastructure and student and faculty satisfaction to understand a more complete measure of total institutional strength.

In addition to the three core ratios discussed above, three additional ratios for each institution are presented:

- Expendable Resources to Total Net Assets Ratio– measures how much of Total Net Assets is expendable. Excludes balances related to bond proceeds and endowments/annuities.
- Operating Margin excluding Gifts Ratio– measures an institution's dependence on gifts to finance operations. Excludes activity related to bond proceeds and endowments/annuities.
- Debt Burden Ratio – measures actual debt burden on operating expenses

In future periods, when comparable data is once again available, trends for each ratio by institution will be shown.

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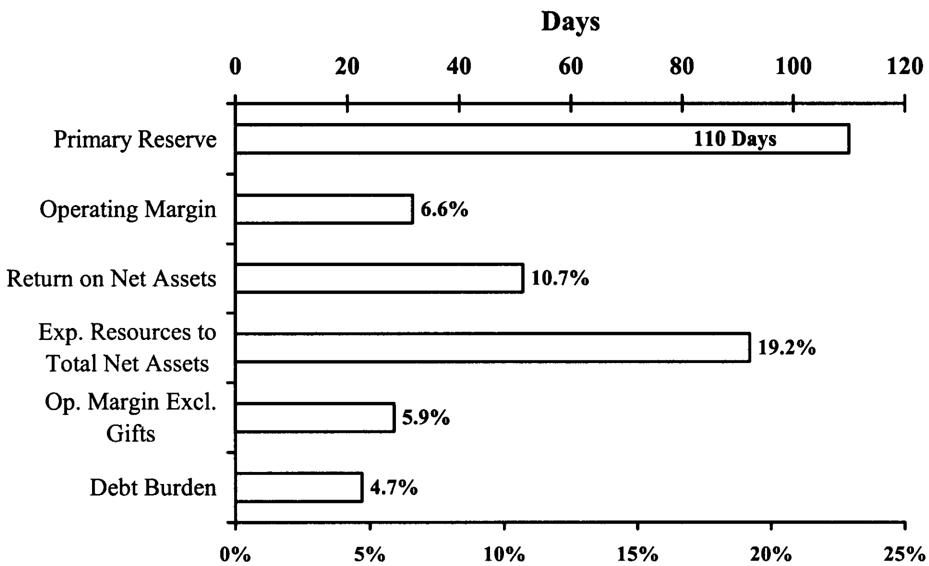
The University of Texas at Arlington
Summary of Financial Condition
Fiscal Year 2002



Primary Reserve Ratio measures the financial strength of an institution by comparing expendable net assets to total expenses (**in days**).

Annual Operating Margin Ratio indicates the direction and degree to which an institution has balanced annual operating expenses with revenues.

Return on Net Assets Ratio determines whether an institution is financially better off than in previous years by measuring total economic return.

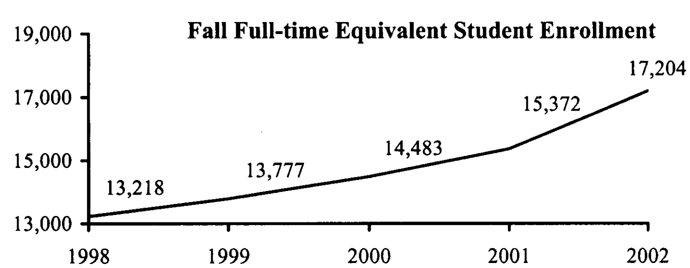
Expendable Resources to Total Net Assets Ratio measures how much of Total Net Assets is expendable.

Operating Margin Excluding Gifts Ratio measures the institution's dependence on gifts to finance annual operations.

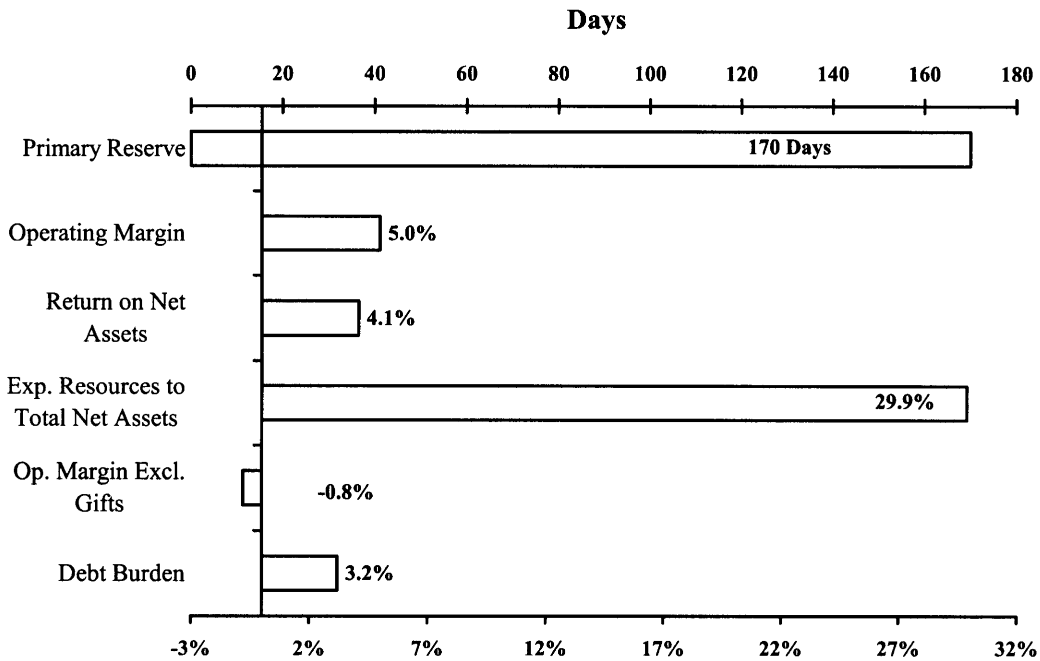
Debt Burden Ratio measures the actual debt burden on the annual operating expenses.

- Enrollment increased more than 8% from 2001 to 2002, which accounted for a majority of the increase in revenues. Many of the new students chose to live in several new on-campus housing projects. Since August of 1999, U.T. Arlington has opened and fully occupied more than 1,100 new beds for students desiring to live on campus.
- U.T. Arlington received $4.6 million in HB 1839 University Research Funds. A large portion of these funds was used to establish research laboratories for new research faculty, as well as support the faculty and graduate research assistants involved in research initiatives.
- Total operating expenses for 2002 include depreciation expense of $8.3 million, which was not previously recorded.
- Beginning net assets were restated as a result of prior years' depreciation expenses ($114 million) and increases in statewide capitalization thresholds ($30.2 million).

Full-time Equivalent (FTE) Student Enrollment gains since 1998 result from recruitment and retention efforts, additional sections for high demand courses and new online degrees, such as a Bachelor's degree in Criminal Justice, a Master's degree in Public Administration and a Spanish for Police Officers course sequence, which is being developed in partnership with the Arlington Police Department. A fifth academic program at the upper division level was launched by the School of Social Work on the McLennan Community College campus in Waco. Upper division coursework in Business Administration was also launched on the Tarrant County College Northeast Campus. The Texas Two Step Initiative was initiated in Partnership with five area community college districts. This program, funded in part by the Texas Higher Education Coordinating Board, streamlines the transfer process for community college students.



The University of Texas at Austin
Summary of Financial Condition
Fiscal Year 2002



Primary Reserve Ratio measures the financial strength of an institution by comparing expendable net assets to total expenses (**in days**).

Annual Operating Margin Ratio indicates the direction and degree to which an institution has balanced annual operating expenses with revenues.

Return on Net Assets Ratio determines whether an institution is financially better off than in previous years by measuring total economic return.

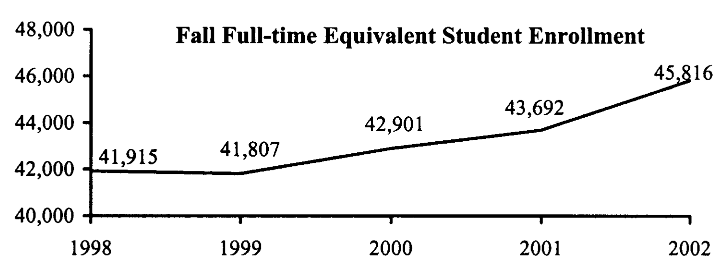
Expendable Resources to Total Net Assets Ratio measures how much of Total Net Assets is expendable.

Operating Margin Excluding Gifts Ratio measures the institution's dependence on gifts to finance annual operations.

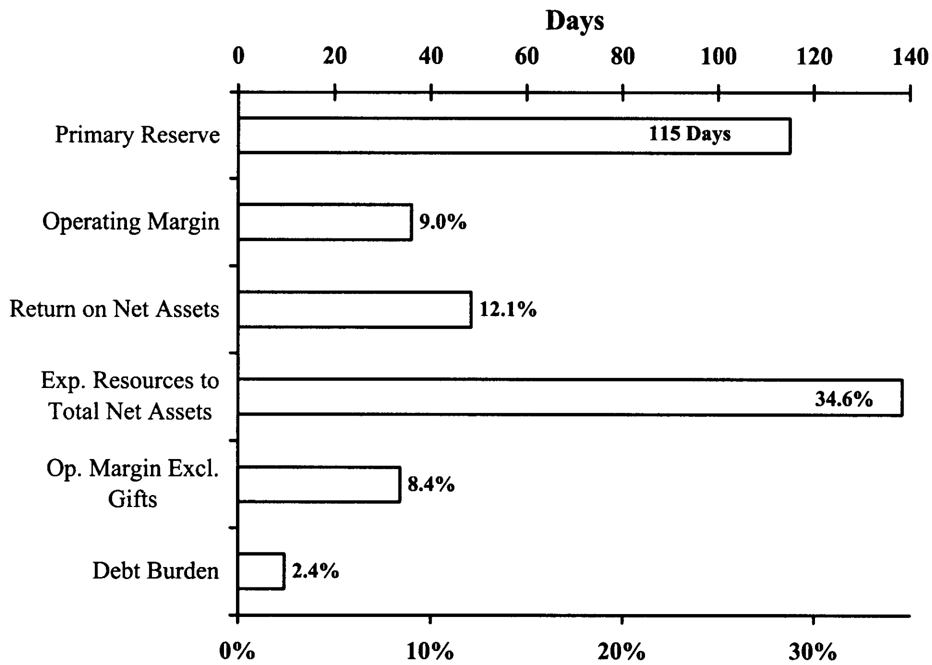
Debt Burden Ratio measures the actual debt burden on the annual operating expenses.

- Tuition and fees increased $29.2 million due to a 2.6% increase in enrollment, a 2.8% increase in semester credit hours and an increase in fee rates.
- Federal sponsored programs revenue (including pass-throughs) increased $39.4 million due to activity on sponsored projects with several different Federal Agencies including an Omnibus contract between the Navy and Applied Research Laboratories. These revenues are offset by the expenses incurred in performing the research.
- State sponsored programs revenue (including pass-throughs) increased $21.1 million in 2002 primarily due to increases in the Advanced Technology/Advanced Research Program funding of $12.5 million and TEXAS Grant Program funding of $6.2 million. The full amount of the biennium for Advanced Technology/Advanced Research program revenues was record in 2002; however, $10.2 million remained unspent at the end of the first year of the biennium.
- U.T. Austin changed its investment strategy and shifted the majority of the Short/Intermediate Fund holdings managed by UTIMCO into a debt index fund managed by Barclay's Global Investments, resulting in a realized gain of $6.5 million on these investments.
- Total operating expenses for 2002 include depreciation expense of $68.4 million, which was not previously recorded.
- Beginning net assets were restated as a result of prior years' depreciation expense ($187.3 million) and increases in statewide capitalization thresholds ($943.1 million).

Full-time Equivalent (FTE) Student Enrollment has increased since 1999 as various undergraduate programs have required higher credit hours per semester in order to facilitate more timely degree completions.



The University of Texas at Brownsville
Summary of Financial Condition
Fiscal Year 2002



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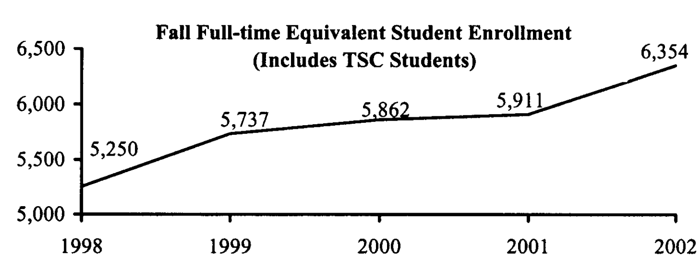
Expendable Resources to Total Net Assets Ratio measures how much of Total Net Assets is expendable.

Operating Margin Excluding Gifts Ratio measures the institution's dependence on gifts to finance annual operations.

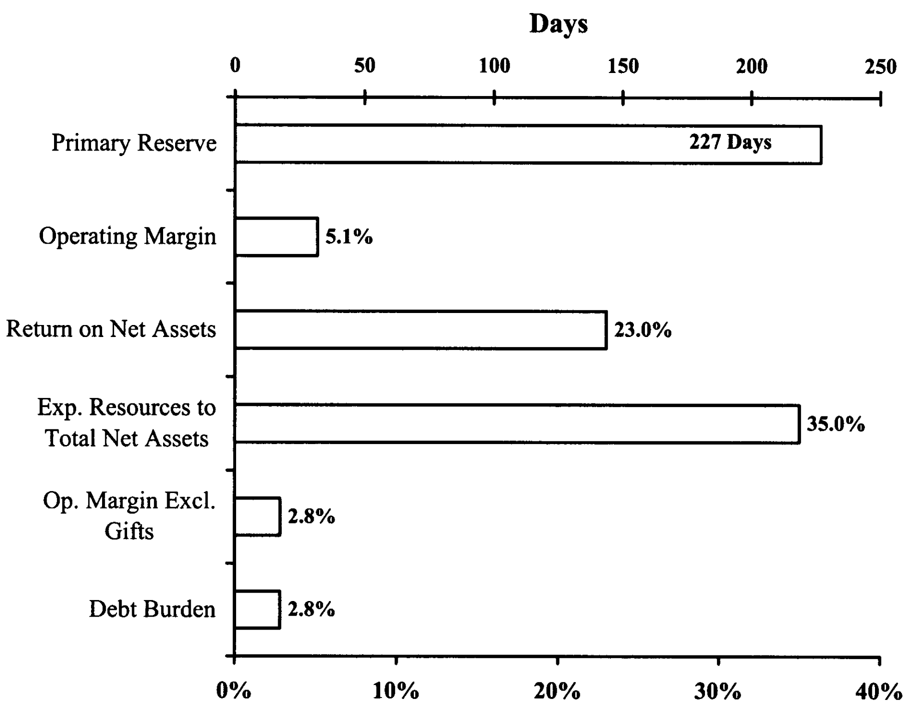
Debt Burden Ratio measures the actual debt burden on the annual operating expenses.

- Total semester credit hours increased 16.9% over 2001 levels.
- U.T. Brownsville received $29,000 in HB 1839 Texas Excellence Funds. These funds were used to partially fund the salary of a faculty member conducting research activities at U.T. Brownsville.
- State sponsored programs revenue (including pass-throughs) increased $1.3 million due to an increase in the TEXAS Grant Program funding.
- Local sponsored programs revenue increased $4.2 million resulting from the U.T. Brownsville and Texas Southmost College partnership revenues.
- Net sales and services of educational activities increased $1.2 million due to increases in Continuing Education programs.
- Total operating expenses for 2002 include depreciation expense of $2.6 million, which was not previously recorded.
- Capital assets increased due to construction of new academic facilities including the Life Health Science Building and the Education and Business Complex.
- Beginning net assets were restated as a result of prior years' depreciation expense ($5.3 million) and increases in statewide capitalization thresholds ($9.3 million).

Full-time Equivalent (FTE) Student Enrollment has increased since 1998 due to recruitment efforts, the availability of increased financial aid offered to U.T. Brownsville students through the TEXAS Grant Program and statutory removal on entering freshmen limitations.



The University of Texas at Dallas
Summary of Financial Condition
Fiscal Year 2002



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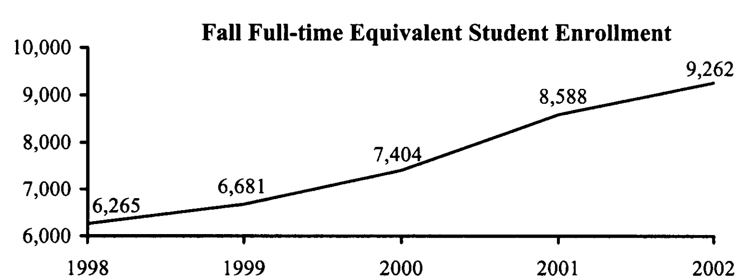
Operating Margin Excluding Gifts Ratio measures the institution's dependence on gifts to finance annual operations.

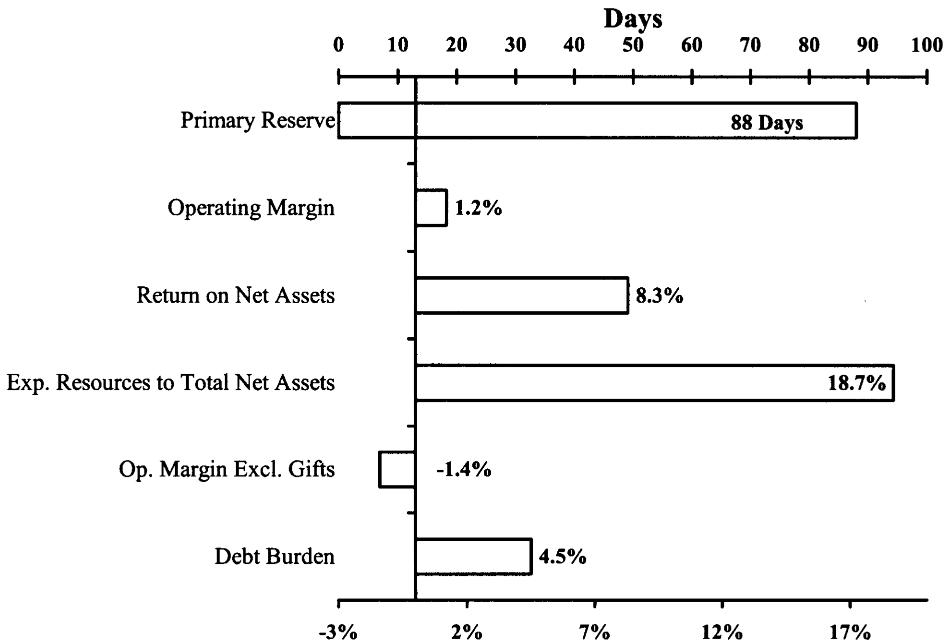
Debt Burden Ratio measures the actual debt burden on the annual operating expenses.

- Tuition and fees increased $9 million primarily due to increases in enrollment of 6.1% and semester credit hours of 8%.
- U.T. Dallas received $4.1 million in HB 1839 University Research Funds. These funds were allocated for such programs as the Nanotech Institute, Sickle-cell Research Institute, Hanson Space Science Institute, Lithospheric Research Institute, Green Center Science and Society, Brain Health Institute, Neuro-cognitive Research Center, Embedded Software Center Microelectronics, Language Processing, Analog and Digital VSLI, Digital Signal and Networking.
- Sponsored programs revenue (including pass-throughs) increased $9.8 million. Funding by the Texas Higher Education Coordinating Board represented $4.2 million of this increase, of which $1.9 million is bi-annual (Advanced Technology/Advanced Research program). The remaining increase $5.6 million resulted from continued efforts by U.T. Dallas to increase its research activities.
- Operating expenses increased $37.8 million with a large portion of this increase (48%) attributable to increases in employee compensation and benefits. U.T. Dallas recruited a number of distinguished researchers and other faculty members, resulting in higher compensation expenses. Additionally, significant higher medical insurance premium costs contributed to the increase in benefits.
- Total operating expenses for 2002 include depreciation expense of $7.3 million, which was not previously recorded.
- Gift contributions decreased 22.5% due to a combination of the weak economy and U.T. Dallas' dependence upon the local high technology sector.
- Capital assets increased due to the completion of the new engineering building and acquisition of the former Alliance for Higher Education facility.
- Beginning net assets were restated as a result of prior years' depreciation expense ($94.5 million) and increases in statewide capitalization thresholds ($19.5 million).

Full-time Equivalent (FTE) Student Enrollment growth has occurred in each of the last five years, with gains primarily in the Engineering, Computer Science and Management curriculums. Enrollment increases have also been achieved in other key programs. While FTEs continue to increase, the pace of the increase has declined due to the economic downturn.



The University of Texas at El Paso
Summary of Financial Condition
Fiscal Year 2002



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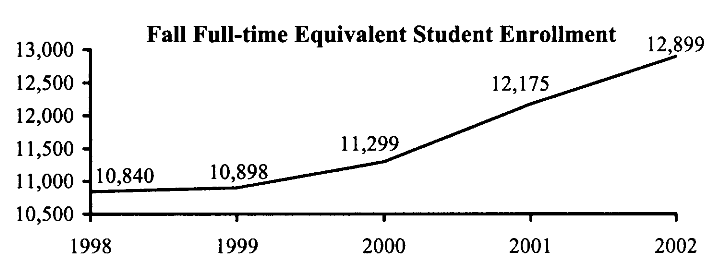
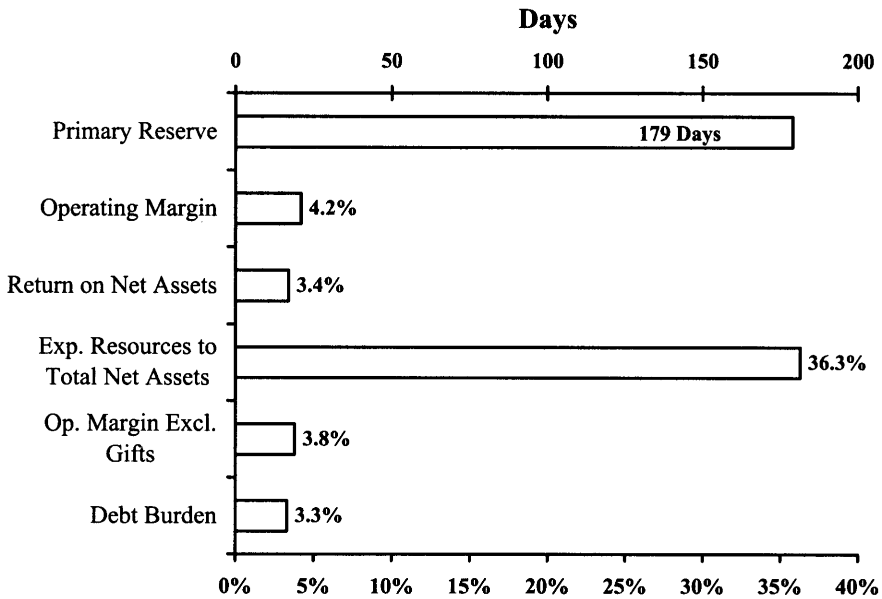
Debt Burden Ratio measures the actual debt burden on the annual operating expenses.

- U.T. El Paso experienced headcount enrollment growth of 8.7% and an increase in semester credit hours of 8.9%. This growth, coupled with fee increases, generated approximately $5.8 million in additional tuition and fees.
- U.T. El Paso received significant supplemental appropriation allocations as follows: $3.9 million in HB 1839 University Research Funds to support university centers of excellence and $3 million in TEXAS Grant Program funding to support a new cohort of entering freshmen.
- Instructional expenses increased $8.1 million primarily due to salary and related fringe benefit increases, growth in graduate and doctoral programs, increased enrollment and the addition of mini-semesters and another summer semester.
- Sponsored programs revenue (including pass-throughs) totaled $54.7 million, an $11 million increase over prior year. This reported amount supported $19 million of research expenditures, $13.3 million in scholarships and fellowships, $4.6 million in instruction and $8 million in public service.
- The terrorist attacks on September 11, 2001, had a significant economic impact on U.T. El Paso. The event resulted in the cancellation of a major home football game. This event also had a significant negative impact on the entertainment industry resulting in minimal activity in concerts and special events, which are a major revenue producer. The loss of gross revenues due to the terrorist attacks is estimated at $3 million, primarily impacting Auxiliary Enterprises.
- Capital assets increased by $21.3 million primarily due to the completion of the Miner Village student housing complex and the Larry K. Durham Center. The Miner Village provides apartment style dormitories and is currently at full capacity. The Larry K. Durham Center, adjacent to U.T. El Paso Sun Bowl stadium, includes a state-of-the-art athletic training facility and kinesiology lab. Finally, U.T. El Paso acquired land adjacent to the university for future expansion.
- Beginning net assets were restated as a result of prior years' depreciation expense ($101.3 million) and increases in statewide capitalization thresholds ($7.7 million).
- Total operating expenses for 2002 include depreciation expense of $11.7 million, which was not previously recorded.

Full-time Equivalent (FTE) Student Enrollment gains have continued since 1998 due to recruitment efforts targeted at area high schools and to a number of cooperative programs with the community college. Student FTE growth has also been fueled by increased retention efforts spearheaded by the University College. University College is a department, headed by the Dean of Enrollment Services, which combines all departments that have an indirect impact on the student's educational experience. Finally, graduate and doctoral programs continue to experience robust growth.



The University of Texas – Pan American
Summary of Financial Condition
Fiscal Year 2002



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Expendable Resources to Total Net Assets Ratio measures how much of Total Net Assets is expendable.

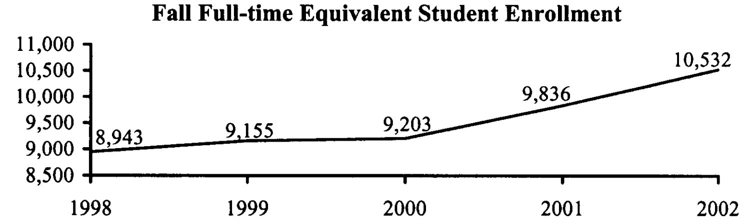
Operating Margin Excluding Gifts Ratio measures the institution's dependence on gifts to finance annual operations.

Debt Burden Ratio measures the actual debt burden on the annual operating expenses.

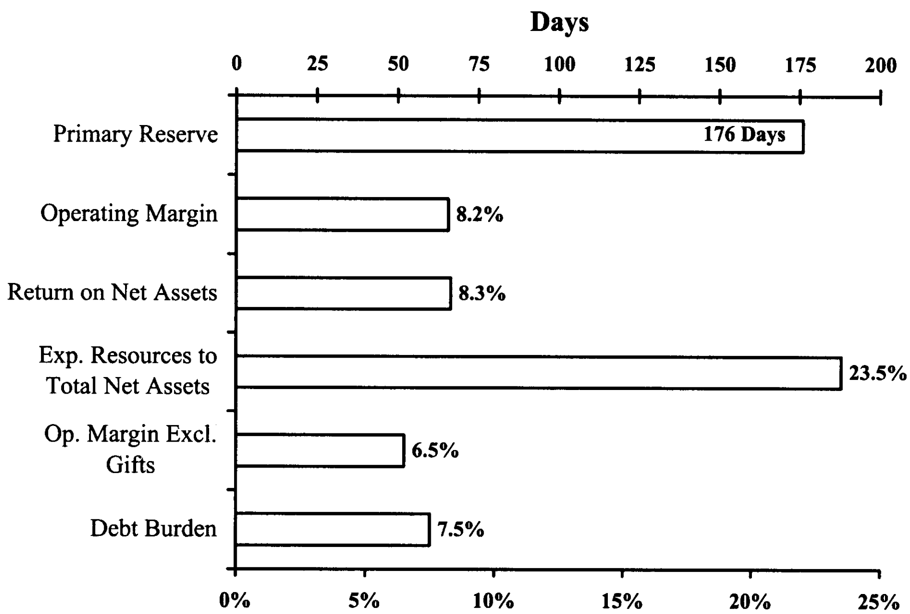
- Total semester credit hours increased 9.5% resulting in increases in tuition and fees, other types of student-related revenue and student-related expenses.
- U.T. Pan American received $99,000 in HB 1839 Texas Excellence Funds. These funds were used for research in the areas of Computer Science; Modern Languages and Literature; Engineering; Sociology; Communication; and Economics and Finance. This research was performed in various fields, including Data Mining and Web Mining for Information Technology, literary works written by Latin American authors, and International Communication.
- State sponsored programs revenue (including pass-throughs) increased $7.1 million primarily due to an increase in TEXAS Grant Program funding of $6.2 million, as well as two large grants from Telecommunications Infrastructure Fund Board totaling $651,000.
- The Federal Pell Grant Program increased $3.4 million as compared to 2001.
- U.T. Pan American began Gear Up, an outreach program, late in 2001. The goal of Gear Up is to significantly increase the number of students who are prepared to enter and succeed in post-secondary education. It also promotes increased parental involvement. The program is primarily funded through a grant from the Department of Education. In 2002 Gear Up had revenues/expenses of $5.7 million.
- Salaries/wages and benefits increased $9.3 million due to the state mandated salary increases.
- Total operating expenses for 2002 include depreciation expense of $7.3 million, which was not previously recorded.
- Beginning net assets were restated as a result of prior years' depreciation expense ($87.7 million) and increases in statewide capitalization thresholds ($18.2 million).

Full-time Equivalent (FTE) Student Enrollment increased significantly in 2001 and 2002 due to increased recruitment and retention efforts. This rise in enrollment is expected to continue as a result of the *Uniform Recruitment and Retention Act* and the *Closing the Gaps* study developed by the Texas Higher Education Coordinating Board.

Fall Full-time Equivalent Student Enrollment



The University of Texas of the Permian Basin
Summary of Financial Condition
Fiscal Year 2002



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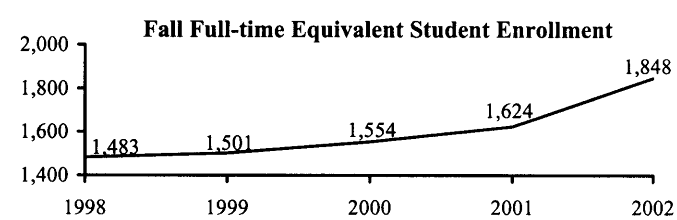
Operating Margin Excluding Gifts Ratio measures the institution's dependence on gifts to finance annual operations.

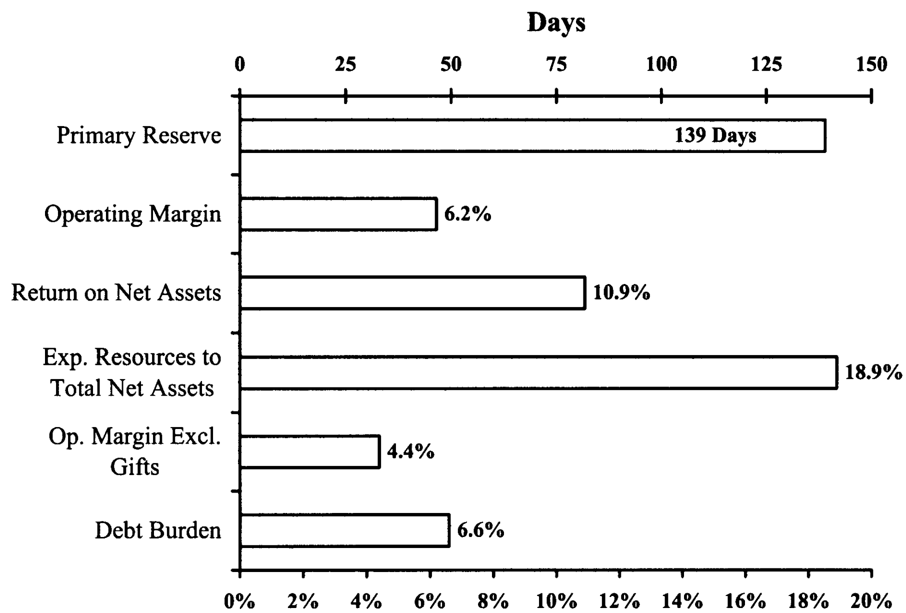
Debt Burden Ratio measures the actual debt burden on the annual operating expenses.

- Tuition and fees increased $1.4 million as a result of enrollment growth and increases in tuition rates. Enrollment increased 7.5% and semester credit hours increased 10.8% in 2002.
- U.T. Permian Basin received $250,000 in HB 1839 University Research Funds. These funds were used for the Faculty Research Development Fund and Sponsored Project Development Fund. The Faculty Research Development Fund was for direct research expenses generally limited to $2,000 or less. The Sponsored Project Development Fund was for research project enhancements in order to seek external grant funding.
- Net auxiliary activity declined in 2002 due to the outsourcing of the bookstore to Follett Corporation in March of 2001.
- Operating expenses increased as a result of the enrollment growth, salary increases and increased utility/maintenance costs associated with the expanded physical plant.
- Total operating expenses for 2002 include depreciation expense of $1.3 million, which was previously not recorded.
- Beginning net assets were restated as a result of prior years' depreciation expense ($27.7 million) and increases in statewide capitalization thresholds ($11.4 million).

Full-time Equivalent (FTE) Student Enrollment continues to increase. The increases result from recruitment and retention efforts, as well as improvements to library and lecture facilities. Additionally, the sluggish economy in 2002 resulted in more individuals returning to college to obtain new skills. Physical plant additions, increased focus on athletic program expansion, and a statewide multi-media marketing campaign are all part of concerted efforts to continue enrollment growth equal to 5.5%.



The University of Texas at San Antonio
Summary of Financial Condition
Fiscal Year 2002



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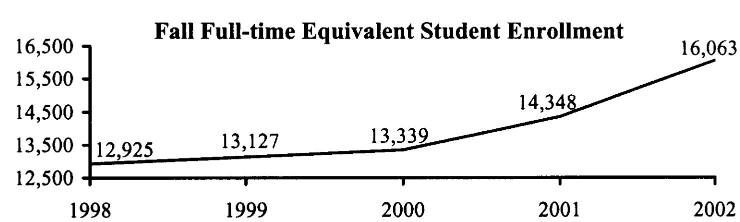
Expendable Resources to Total Net Assets Ratio measures how much of Total Net Assets is expendable.

Operating Margin Excluding Gifts Ratio measures the institution's dependence on gifts to finance annual operations.

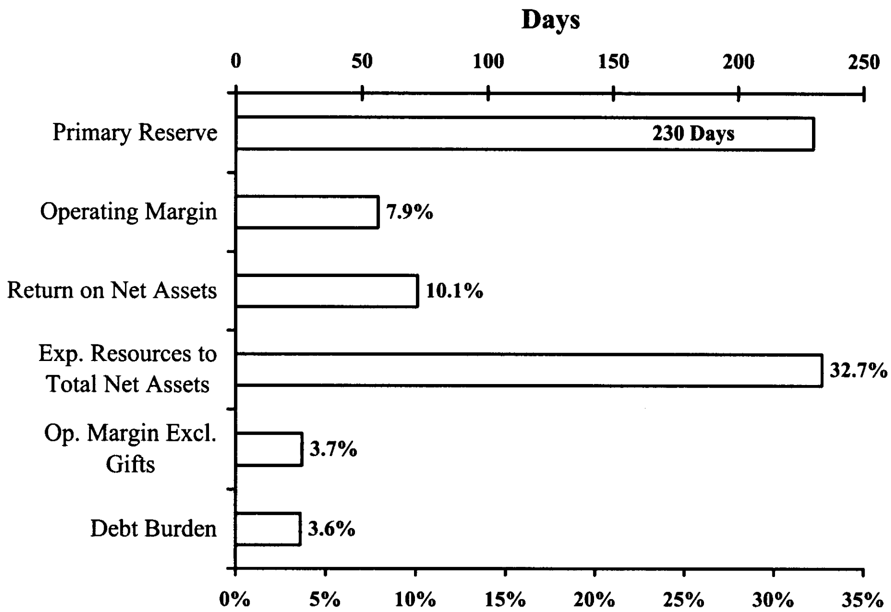
Debt Burden Ratio measures the actual debt burden on the annual operating expenses.

- Tuition and fees increased $9.7 million as a result of a 5.7% increase in enrollment, rate increases in existing fees and the establishment of new college based incidental fees. In addition, U.T. San Antonio had a 10% increase in the retention rate for first time freshmen.
- U.T. San Antonio received $1.7 million in HB 1839 University Research Funds. These funds were used for faculty salaries related to new PHD programs and research related equipment, as well as graduate assistant support and doctoral fellowships.
- Total operating expenses for 2002 include depreciation expense of $13.8 million, which was previously not recorded.
- Beginning net assets were restated as a result of prior years' depreciation expense ($100.1 million) and increases in statewide capitalization thresholds ($3.1 million).
- During 2002 construction commenced on a $19.4 million Recreation and Childcare Center and a $6.2 million addition to the Downtown Campus Durango Street building.

Full-time Equivalent (FTE) Student Enrollment continues to increase at both the Main and Downtown campuses due to recruitment and retention efforts. Enrollment caps at U.T. Austin have also contributed to the enrollment growth at U.T San Antonio.



The University of Texas at Tyler
Summary of Financial Condition
Fiscal Year 2002



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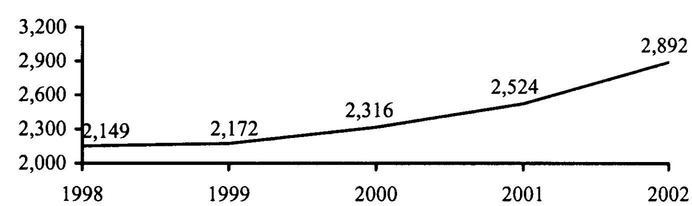
Operating Margin Excluding Gifts Ratio measures the institution's dependence on gifts to finance annual operations.

Debt Burden Ratio measures the actual debt burden on the annual operating expenses.

- Revenues from tuition and fees reflect a net increase of 15.4% or $1.2 million. This increase was the result of growth in semester credit hours, implementation of a new mandatory athletic fee and rate increases in base tuition and designated tuition.
- U.T. Tyler received $250,000 in HB 1839 University Research Funds. These funds were used to establish research grants for faculty/student research programs and to support research assistants.
- Total operating expenses increased 9.2%, excluding the adjustment for depreciation. Expenses for student services increased 26.4% as a result of new enrollment management initiatives. Additionally, scholarships and fellowships increased 22% and auxiliary enterprises increased 59.6% due to new athletic programs.
- Athletic Programs were initiated in 2002 and were funded entirely by a new student athletic fee.
- Total operating expenses for 2002 include depreciation expense of $2.5 million, which was previously not recorded.
- To meet demands of four-year status and a growing student body, U.T. Tyler has embarked on a major capital improvement plan. Fiscal year 2002 reflects a 61% increase in construction over the prior year related to initial phases of the Patriot Center and the Braithwaite Nursing Building.
- Beginning net assets were restated as a result of prior years' depreciation expense ($26 million) and increases in statewide capitalization thresholds ($6.1 million).

Full-time Equivalent (FTE) Student Enrollment gains continued due to recruitment and retention efforts, increased scholarship availability among institutional funds and the TEXAS Grant Program. The statutory enrollment caps were relieved in 2002. U.T. Tyler allocated $800,000 for a comprehensive advertising program in 2002. The intent of the program was to raise awareness of the university and events.

Fall Full-time Equivalent Student Enrollment



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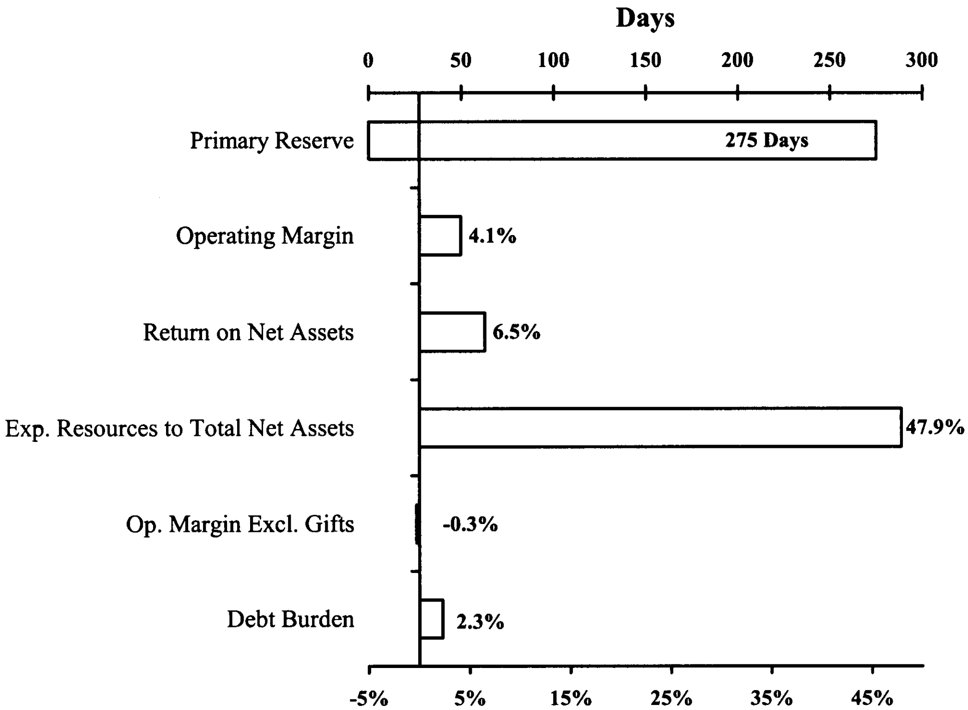
The University of Texas Southwestern Medical Center at Dallas
Summary of Financial Condition
Fiscal Year 2002



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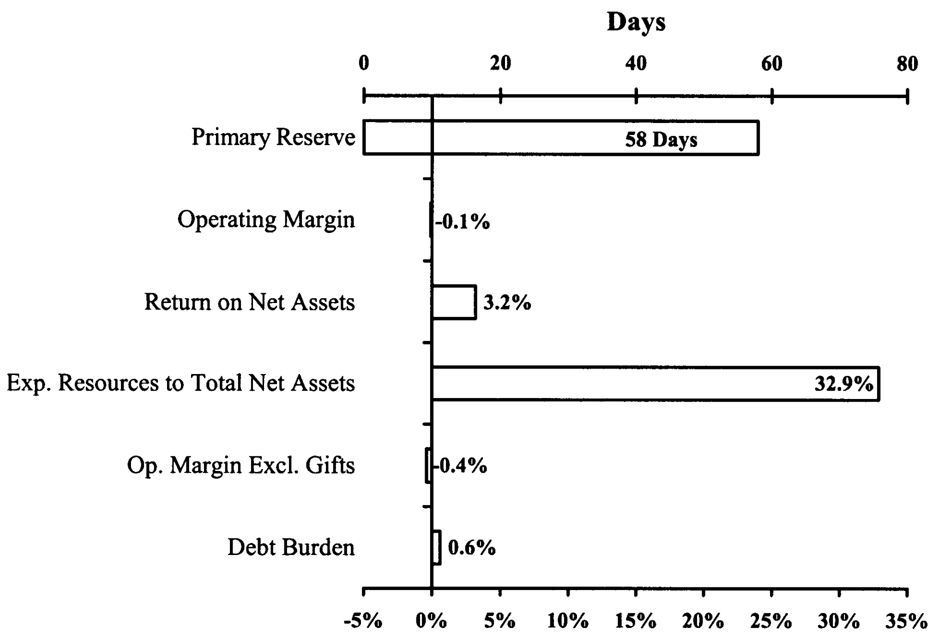
Operating Margin Excluding Gifts Ratio measures the institution's dependence on gifts to finance annual operations.

Debt Burden Ratio measures the actual debt burden on the annual operating expenses.

- Federal sponsored programs revenue increased $24 million in 2002 due to increased spending on numerous Federally funded programs. Many of these are multi-year awards, thus producing a revenue stream that will continue into the future. The two programs with the most significant increases in revenue were the Alliance for Cellular Signaling program in the Pharmacology Department and the Star*D depression study in the Psychiatry Department.
- Federal sponsored research programs expenses increased $20 million. Almost 50% of the increase in Federal research occurred in the Alliance for Cellular Signaling program and the Star*D depression study.
- Local sponsored programs revenue increased $10 million due to growth in contractual income with affiliated hospitals. The increase in contractual income is largely reflective of U.T. Southwestern's emphasis on negotiating the terms of annual contracts with affiliated hospitals to more closely reflect the cost of providing administrative, training and indigent care services. The most significant increase relates to the contract with Parkland Memorial Hospital, the primary teaching hospital of U.T. Southwestern, which increased approximately 10%. The Parkland contract also included a $1.8 million market adjustment to fund recruitment and market salary adjustments for Internal Medicine and Radiology faculty.
- U.T. Southwestern's first student housing facility was completed in early 2002 and contributed an additional $1 million to Auxiliary Enterprise revenue.
- Employee compensation and benefits in instruction increased substantially due to the growth in clinical activities, as well as merit increases and increases in group insurance premiums.
- Gross capital assets increased $89 million (net of retirements of $7 million) due to construction on the North Campus IV building ($43 million), the student services building ($6 million), the student housing facility ($2 million) and the Seay building ($1 million), as well as capital renovations ($9 million). Additionally, U.T. Southwestern acquired the LifeCare building ($12 million) and equipment ($23 million).
- Total operating expenses for 2002 include depreciation expense of $27.6 million, which was previously not recorded.
- Beginning net assets were restated as a result of prior years' depreciation expense ($231.3 million) and increases in statewide capitalization thresholds ($63.8 million).
- The $450 million Innovations in Medicine fundraising campaign commenced in 2002.

The University of Texas Medical Branch at Galveston
Summary of Financial Condition
Fiscal Year 2002



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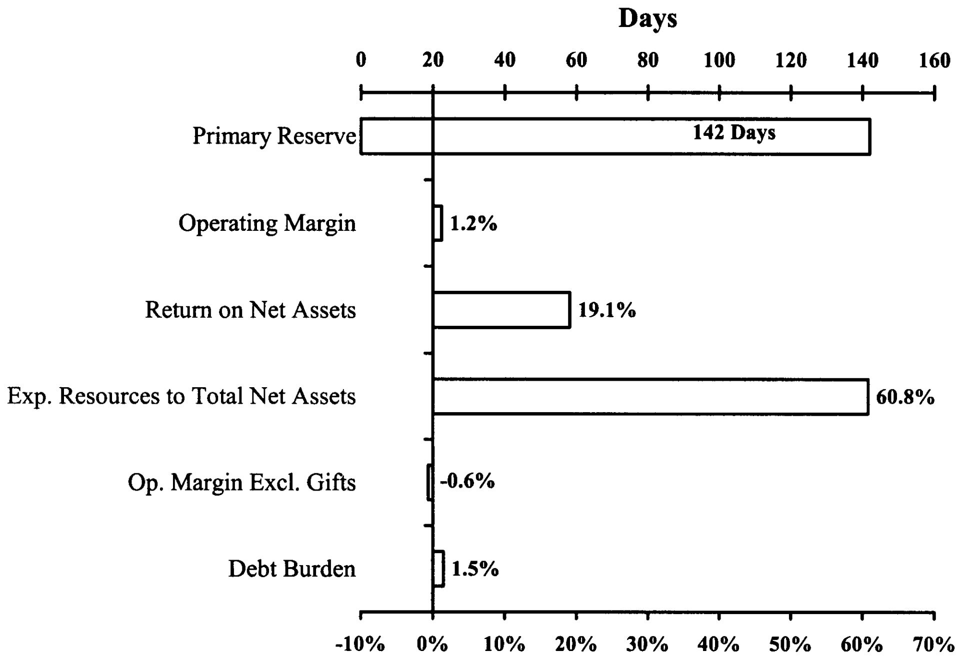
Debt Burden Ratio measures the actual debt burden on the annual operating expenses.

- U.T. Medical Branch's operating margin in 2002 was essentially breakeven, a significant improvement from a 2% loss in 2001. Over 60% of U.T. Medical Branch's budget is related to Correctional Care and to the multi-categorical teaching hospital, two mission areas that are unique among U.T. components. Correctional Care broke even in 2002, but contributes to indirect cost recovery.
- Overall, hospital activities have been financially stable with growing volumes. Hospital inpatient admissions and outpatient clinic visits grew by 6.6% and 7.9%, respectively, in 2002. Over 80% of this growth was from patients with third party insurance coverage. The growth in inpatient admissions was primarily attributable to growth in Medicare and Medicaid admissions. Medicare admissions are growing largely due to U.T.M.B. Galveston's development of the Geriatric and Cardiology service lines. U.T.M.B. Galveston made major investments in these programs in the last few years. Medicaid admissions increased largely due to increased Obstetric and Newborn admissions. U.T.M.B. Galveston continues to expand the Regional Maternal OB Clinics, as well as develop the community-based private obstetrics service. The growth in outpatient visits was also primarily attributable to the development of service lines and the Regional Maternal OB Clinics.
- U.T. Medical Branch continues to be severely and adversely impacted by the national shortage of nurses and other patient care providers. Demand for hospital services continues to be high, and as a result, U.T. Medical Branch must rely heavily on expensive contract nursing and overtime to meet staffing demands. Also, significant competition among hospitals in the Houston/Galveston market is driving up labor costs. Market salary adjustments have been as high as 25% in 2002. Increased labor cost per hour resulted in a greater than projected outlay of $8.7 million in 2002. This unfavorable variance was partially offset by favorable variances in labor productivity of $4.6 million in 2002, through enhanced nurse staffing activities.
- The high cost of medical implants, pharmaceuticals and other medical supplies continues to challenge the hospitals and clinics. These costs are being offset through supply cost reduction efforts such strict adherence to formulary and utilization management efforts.
- U.T. Medical Branch has historically relied upon capital giving, particularly the Sealy and Smith Foundation whose sole beneficiary is the U.T. Medical Branch, to fund clinical and other capital requirements.
- The Primary Reserve at U.T. Medical Branch is relatively low as a result of a history of utilizing expendable resources to finance building and equipment, in lieu of any material reliance on debt financing. Correspondingly, the debt burden ratio is low.
- Total operating expenses for 2002 include depreciation expense of $47.9 million, which was previously not recorded.
- Beginning net assets were restated as a result of prior years' depreciation expense ($498 million) and increases in statewide capitalization thresholds ($69.3 million).

The University of Texas Health Science Center at Houston
Summary of Financial Condition
Fiscal Year 2002



Primary Reserve Ratio measures the financial strength of an institution by comparing expendable net assets to total expenses (**in days**).

Annual Operating Margin Ratio indicates the direction and degree to which an institution has balanced annual operating expenses with revenues.

Return on Net Assets Ratio determines whether an institution is financially better off than in previous years by measuring total economic return.

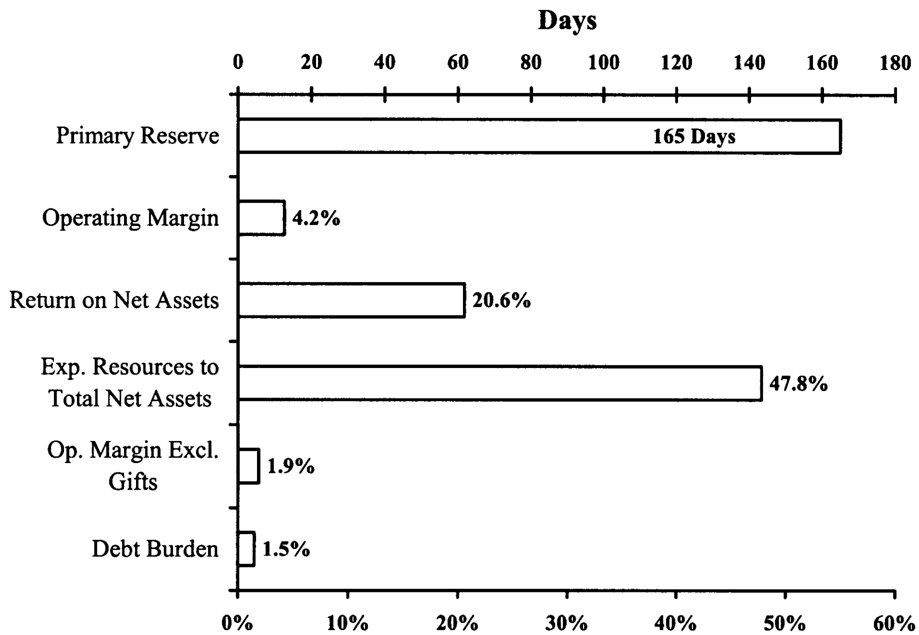
Expendable Resources to Total Net Assets Ratio measures how much of Total Net Assets is expendable.

Operating Margin Excluding Gifts Ratio measures the institution's dependence on gifts to finance annual operations.

Debt Burden Ratio measures the actual debt burden on the annual operating expenses.

- U.T.H.S.C. Houston incurred net extraordinary expenses of $13.6 million in 2002 as a result of continued costs for debris removal, emergency protective measures and replacement supplies relating to flood damage sustained during Tropical Storm *Allison* in June 2001. Since *Allison*, receipts have been realized from commercial insurance coverage of $25.5 million, National Flood Insurance of $2 million, U.T. System Comprehensive Property Protection Program of $632,000 and from the United States Federal Emergency Management Agency (FEMA) of $500,000. Additional insurance and FEMA receipts are anticipated; however, the amount and timing of such receipts cannot reasonably be predicted due to on-going settlement negotiations and numerous variables that preclude estimation.
- By the end of the first quarter of 2002 the research enterprise at U.T.H.S.C. Houston rebounded from *Allison's* negative impact on the laboratory and animal facilities. Total direct and indirect research expenditures increased approximately $17 million, of which approximately $10.1 million was due to an increase in Federal direct and indirect costs. The largest increases in Federal expenditures resulted from new National Science Foundation and U.S. Department of Health and Human Services awards. State research expenses also increased due to the receipt of $3.6 million in funding for the Institute of Molecular Medicine and Biotechnology Program research activities.
- Auxiliary Enterprise revenues increased in 2002 due to the reopening of the recreation center, which was destroyed by fire in 2001. The rebuilding process was completed in April of 2002.
- Total operating expenses for 2002 include depreciation expense of $17.4 million, which was previously not recorded.
- Beginning net assets were restated as a result of prior years' depreciation expense ($222 million) and increases in statewide capitalization thresholds ($421,000).
- Construction commenced on the Nursing & Student Commons Center building with completion scheduled for mid 2004.
- The capital campaign to raise $200 million for the Institute of Molecular Medicine for the prevention of human diseases continued in 2002.
- Total philanthropic support at the end of 2002 reached approximately $70 million, which is the highest level ever attained at U.T.H.S.C. Houston.

The University of Texas Health Science Center at San Antonio
Summary of Financial Condition
Fiscal Year 2002



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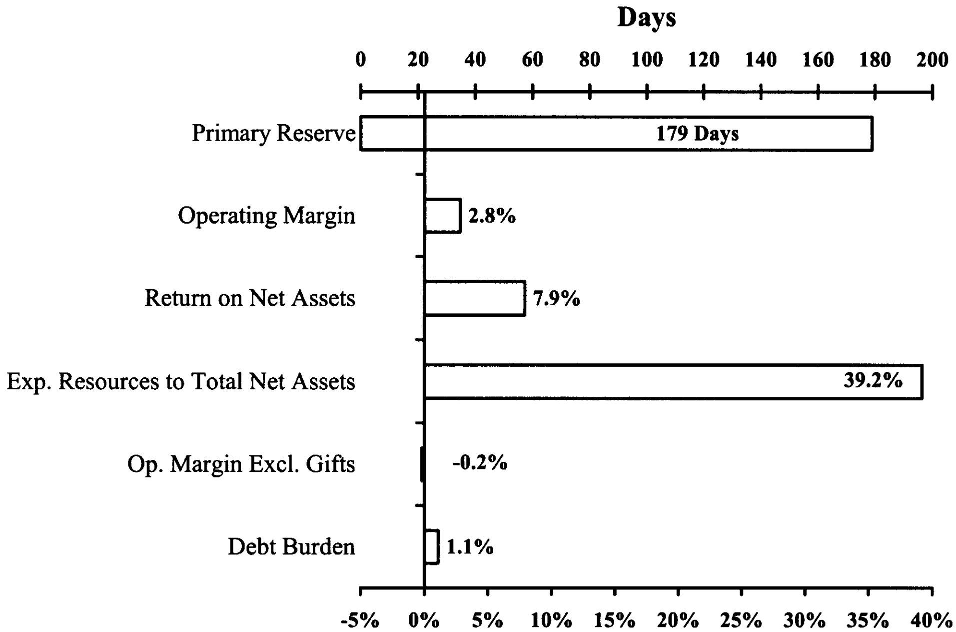
Debt Burden Ratio measures the actual debt burden on the annual operating expenses.

- Despite new changes in accounting standards, which required U.T.H.S.C. San Antonio to add $4 million to the beginning state funds deficit, the state funds deficit improved by $2.6 million. This improvement was attributable to a savings plan that required all departments to cut costs by a cumulative $500,000. More effective budgeting, monitoring and spending practices during the course of the year also enabled U.T.H.S.C. San Antonio to drive down the deficit. Another contributing factor to the growth of state funds was the legislative authority to carry forward approximately $3.6 million of South Texas Border Initiative appropriations from 2002 to 2003.
- U.T.H.S.C. San Antonio renegotiated the indirect cost recovery rate earned on all grants, contracts and other agreements with the Federal government. This resulted in an incremental growth of $2.6 million over 2001.
- A primary focus of U.T.H.S.C. San Antonio is to reinvest more indirect cost recoveries in research and thereby elevate the institution's status as one of the top research institutions in the country. Total sponsored program expenditures increased by $17.5 million due to increased research awards and activity, which grew by $19.6 million.
- Total operating expenses for 2002 include depreciation expense of $14.6 million, which was previously not recorded.
- Beginning net assets were restated as a result of prior years' depreciation expense ($187.7 million) and increases in statewide capitalization thresholds ($52.3 million).
- In 2002 $13.3 million was spent on the Regional Academic Health Center's (RAHC) Medical Education Division. The 94,000 square foot, three-story Harlingen facility opened on July 1, 2002.
- The first building in the new Laredo Campus Extension, the D. D. Hachar Building, incurred capital expenditures of $4.5 million in 2002. The 19,800 square foot facility will house programs funded through the South Texas/Border Region Health Professional Initiative; allied health course offerings in emergency medical technology, clinical laboratory sciences, occupational therapy and respiratory care; an academy of homeland defense and preparedness; and occupational/environmental health training for medical students and physicians.
- In August 2001, U.T.H.S.C. San Antonio broke ground on the Children's Cancer Research Center, which will focus on basic mechanisms of childhood cancer and will include the development of new therapies for the many forms of cancer. The four-story, $49.5 million structure will provide 100,000 square feet of needed research space.

The University of Texas M. D. Anderson Cancer Center
Summary of Financial Condition
Fiscal Year 2002



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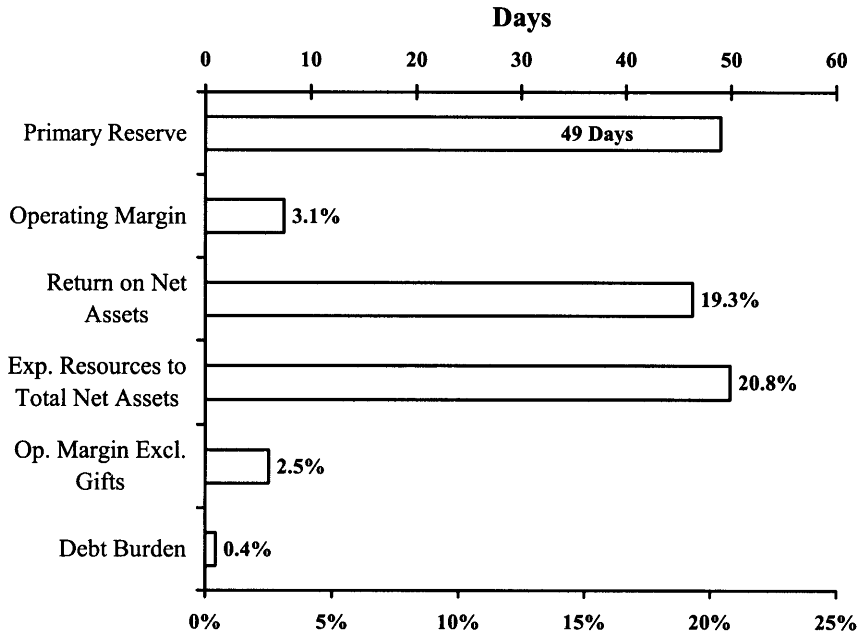
Debt Burden Ratio measures the actual debt burden on the annual operating expenses.

- Several patient volume records were set in 2002 with outpatient visits, treatments and procedures increasing 0.6%; inpatient admissions increasing 1% and surgery cases increasing 3.2%. These increased volumes generated additional downstream clinical activities in areas such as Diagnostic Imaging and Radiation Oncology, which experienced increases in billing procedures of 2.1% and 7.1%, respectively. The increases in clinical activity along with an average price increase of 6.3%, better collections and improved managed care contract rates resulted in an increase in Net Sales and Services of Hospitals of 18.4% over 2001.
- U.T.M.D. Anderson was adversely impacted by the tragic events of September 11. Clinical volumes were not as strong in the months following the tragedy as patients curtailed travel. In addition the increased security measures surrounding September 11 made it difficult for many international patients to travel to U.T.M.D. Anderson for diagnosis and treatment. The reimbursement for international patients is typically greater than most other reimbursement sources such as Medicare, Medicaid and managed care. The reduction in international patients created a negative financial impact of approximately $11 million in 2002. Clinical volumes improved in the second half of 2002.
- Federal sponsored programs revenue increased 27.7% primarily due to increases in Army grants ($1 million), SPORE in Genitourinary Cancers Multi-project ($2.5 million), other research grants from the National Cancer Institute ($8.7 million), grants from other National Institute of Health components ($7.9 million) and Basic Science Research Building Veterinary (Vivarium) Facility Construction Grant ($2 million).
- The additional operating activities also caused increases in operating expenses. Salaries and wages and payroll related costs increased 17% over 2001. This increase was primarily the result of an increasing number of full-time equivalents. Additionally, the average hourly rate paid to employees increased 5.6%. Materials and supplies increased 9.1% and represented the second largest expense in 2002.
- Total operating expenses for 2002 include depreciation expense of $61.7 million, which was previously not recorded.
- Beginning net assets were restated as a result of prior years' depreciation expense ($260 million) and increases in statewide capitalization thresholds ($91.1 million).
- U.T.M.D. Anderson continued to prepare for future growth with $254 million in expenditures for capital equipment and facilities. The majority of the capital expenditures related to the construction on two major research facilities and a major clinical facility. Approximately 132,000 square feet of research space will be added with the completion of the South Campus Research Facility. An additional 486,000 square feet of research space will be added with the George and Cynthia Mitchell Basic Science Research Building, and 733,000 square feet of clinical space will be added with the Ambulatory Clinic Building.
- In 2002, U.T.M.D. Anderson was named "America's Best Hospital" for treatment of cancer in *U.S. News & World Report's* 13th annual edition of <u>America's Best Hospitals</u>.

The University of Texas Health Center at Tyler
Summary of Financial Condition
Fiscal Year 2002



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Operating Margin Excluding Gifts Ratio measures the institution's dependence on gifts to finance annual operations.

Debt Burden Ratio measures the actual debt burden on the annual operating expenses.

- In 2002, U.T.H.C. Tyler began aggressively promoting itself within the community, with a marketing effort aimed at presenting U.T.H.C. Tyler as a competitive alternative to the two other large hospitals in Tyler.
- Total gross patient revenue increased $25.6 million, which consisted of an increase in hospital gross revenue of $20.4 million and an increase in Medical Services Research and Development Plan (MSRDP) gross revenue of $5.2 million. These increases are primarily due to a 12% increase in admissions, a 5% increase in inpatient days, a 5% increase in average-daily-census, a 6% increase in occupancy rate and a 7% increase in emergency room visits.
- One of the most significant factors contributing to the increases mentioned above was a full medical staff for the majority of the year. Additionally, U.T.H.C. Tyler benefited from a full year of the price increase that occurred mid-year 2001.
- Salaries and wages increased $3.7 million in 2002. This increase includes a $1.5 million increase in MSRDP salaries primarily attributable to the Physician Incentive Plan and physician salary market increases. Other Designated salaries increased $2 million due to Tobacco Research Funding. Fringe benefits increased $2.7 million largely due increases in insurance premiums and retirement matching expenses.
- Total operating expenses for 2002 include depreciation expense of $3.4 million, which was previously not recorded.
- Beginning net assets were restated as a result of prior years' depreciation expense ($48.1 million) and increases in statewide capitalization thresholds ($11.9 million).
- U.T.H.C. Tyler is planning a minimum 3% rate increase in hospital charges in 2003. There will be an evaluation of supply costs within the hospital. This analysis should continue to increase gross revenue in 2003.

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Appendix A - Definitions of Evaluation Factors

1. **Primary Reserve Ratio (in days)** – Measures the financial strength of an institution by comparing expendable net assets to total expenses (excluding depreciation expense). This ratio provides a snapshot of financial strength and flexibility by indicating how long the institution could function using its expendable reserves without relying on additional net assets generated by operations. This ratio excludes balances and activity related to bond proceeds and endowments/annuities.

$$\textbf{Formula} = \left(\frac{\text{Expendable Net Assets + Unrestricted Net Assets}}{\text{Total Expenses – Depreciation Expense}} \right) * 365$$

2. **Annual Operating Margin Ratio** - Indicates whether an institution is living within its available resources. This ratio excludes the activity related to bond proceeds and endowments/annuities.

$$\textbf{Formula} = \frac{\text{Op. Rev. + Approp. + RAHC Transfer + Op. Gifts + Inv. Inc. + AUF Transfer + GEF Transfer + Excellence Funding – Op. Exp. – Int. Exp.}}{\text{Op. Rev. + Approp. + RAHC Transfer + Op. Gifts + Inv. Inc. + AUF Transfer + GEF Transfer + Excellence Funding}}$$

3. **Return on Net Assets Ratio** – Determines whether the institution is financially better off than in previous years by measuring total economic return. An improving trend indicates that the institution is increasing its net assets and is likely to be able to set aside financial resources to strengthen its future financial flexibility. This ratio excludes balances and activity related to bond proceeds and endowments/annuities.

$$\textbf{Formula} = \frac{\text{Change in Net Assets}}{\text{Beginning Restated Net Assets}}$$

4. **Expendable Resources to Total Net Assets Ratio** – Measures the amount of an institution's total net assets that are expendable. This ratio excludes balances related to bond proceeds and endowments/annuities.

$$\textbf{Formula} = \frac{\text{Expendable Net Assets + Unrestricted Net Assets}}{\text{Total Net Assets}}$$

5. **Operating Margin Excluding Gifts Ratio** – Determines an institution's dependence on gifts to finance annual operations. This ratio excludes the activity related to bond proceeds and endowments/annuities.

$$\textbf{Formula} = \frac{\text{Op. Rev. + Approp. + RAHC Transfer + Inv. Inc. + AUF Transfer + GEF Transfer + Excellence Funding – Op. Exp. – Int. Exp.}}{\text{Op. Rev. + Approp. + RAHC Transfer + Inv. Inc. + AUF Transfer + GEF Transfer + Excellence Funding}}$$

6. **Debt Burden Ratio** – This ratio examines the institution's dependence on borrowed funds as a source of financing and the cost of borrowing relative to overall expenses.

$$\textbf{Formula} = \frac{\text{Mandatory Debt Transfers}}{\text{Operating Expenses – Depreciation + Mandatory Transfers}}$$

7. **Full-Time Equivalent (FTE) Student Enrollment** - Total semester credit hours taken by students during the fall semester, divided by factors of 15 for undergraduate students, 12 for graduate and special professional students, and 9 for doctoral students to arrive at the full-time equivalent (FTE) students represented by the course hours taken.

Appendix B - Calculation of Expendable Net Assets
Academic Institutions
As of August 31, 2002
(In Millions)

Institution	Restricted Expendable Net Assets* Capital Projects	Funds Functioning Restricted	Other Expendable	Total	Total Unrestricted Net Assets*	Less: Bond Adjustments	Endow./Annuity Adjustments	Total Expendable Net Assets
Arlington	$ 6.6	2.2	21.9	30.6	44.8	7.2	2.2	66.0
Austin	66.9	66.3	268.0	401.2	301.8	37.5	84.6	581.0
Brownsville	4.7	-	3.5	8.2	22.5	4.1	-	26.6
Dallas	13.1	5.0	47.8	66.0	46.7	12.6	5.1	95.0
El Paso	9.4	3.5	25.1	37.9	43.3	8.4	25.0	47.8
Pan American	3.2	6.8	13.0	23.1	54.8	3.2	6.8	67.8
Permian Basin	0.6	-	4.7	5.3	6.7	0.5	-	11.5
San Antonio	74.8	0.3	23.9	99.0	39.7	73.1	1.7	64.0
Tyler	-	-	18.2	18.2	10.3	4.9	0.2	23.4

*Per 2002 Annual Financial Report.

Appendix C - Calculation of Expendable Net Assets
Health Institutions
As of August 31, 2002
(In Millions)

Institution	Restricted Expendable Net Assets* Capital Projects	Funds Functioning Restricted	Other Expendable	Total	Total Unrestricted Net Assets*	Less: Bond Adjustments	Endow./Annuity Adjustments	Total Expendable Net Assets
Southwestern Med.	$ 52.1	8.8	265.4	326.3	302.0	41.4	70.2	516.6
M.B. Galveston	7.5	10.3	61.2	78.9	154.9	0.5	39.7	193.7
HSC-Houston	81.3	25.2	64.8	171.3	136.2	38.1	60.0	209.4
HSC-San Antonio	50.3	3.4	93.5	147.2	268.2	48.6	176.3	190.5
M.D. Anderson	131.6	56.8	162.4	350.8	521.1	74.5	143.2	654.2
HC Tyler	1.2	0.1	3.8	5.1	31.9	1.3	21.4	14.3

*Per 2002 Annual Financial Report.

Appendix D - Calculation of Annual Operating Margin
Academic Institutions
As of August 31, 2002
(In Millions)

Institution	Income/(Loss) Before Other Rev., Exp., Gains/(Losses) & Transfers	Less: Nonoperating Items: Other Nonop. Revenues	Other Nonop. Expenses	Gain/Loss on Sale of Cap. Assets	Net Increase/ (Decrease) in FV of Inv.	Margin From SRECNA	Other Adjustments: GEF Transfer	AUF Transfer & GR Adj.	HB 1839 Excellence Funding	Interest Expense	Bond Proceeds Activity	Endowments/ Annuities Activity	Annual Operating Margin
Arlington	$ 12.1	5.5	(1.5)	-	(3.6)	11.7	0.9	-	4.6	(3.9)	2.7	-	16.0
Austin	(239.8)	13.3	(15.8)	-	(168.4)	(68.9)	40.2	109.6	-	(16.1)	2.1	(0.8)	67.6
Brownsville	7.2	0.1	(1.9)	-	(0.3)	9.2	-	-	-	(1.3)	0.5	-	8.5
Dallas	(10.2)	7.5	(4.3)	-	(15.1)	1.7	3.5	-	4.1	(2.2)	1.6	0.5	8.4
El Paso	(11.6)	5.1	(0.5)	-	(12.4)	(4.0)	2.2	0.5	3.9	(3.0)	2.8	(0.1)	2.5
Pan American	4.6	4.0	(4.3)	-	(3.1)	8.0	0.5	-	0.1	(2.4)	0.0	-	6.2
Permian Basin	0.8	0.2	(0.2)	-	(1.4)	2.2	0.3	-	0.3	(0.9)	0.4	-	2.2
San Antonio	10.0	0.5	(0.7)	-	(3.0)	13.2	0.7	-	1.7	(5.2)	1.7	-	12.0
Tyler	(2.7)	0.2	(0.5)	-	(4.9)	2.5	1.2	-	0.3	(0.7)	0.2	0.1	3.4

Appendix E - Calculation of Annual Operating Margin
Health Institutions
As of August 31, 2002
(In Millions)

Institution	Income/(Loss) Before Other Rev., Exp., Gains/(Losses) & Transfers	Less: Nonoperating Items Other Nonop. Revenues	Other Nonop. Expenses	Gain/Loss on Sale of Cap. Assets	Net Increase/ (Decrease) in FV of Inv.	Margin From SRECNA	Other Adjustments GEF Transfer	RAHC Transfer	NETI & GR Adj. (HCT Only)	Interest Expense	Bond Proceeds Activity	Endowments/ Annuities Activity	Annual Operating Margin
SWMC	$ (49.5)	4.3	(8.0)	(1.7)	(69.4)	25.3	12.5	-	-	(7.7)	-	(0.2)	30.4
MBG	(46.8)	3.1	(2.8)	(4.5)	(34.2)	(8.3)	5.9	-	-	(1.8)	2.4	(0.3)	(1.5)
HSCH	(3.3)	15.6	(9.8)	(3.0)	(9.4)	3.2	1.7	1.7	-	(3.4)	3.5	(0.1)	6.7
HSCSA	(16.6)	2.0	(1.5)	-	(30.5)	13.4	1.7	6.5	-	(3.4)	1.4	1.0	18.8
MDA	4.9	27.6	(22.7)	(0.2)	(41.0)	41.3	5.1	-	-	(7.3)	-	-	39.1
HCT	2.4	(0.9)	(0.2)	(1.0)	(3.5)	8.0	0.2	-	(4.7)	-	0.2	-	3.6

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Appendix F - Definitions

Medical Services Research and Development Plan (MSRDP) – These plans (often referred to as practice plans) are trust funds established by the U.T. Board of Regents that operate under approved bylaws, authorizing the specific types of expenditures that can be made. The revenue in these plans is derived from the physician fees for services to patients. MSRDP also includes the Dental Services Research and Development Plan (DSRDP) at U.T.H.S.C. San Antonio. Additionally, Allied Health Faculty Services Plan at U.T. Southwestern Medical Center is included. This plan is similar to MSRDP and DSRDP as defined above with the exception that the revenue is derived from practitioner fees. Practitioners are defined as Physical Therapists, Prosthetists/Orthotists, Registered Dieticians, Medical Technologists and Rehabilitation Counselors.

Non-profit Healthcare Corporation (NPHC) - Certified non-profit healthcare corporations developed pursuant to the Texas Medical Practice Act, Section 5.01, Article 4495b, V.T.C.S., established by each U.T. health component to accept risk contracts for physician services without being licensed as a health maintenance organization. These corporations were previously referred to as 5.01(a) Corporations. However, this Act is now included in the Occupation Code, and therefore, these corporations are referred to as non-profit healthcare corporations.

Net Accounts Receivable (in days) – Measures the average number of days that a patient account takes to be collected.

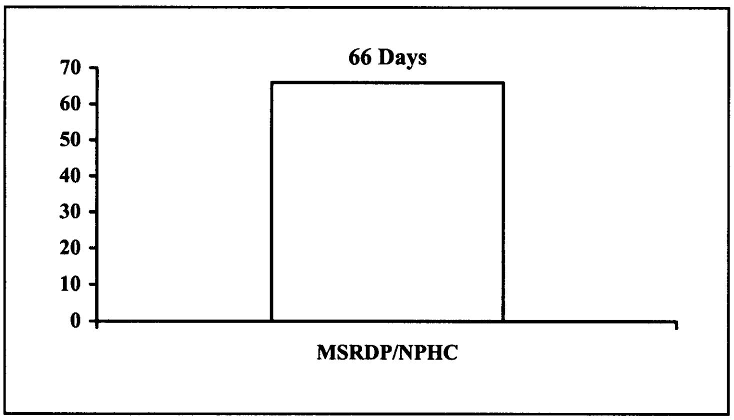
$$\textbf{Formula} = \frac{\text{Ending Accounts Receivable}}{\text{(Net Charges / 365 days)}}$$

Annual Operating Margin Ratio – Indicates the ability to cover annual expenses with revenues generated in the same period.

$$\textbf{Formula} = \frac{\text{Operating Income + Investment Income – Operating Expenses – Interest Expense}}{\text{Operating Income + Investment Income}}$$

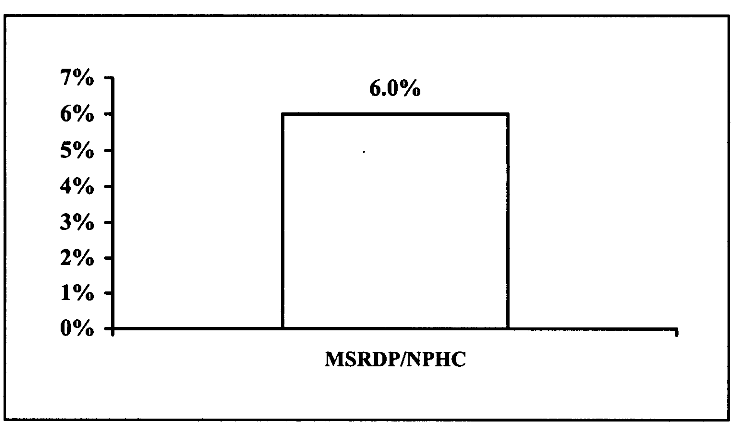
Appendix F
The University of Texas Southwestern Medical Center at Dallas
Key MSRDP/NPHC Operating Factors
Fiscal Year 2002

Net Accounts Receivable (in days)



Net patient charges increased $10.8 million over 2002 while net patient accounts receivable decreased $3.3 million. Rigorous collection effort and conservative reservations for uncollectible accounts resulted in a decrease in days in net accounts receivable from 78 to 66.

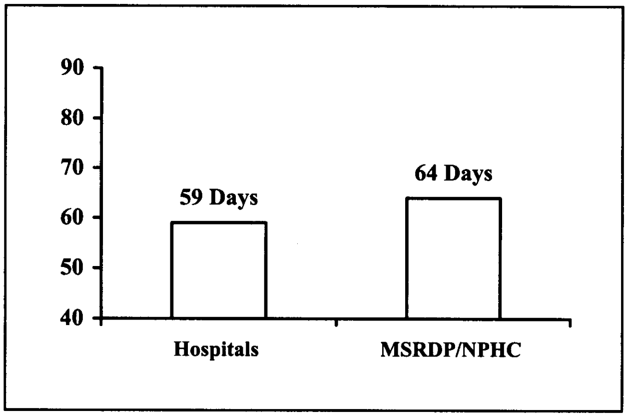
Annual Operating Margin Ratio



Net patient revenues increased $11 million primarily due to continued growth in clinical departments. To meet the healthcare service demands of a growing and aging population, there has been significant clinical expansion through additions and renovation of space. As a result, during 2002 patient visits at campus clinics increased 6.3%. Corresponding increases in clinical faculty have contributed to revenue growth. Revenue also increased due to improved managed care contracts and stronger collection efforts.

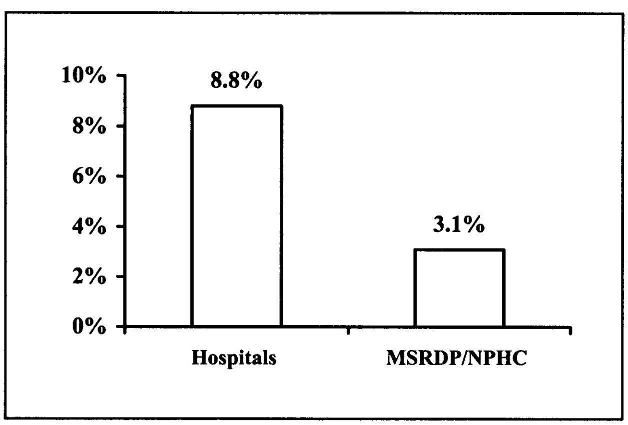
Appendix F
The University of Texas Medical Branch at Galveston
Key Hospital and MSRDP/NPHC Operating Factors
Fiscal Year 2002

Net Accounts Receivable (in days)



Days in net accounts receivable for both the Hospitals and Clinics and MSRDP improved in 2002 from 2001 levels. Reductions in charge lag days from automation of charge capture processes, strict adherence to front end collection of patient co-pay/deductible policies, improved account follow-up processes, improved payor mix and resolution of disputed managed care receivables, all positively impacted days in accounts receivable.

Annual Operating Margin Ratio

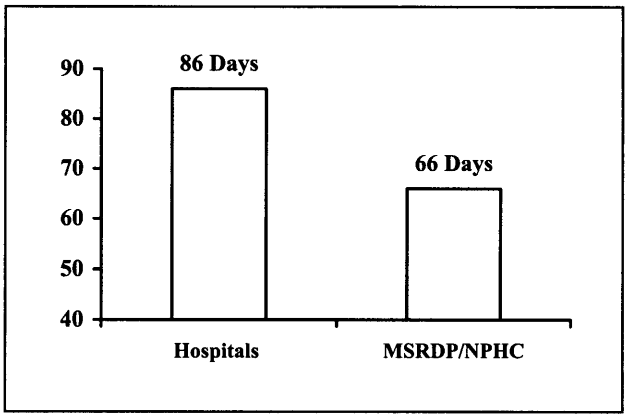


The Hospitals and Clinics operating margin improved from 2001, largely as a result of increasing patient care volumes, offset by escalating costs associated with a nationwide shortage of nurses. Hospital inpatient admissions and outpatient clinic visits grew by 6.6% and 7.9%, respectively, in 2002. Over 80% of this growth was from patients with third party insurance coverage.

MSRDP/NPHC operating margin improved primarily as a result of discontinuing unprofitable HMO operations in the NPHC. With the exception of CHIP and Medicare Select, all other HMO products were terminated at August 31, 2001. U.T. Medical Branch was successful in negotiating a 20% rate increase in CHIP premiums and received a $2.7 million lump sum bridge financing payment. MSRDP rate increases on governmental and other patient care payors continue to lag behind inflationary expense increases, requiring a continued dependence on increased productivity and cost reductions in MSRDP.

Appendix F
The University of Texas Health Science Center at Houston
Key Hospital and MSRDP/NPHC Operating Factors
Fiscal Year 2002

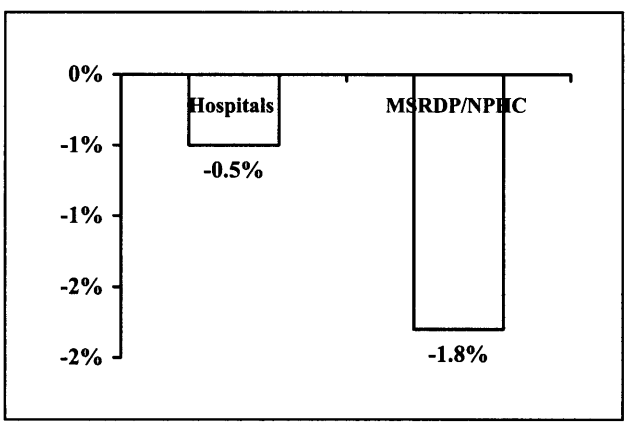
Net Accounts Receivable (in days)



The hospital's net accounts receivable in days declined from 128 days in 2001 to 86 days in 2002 due to increased collection efforts. In 2001, the hospital employed a collection agency to attempt to increase collections of receivables. As a result, cash collections increased in 2002, thereby reducing accounts receivable in days.

MSRDP/NPHC net accounts receivable in days increased from almost 61 days at the end of 2001 to 66 days at the end of 2002. This increase of 5 days (almost 9%) is due to several factors. The 2001 results were reduced by the effects of Tropical Storm *Allison* (i.e., a business interruption of some $25 million of gross charges that started on June 9, 2001, and from which the practice plan did not fully recover until early in FY 2002). Net accounts receivable at year-end 2001 were at their lowest level in several years. In contrast, 2002 net accounts receivable increased by $3.7 million (or 30%) from 2001, due to both a return to normal, post-*Allison* operations and the significant overall improvement in billing and collection activities, as a result of the outsourcing of PBS management to Health Directions.

Annual Operating Margin Ratio



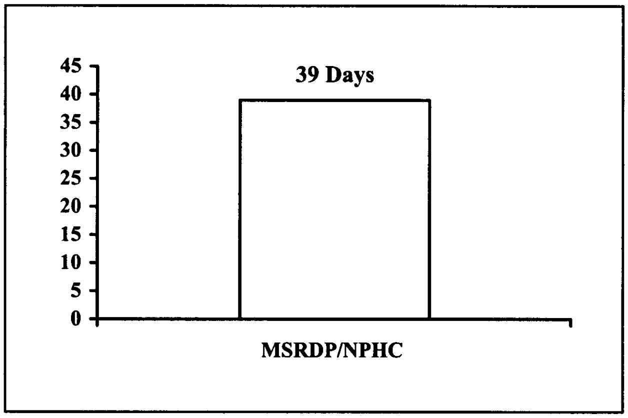
Harris County Psychiatric Center's (HCPC) net patient revenue increased 12% primarily due to a significant improvement in the billing and collection efforts of the hospital. Although patient revenue increased in 2002, state and county funding continued to remain at the same level as in previous years. HCPC's challenge is to attract and retain nursing staff in the very competitive Texas Medical Center. As a result, HCPC increased nursing salary ranges. This increase in nursing salaries and the expenses required to maintain and renovate the facility created a negative operating margin in 2002.

The lingering affects of Tropical Storm *Allison* adversely impacted the 2002 financial results for the Faculty Practice Plan (Medical Services Research and Development Plan and University Care Plus, Inc.). Though the storm occurred in early June 2001, Memorial Hermann Hospital (the Plan's primary teaching hospital) did not return to full capacity until early in the second quarter of 2002. Therefore, faculty physician's charge volumes were significantly reduced.

U.T.H.S.C. Houston outsourced the leadership and management of the physician billing services to Health Directions. Despite record charges (21% improvement in net professional fee revenues) and collections in the latter months of 2002 and a significant reduction to the costs of patient billing, these improvements were not enough to offset the negative impact of *Allison* or the unfavorable spending variances in the clinic operations in the months preceding the process improvements.

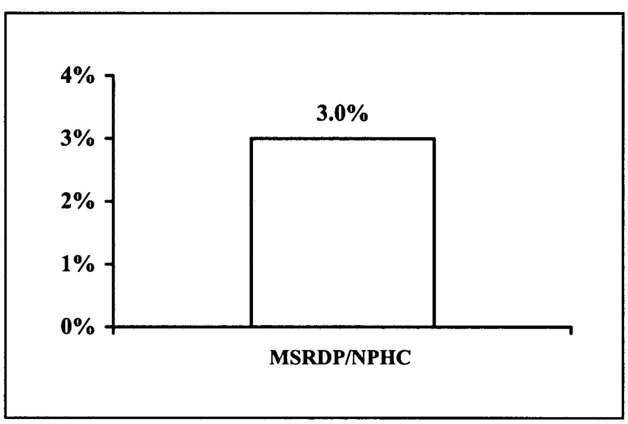
Appendix F
The University of Texas Health Science Center at San Antonio
Key MSRDP/NPHC Operating Factors
Fiscal Year 2002

Net Accounts Receivable (in days)



Days in accounts receivable have decreased primarily as the result of two initiatives. Collections oversight responsibility has moved to the clinical departments. As a result of this action, MSRDP/NPHC has experienced better management of accounts receivable, which has led to higher collections. Additionally, significant accounts receivable "clean-up" occurred in 2002. This entailed a detail review of charges, specifically those in the self-pay category aged greater than 150 days. These write-offs, while not significant to the plan, also contributed to the decline in the accounts receivable balances.

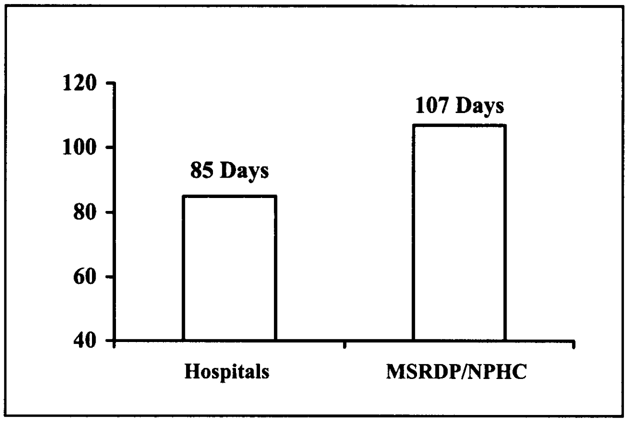
Annual Operating Margin Ratio



Extensive efforts were made during 2002 to minimize any potential losses experienced in the Medical Practice Plan (the Plan). Detailed budgets were developed at the departmental level under strict guidelines that forced the Plan to implement better management of overhead costs and to improve billing and collection efficiency. Total operating revenues of the Plan increased $9 million (10%). Approximately one-third of this increase was due to the unexpected receipt of payment for indigent care services from a prior year. These services are now being delivered under contract with the University Health System to ensure payment in future years. The remainder of the revenue increase was due to growth in capitation revenue and new hospital contracts paid on a full-time equivalent cost reimbursement basis. Offsetting the overall increase in revenue was an increase in operating expenses of $5.4 million at University Physician's Group, Inc. resulting from increased capitation payments to providers.

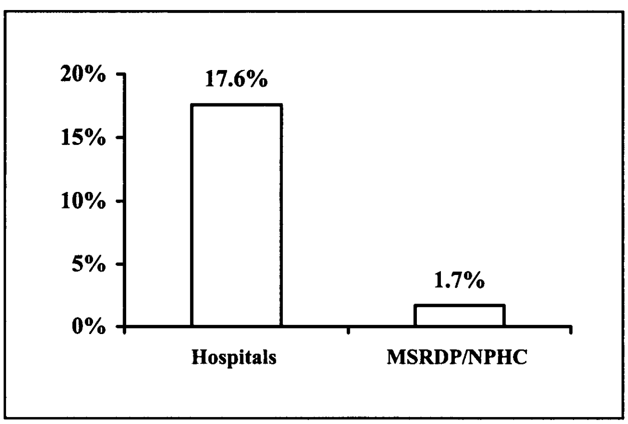
Appendix F
The University of Texas M. D. Anderson Cancer Center
Key Hospital and MSRDP/NPHC Operating Factors
Fiscal Year 2002

Net Accounts Receivable (in days)



Patient net accounts receivable equaled $237 million at the end of 2002, which was a decrease of 4% from 2001. This significant improvement was accomplished through improved operations in the Patient Business Services department, which reduced net days in patient accounts receivable between year-end 2001 and year-end 2002 from 100 days to 85 days for the Hospitals and Clinics and from 140 days to 107 days for Physicians Referral Service (PRS). Hospitals and Clinics represented approximately 80%of net patient accounts receivable and PRS represented approximately 20% of net patient accounts receivable at the end of 2002.

Annual Operating Margin Ratio

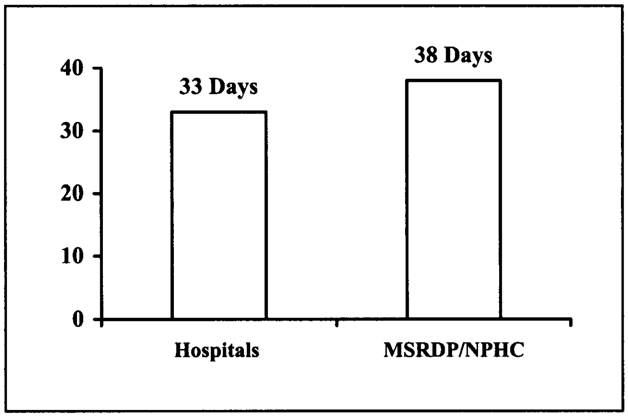


The Hospitals and Clinics operating margin was $169 million in 2002 or 17.6%. This margin includes only direct Hospital and Clinics revenue and expenses along with allocations of costs for institutional support and operations and maintenance of plant in the Educational and General fund group. The margin does not include revenues and expenses associated with research, instruction or other functional activities. The margin also does not include the financial transactions relating to Hospitals and Clinics occurring in fund groups other than Educational and General. While prior year comparisons are not available due to changes in accounting principles required by GASB 35, the operating activities and revenues of U.T. M.D. Anderson grew at rates sufficient to support the costs of institutional operations in 2002, and to produce an operating margin capable of allowing U.T. M.D. Anderson to continue to invest in cutting-edge programs, technologies and infrastructure to meet the institutional mission of eliminating cancer as a serious health risk.

PRS/NPHC operating margin was $3.0 million at the end of 2002 or 1.7%. While prior year comparisons again are not available, the operating margin produced by PRS/NPHC in 2002 is sufficient to ensure that U.T. M.D. Anderson is capable of attracting and retaining the world-class faculty required to meet the institutional mission.

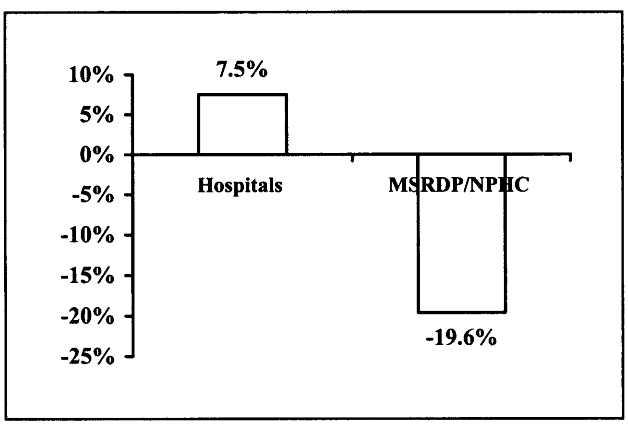
Appendix F
The University of Texas Health Center at Tyler
Key Hospital and MSRDP/NPHC Operating Factors
Fiscal Year 2002

Net Accounts Receivable (in days)



Net days in accounts receivable decreased during this fiscal year. This decrease is the result of increased efforts to collect the amounts owed to the Health Center and a more conservative reserve policy of the institution. An analysis of the accounts receivable was performed as of August 31, 2002 and the reserve for bad debts was increased as a result. This in turn also reduced the net days for both the hospital and MSRDP.

Annual Operating Margin Ratio



The Hospital operating margin increased in 2002 from 2001. Many operational changes were made, such as reductions in full-time equivalents at the end of 2001 and in 2002, which positively impacted the operating margin. Net Patient Revenues increased over the prior year by 22% while expenses increased only 13%.

MSRDP continued to experience a declining operating margin. Net Patient Revenue increased by 22% over the prior year but operating expenses increased in excess of 23%. Salaries and wages increased by 15%. Bad Debt expense increased by 83% as a result of the more conservative reserve policy adopted by the Health Center. A review of MSRDP operations is being conducted and changes will be made where indicated by the review. A significant improvement in MSRDP operations is anticipated in 2003.

The University of Texas System
Office of Finance

Quarterly Permanent University Fund Update

Finance and Planning Committee

January 7, 2003

Executive Summary

- As of November 30, 2002, the market value of the PUF was $6.4 billion, down from $6.7 billion on August 31, 2002.
- On September 3, 2002, $363.0 million was distributed to the AUF, representing 5.4% of the August 31st PUF market value.
- The debt capacity analyses are based on an expected average annual rates of return on PUF investments of 9.35% (Prior Asset Allocation) and 7.40% through FY 2009 and 9.35% beginning FY 2010 (UTIMCO-approved Asset Allocation).
- There is no additional PUF debt capacity, beyond PUF projects currently approved, based on the current assumptions under either interest rate scenario.

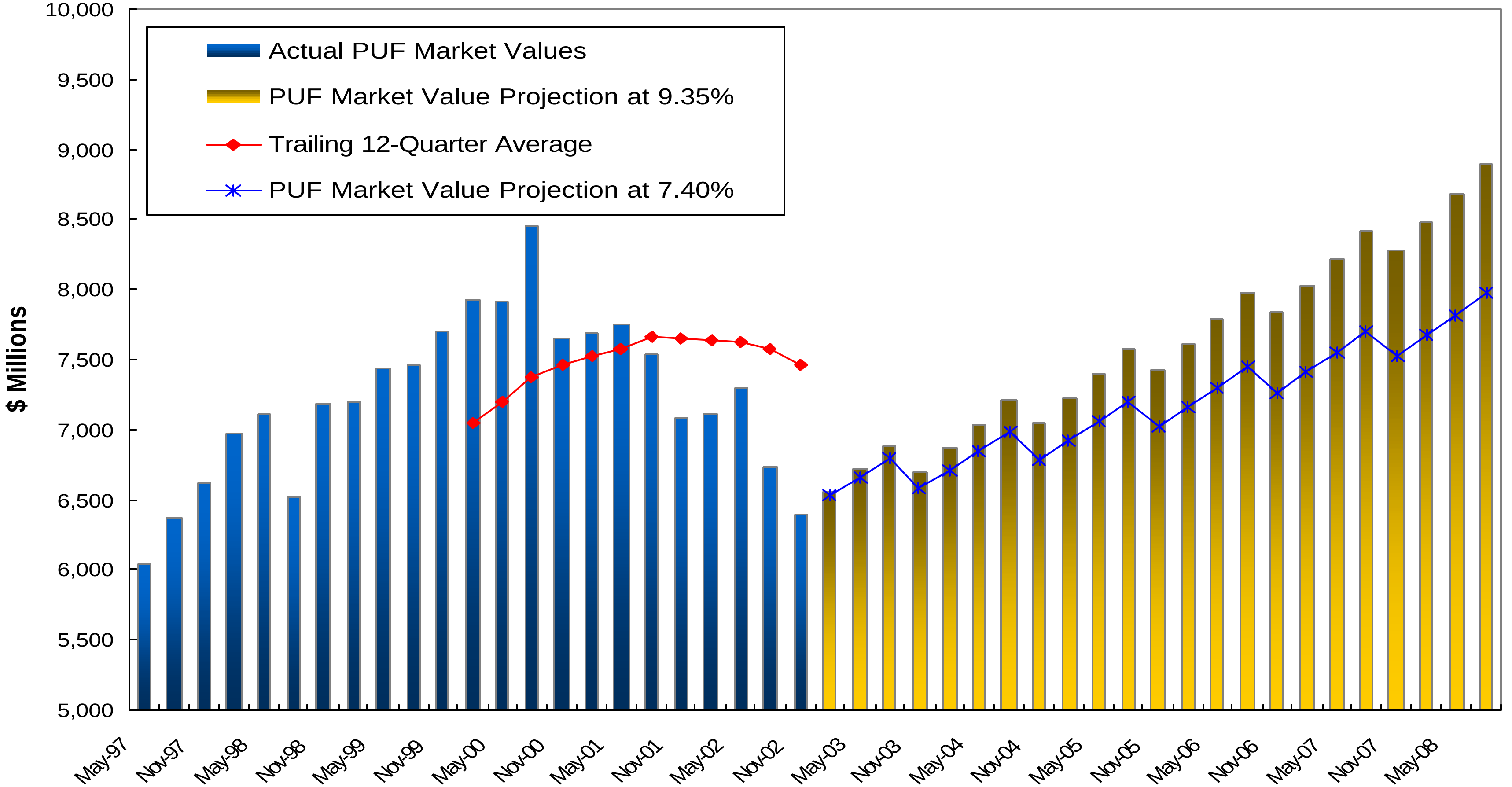
Executive Summary, Cont.

- PUF distributions are projected to decline through FY 2006 and to be capped for a period of time because the purchasing power of the PUF will not have been maintained, as required by the Texas Constitution.

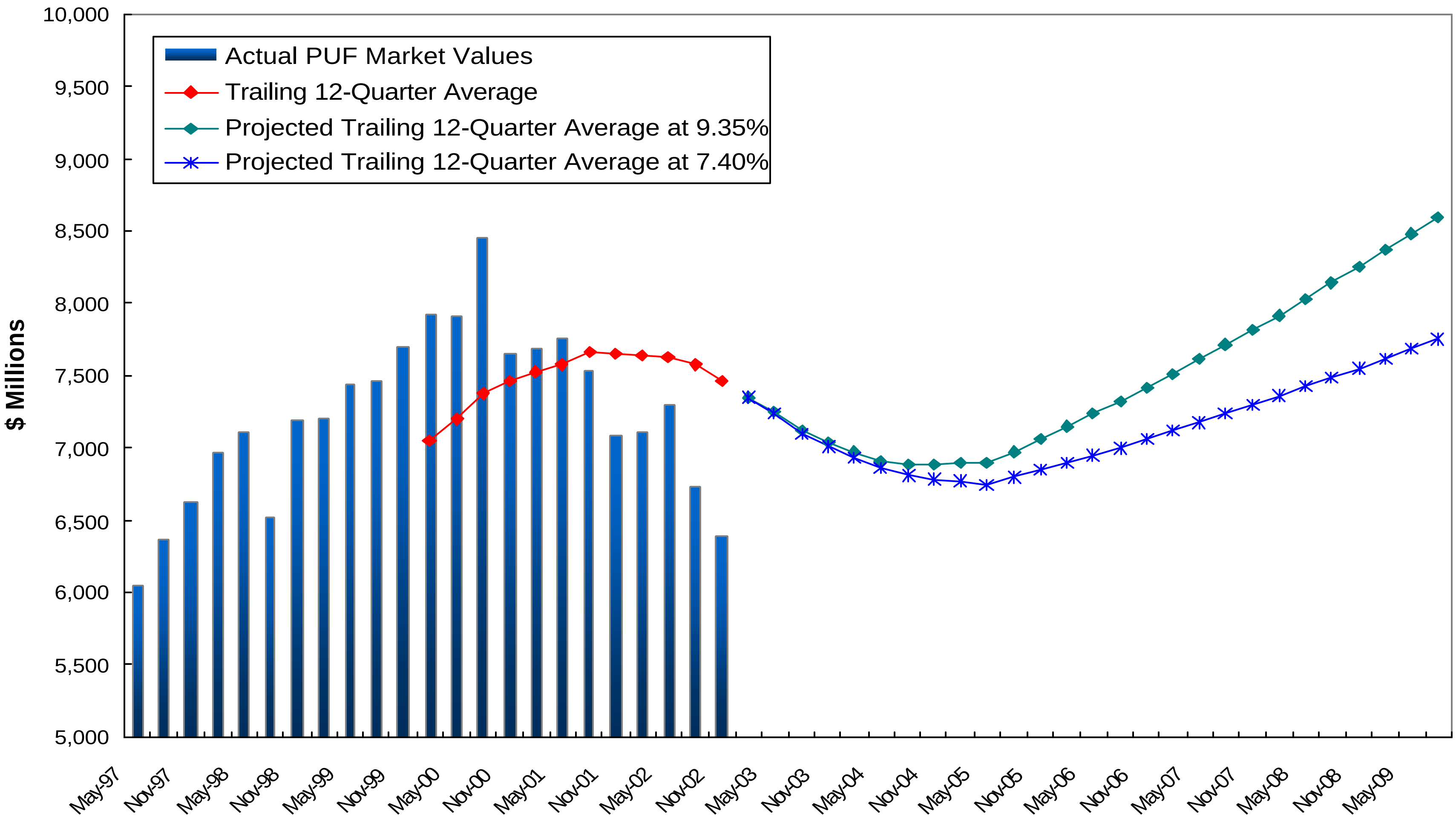
- Under the 9.35% scenario, the PUF distribution is capped at $327.3 million from FY 2007 through FY 2012.

- Under the 7.40% scenario the PUF distribution is capped at $321.6 million from FY 2007 through FY 2013.

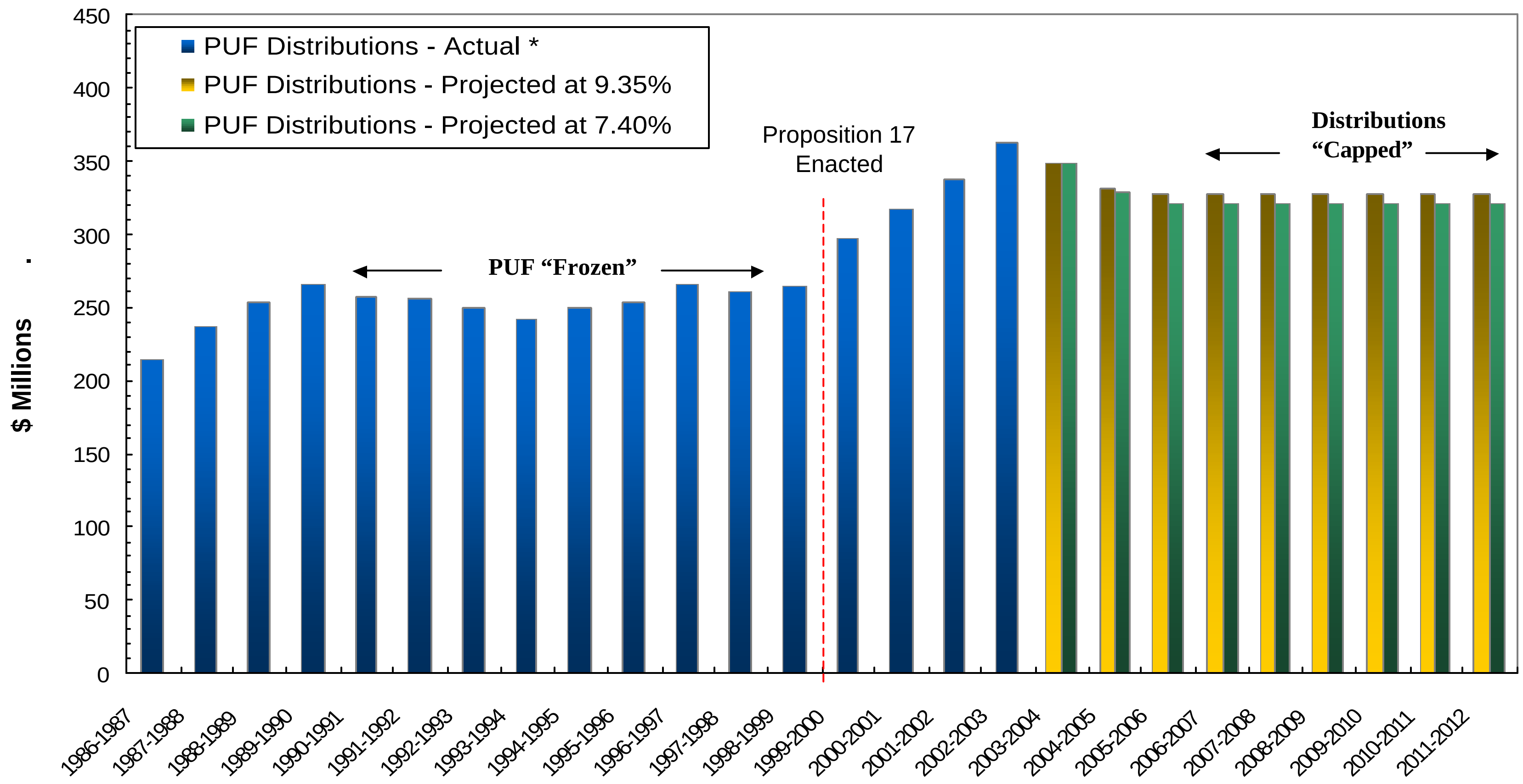
PUF Market Value Through November 30, 2002



Comparison of Projected Trailing 12Q Market Averages



Permanent University Fund Distributions



* Effective September 1, 1997, a statutory amendment changed the distribution of income from cash to an accrual basis, resulting in a one-time distribution adjustment to the AUF of $47.3 million, which is not reflected.

PUF Debt Capacity Base Case Assumptions

- The assumptions are the same for both cases except for the projected PUF annual rate of return, assuming either 9.35% or 7.40%, starting from the PUF market value as of November 30, 2002.

    - PUF Distribution equals 4.75% of the average PUF net asset value for the trailing 12 quarters, unless restricted by Constitutional purchasing power requirements.
    - U.T. Austin Excellence Funds equal 45% of the income available to U.T. System.
    - Includes all PUF projects approved through November 2002.
    - Annual LERR appropriations of $30 million are projected to continue from FY 2004 through FY 2009.
    - New PUF debt service structured as 20-year, tax-exempt debt with level debt service.

PUF Debt Capacity-Base Case at 9.35%

Additional PUF Debt Capacity ($0 Million)	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0
Cumulative Additional PUF Debt Capacity	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0

Available University Fund Operating Statement Forecast Data ($ Millions)	Actual FY 02	Projected FY 03	FY 04	FY 05	FY 06	FY 07	FY 08	FY 09
PUF Distribution Amount	$338.43	$363.02	$349.05	$331.14	$327.31	$327.31	$327.31	$327.31
Surface & Other Income	8.1	7.4	7.4	7.5	7.5	7.6	7.6	7.6
Divisible Income	346.5	370.4	356.5	338.6	334.8	334.9	334.9	334.9
UT System Share (2/3)	231.0	246.9	237.6	225.8	223.2	223.2	223.3	223.3
AUF Interest Income	8.4	6.1	5.5	8.0	9.3	9.8	9.7	9.1
Income Available to U.T.	239.4	253.1	243.2	233.8	232.5	233.0	233.0	232.4
TRANSFERS:								
UT Austin Excellence Funds (45%)	(107.2)	(114.8)	(109.4)	(105.2)	(104.6)	(104.8)	(104.8)	(104.6)
PUF Debt Service on Approved Projects	(68.1)	(72.8)	(93.4)	(101.3)	(104.1)	(107.3)	(110.4)	(113.4)
PUF Cash Defeasance/CPPP Insurance Funding	(59.0)	-	-	-	-	-	-	-
PUF Debt Service on Add. Debt Capacity	-	-	-	-	-	-	-	-
System Administration	(25.7)	(30.6)	(31.2)	(32.1)	(33.6)	(35.2)	(36.8)	(38.6)
Other	(3.0)	(4.5)	(1.1)	(1.1)	(1.1)	(1.1)	(1.1)	(1.1)
Debt Service (Bldg Rev)	(3.4)	(3.4)	(3.4)	-	-	-	-	-
Net Surplus/(Deficit)	(27.0)	27.0	4.7	(5.8)	(10.9)	(15.4)	(20.1)	(25.2)
Ending AUF Balance - System	49.2	76.2	80.9	75.1	64.2	48.8	28.7	3.5
PUF Debt Service Coverage	3.11:1	3.48:1	2.60:1	2.31:1	2.23:1	2.17:1	2.11:1	2.05:1

PUF Debt Capacity-Base Case at 7.40%

	FY 02	FY 03	FY 04	FY 05	FY 06	FY 07	FY 08	FY 09
Additional PUF Debt Capacity ($0 Million)	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0
Cumulative Additional PUF Debt Capacity	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0

Available University Fund Operating Statement Forecast Data ($ Millions)	Actual	**Projected**						
	FY 02	FY 03	FY 04	FY 05	FY 06	FY 07	FY 08	FY 09
PUF Distribution Amount	$338.43	$363.02	$348.94	$329.32	$321.65	$321.65	$321.65	$321.65
Surface & Other Income	8.1	7.4	7.4	7.5	7.5	7.6	7.6	7.6
Divisible Income	346.5	370.4	356.3	336.8	329.1	329.2	329.2	329.3
UT System Share (2/3)	231.0	246.9	237.6	224.5	219.4	219.5	219.5	219.5
AUF Interest Income	8.4	6.1	5.5	8.0	9.1	9.5	9.3	8.5
Income Available to U.T.	239.4	253.1	243.1	232.5	228.5	228.9	228.8	228.0
TRANSFERS:								
UT Austin Excellence Funds (45%)	(107.2)	(114.8)	(109.4)	(104.6)	(102.8)	(103.0)	(102.9)	(102.6)
PUF Debt Service on Approved Projects	(68.1)	(72.8)	(93.4)	(101.3)	(104.1)	(107.3)	(110.4)	(113.4)
PUF Cash Defeasance/CPPP Insurance Funding	(59.0)	-	-	-	-	-	-	-
PUF Debt Service on Add. Debt Capacity	-	-	-	-	-	-	-	-
System Administration	(25.7)	(30.6)	(31.2)	(32.1)	(33.6)	(35.2)	(36.8)	(38.6)
Other	(3.0)	(4.5)	(1.1)	(1.1)	(1.1)	(1.1)	(1.1)	(1.1)
Debt Service (Bldg Rev)	(3.4)	(3.4)	(3.4)	-	-	-	-	-
Net Surplus/(Deficit)	(27.0)	27.0	4.7	(6.5)	(13.1)	(17.6)	(22.5)	(27.6)
Ending AUF Balance - System	49.2	76.2	80.9	74.3	61.3	43.7	21.2	(6.4)
PUF Debt Service Coverage	3.11:1	3.48:1	2.60:1	2.30:1	2.20:1	2.13:1	2.07:1	2.01:1

PUF Debt Capacity Sensitivities at 9.35%

Annual LERR	U.T. Austin Excellence	PUF Distribution Rate	PUF Investment Return	Change in Tax-Exempt Rates	Projected Available University Fund Balance ($ Millions) FY2004	FY2005	FY2006	FY2007	FY2008	FY2009	FY2010	Add. Debt Capacity	Projected PUF Market Value in FY 2030
Board-Determined	Board-Determined	Board-Determined	Market-Dependent	Market-Dependent									
$30 Million	45.0%	4.75%	9.35%	NA	80.9	75.1	64.2	48.8	28.7	3.5	-27.4	None	25,298,842,555
$30 Million	45.0%	4.75%	9.35%	NA	80.9	75.1	64.2	48.8	28.7	3.5	-27.4	None	25,298,842,555
$20 Million	45.0%	4.75%	9.35%	NA	81.8	77.7	69.5	57.8	42.2	22.7	-1.5	None	25,298,842,555
$10 Million	45.0%	4.75%	9.35%	NA	82.7	80.4	74.9	66.7	55.8	41.9	24.4	None	25,298,842,555
None	45.0%	4.75%	9.35%	NA	82.9	81.7	78.1	72.8	65.7	56.7	45.0	8.4	25,298,842,555
$30 Million	**40.0%**	4.75%	9.35%	NA	90.6	94.4	93.3	88.1	78.6	64.4	45.0	29.5	25,298,842,555
$30 Million	**45.0%**	4.75%	9.35%	NA	80.9	75.1	64.2	48.8	28.7	3.5	-27.4	None	25,298,842,555
$30 Million	**50.0%**	4.75%	9.35%	NA	68.7	50.9	27.8	-0.2	-33.5	-72.2	-116.9	None	25,298,842,555
$30 Million	45.0%	**4.50%**	9.35%	NA	74.0	61.5	44.0	21.7	-5.5	-38.2	-76.8	None	26,974,990,597
$30 Million	45.0%	**4.75%**	9.35%	NA	80.9	75.1	64.2	48.8	28.7	3.5	-27.4	None	25,298,842,555
$30 Million	45.0%	**5.00%**	9.35%	NA	87.8	88.6	84.3	75.8	62.8	45.0	21.9	None	23,709,708,299
$30 Million	45.0%	4.75%	**8.35%**	NA	80.9	74.7	62.7	46.1	24.8	-1.6	-33.8	None	19,330,811,138
$30 Million	45.0%	4.75%	**9.35%**	NA	80.9	75.1	64.2	48.8	28.7	3.5	-27.4	None	25,298,842,555
$30 Million	45.0%	4.75%	**10.35%**	NA	80.9	75.5	65.7	57.3	44.3	26.6	3.4	None	32,728,828,966
$30 Million	45.0%	4.75%	9.35%	**+50 bps**	79.4	72.1	59.7	42.6	20.6	-6.7	-39.7	None	25,298,842,555
$30 Million	45.0%	4.75%	9.35%	**NA**	80.9	75.1	64.2	48.8	28.7	3.5	-27.4	None	25,298,842,555
$30 Million	45.0%	4.75%	9.35%	**-50 bps**	82.4	78.0	68.6	54.9	36.6	13.4	-15.3	None	25,298,842,555

THE UNIVERSITY OF TEXAS System

Monthly Financial Report

(Unaudited)

System Office:

The University of Texas System Administration

Academic Components:

The University of Texas at Arlington

The University of Texas at Austin

The University of Texas at Brownsville

The University of Texas at Dallas

The University of Texas at El Paso

The University of Texas – Pan American

The University of Texas of the Permian Basin

The University of Texas at San Antonio

The University of Texas at Tyler

Health Components:

The University of Texas Southwestern Medical Center at Dallas

The University of Texas Medical Branch at Galveston

The University of Texas Health Science Center at Houston

The University of Texas Health Science Center at San Antonio

The University of Texas M.D. Anderson Cancer Center

The University of Texas Health Center at Tyler

October 2002

THE UNIVERSITY OF TEXAS SYSTEM

MONTHLY FINANCIAL REPORT

(Unaudited)

FOR THE TWO MONTHS ENDING

OCTOBER 31, 2002

TABLE OF CONTENTS

The University of Texas System
Monthly Financial Report

Foreword

Beginning September 1, 2001, compliance with Governmental Accounting Standards Board Statement No. 35 (GASB 35), *Basic Financial Statements - and Management's Discussion and Analysis – for Public Colleges and Universities* required substantial changes in the annual reporting of financial results. These changes include: the measurement focus and basis of accounting has changed from modified accrual to full accrual, first-time recognition of depreciation expense for exhaustible capital assets, an entity-wide rather than a National Association of College and University Business Officers (NACUBO) fund groups (E&G, Designated, Auxiliary Enterprises, Restricted, etc.) perspective, a current versus non-current classification of the balance sheet, an operating versus non-operating classification of revenues and expenses, a direct method of cash flow statement and enhanced footnote disclosures.

In anticipation of these changes, the Monthly Financial Report (MFR) was revised in scope and format under the consultation of the U. T. System Institutions' financial reporting staffs. The goal is to provide for better consistency in monitoring financial condition between the MFR and the AFR under GASB 35. The MFR for 2003 will compare the results of operations between the current year-to-date cumulative amounts and the prior year-to-date cumulative amounts. Explanations are provided for institutions having the largest variances in adjusted income (loss) year-to-date as compared to the prior year, both in terms of dollars and percentages. In addition, although no significant variance may exist, institutions with losses may be discussed.

Another significant change for 2003 is inclusion of the endowment funds realized gains and losses in System Administration's operating results. In the past, these amounts have not been included as the focus has been on results from operations. However, since realized gains and losses are included at year-end in determining the system-wide operating margin, we have begun including these realized gains and losses for 2003 at the System Administration level.

The data is reported in three sections: (1) Operating Revenues, (2) Operating Expenses and (3) Other Nonoperating Adjustments. Presentation of State appropriation revenues are required under GASB 35 to be reflected as nonoperating revenues, so all institutions will report an Operating Loss prior to this adjustment. The MFR provides an Adjusted Income (Loss), which takes into account the nonoperating adjustments associated with core operating activities. An Adjusted Margin (as a percentage of operating and nonoperating revenue adjustments) is calculated for each period and is intended to reflect relative operating contributions to financial health.

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UNAUDITED
The University of Texas System
Comparison of Operating Results and Margin
For the Two Months Ending October 31, 2002

	October Year-to-Date FY 2003	October Year-to-Date FY 2002 (Restated)	Variance of Current Year-to-Date to Prior Year-to-Date	Fluctuation Percentage
Operating Revenues				
Student Tuition and Fees	$137,988,568	$118,528,807	$19,459,761	16.42%
Sponsored Programs	316,502,845	268,878,158	47,624,687	17.71%
Net Sales and Services of Educational Activities	41,059,048	29,758,191	11,300,857	37.98%
Net Sales and Services of Hospitals	253,065,086	224,796,525	28,268,561	12.58%
Net Professional Fees	110,551,995	98,978,797	11,573,198	11.69%
Net Auxiliary Enterprises	46,204,964	42,390,963	3,814,001	9.00%
Other Operating Revenues	69,555,989	63,875,302	5,680,687	8.89%
Total Operating Revenues	**974,928,495**	**847,206,743**	**127,721,752**	**15.08%**
Operating Expenses				
Salaries and Wages	602,258,195	559,016,575	43,241,620	7.74%
Employee Benefits and Related Costs	150,002,025	137,018,782	12,983,243	9.48%
Professional Fees and Contracted Services	27,883,694	26,571,843	1,311,851	4.94%
Other Contracted Services	50,155,579	39,490,215	10,665,364	27.01%
Scholarships and Fellowships	137,093,786	110,698,121	26,395,665	23.84%
Travel	12,296,380	9,776,172	2,520,208	25.78%
Materials and Supplies	123,388,405	111,957,658	11,430,747	10.21%
Utilities	23,694,197	23,089,728	604,469	2.62%
Telecommunications	8,936,765	7,429,773	1,506,992	20.28%
Repairs and Maintenance	14,032,369	15,156,021	(1,123,652)	-7.41%
Rentals and Leases	12,237,600	9,606,370	2,631,230	27.39%
Printing and Reproduction	6,011,098	5,486,106	524,992	9.57%
Claims and Losses	0	2,584,554	(2,584,554)	-100.00%
Federal Sponsored Programs Pass-Throughs	5,264,941	4,646,474	618,467	13.31%
State Sponsored Programs Pass-Throughs	615,746	669,749	(54,003)	-8.06%
Depreciation and Amortization	51,408,919	50,770,790	638,129	1.26%
Other Operating Expenses	67,603,459	63,029,090	4,574,369	7.26%
Total Operating Expenses	**1,292,883,158**	**1,176,998,021**	**115,885,137**	**9.85%**
Operating Loss	**(317,954,663)**	**(329,791,278)**	**11,836,614**	**3.59%**
Other Nonoperating Adjustments				
State Appropriations	282,441,218	278,166,069	4,275,149	1.54%
Gift Contributions for Operations	31,608,645	28,351,306	3,257,339	11.49%
Net Investment Income	(92,846,663)	(43,579,483)	(49,267,180)	-113.05%
Interest Expense on Capital Asset Financings	(11,357,270)	(11,184,646)	(172,624)	-1.54%
Net Other Nonoperating Adjustments	**209,845,930**	**251,753,246**	**(41,907,316)**	**-16.65%**
Adjusted Income (Loss)	**$(108,108,733)**	**$(78,038,032)**	**$(30,070,702)**	**-38.53%**
Adjusted Margin (as a percentage)	**-9.04%**	**-7.03%**		

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The University of Texas System
Comparison of 2003 Year-to-Date Adjusted Income (Loss)
to 2002 Year-to-Date Adjusted Income (Loss)
For the Two Months Ending October 31, 2002

	October 2002 Year-to-Date Adjusted Income (Loss)		October 2001 Year-to-Date Adjusted Income (Loss) (Restated)	Variance of Current Year-to-Date to Prior Year-to-Date	Fluctuation Percentage	
UT System Administration	($136,939,816)		($89,030,964)	($47,908,852)	-53.81%	(1)
UT Arlington	$1,806,560		$887,716	$918,844	103.51%	
UT Austin	$3,639,382		$3,964,878	($325,496)	-8.21%	
UT Brownsville	$482,246		$1,277,995	($795,749)	-62.27%	
UT Dallas	($869,484)	(2)	($927,390)	$57,906	6.24%	
UT El Paso	$169,560		($1,365,897)	$1,535,457	112.41%	(3)
UT Pan American	$778,024		$200,536	$577,488	287.97%	
UT Permian Basin	$161,349		($50,906)	$212,255	416.95%	
UT San Antonio	$189,418		$1,018,060	($828,642)	-81.39%	(4)
UT Tyler	$330,589		$762,864	($432,275)	-56.66%	
UTSMC Dallas	$1,729,258		($563,734)	$2,292,992	406.75%	(5)
UTMB Galveston	($3,777,443)	(6)	($3,986,088)	$208,645	5.23%	
UTHSC Houston	$2,030,792		$1,626,563	$404,229	24.85%	
UTHSC San Antonio	$5,933,342		$2,515,596	$3,417,746	135.86%	(7)
UTMD Anderson	$16,458,373		$5,692,457	$10,765,916	189.13%	(8)
UTHC Tyler	($230,883)	(9)	($59,718)	($171,165)	-286.62%	
Total Adjusted Income (Loss)	($108,108,733)		($78,038,032)	($30,070,702)	-38.53%	

THE UNIVERSITY OF TEXAS SYSTEM
EXPLANATION OF VARIANCES ON THE MONTHLY FINANCIAL REPORT
For the Two Months Ending October 31, 2002

Explanations are provided by institution for variances on current year-to-date adjusted income (loss) compared to the prior year-to-date adjusted income (loss).

(1) *U.T. System Administration* – The $137 million net loss year-to-date is due to investment losses for the endowment funds, excluding increases and decreases in fair value of investments. Of this decrease, $67.9 million related to the Permanent University Fund (PUF), $58 million related to the Long Term Fund (LTF) and $15 million related to the Permanent Health Fund (PHF). The combined loss for the funds was $93.2 million through October 2001. The additional decline from prior year to current year is due to worsening market conditions. The rate of return, including unrealized losses, for these three endowment funds for the first two months of 2003 was (1.79%) for the PUF, (1.96%) for the LTF and (2.01%) for the PHF. As compared to the benchmark of (2.17%) used for endowment funds, the funds' performances were slightly better. The negative returns are due to declines in the financial market.

(2) *U.T. Dallas* – The $869,000 net loss year-to-date is primarily due to expenses from prior year balances in materials and supplies and other contracted services in the amount of $340,000 for the library renovation project, $171,000 for scholarships and fellowships expense and $126,000 for Texas Advanced Research Program (TARP) and Texas Advanced Technology Program (TATP) costs.

(3) *U.T. El Paso* – The $1.5 million (112.4%) increase in adjusted income over the same period last year was primarily due to a $5 million increase in operating revenues, a $1.1 million increase in state appropriations both of which are offset by a $4.9 million increase in operating expenses. Net auxiliary enterprises increased $1.6 million due to game guarantees and advertising revenue for Intercollegiate Athletics and a greater number of special events were held in 2002 as the terrorist attacks on September 11, 2001 were very detrimental to 2002 auxiliary enterprises. Salaries and wages increased $1 million due to the 3.5% budgeted salary increase as well as increased full-time tenure and tenure track faculty. Employee benefits expenses increased $619,000 and is due to increased group insurance premiums. Materials and supplies expense increased $593,000 due to the change in the equipment capitalization threshold from $1,000 to $5,000. State appropriations also increased $1.1 million.

(4) *U.T. San Antonio* – The $829,000 (81.4%) decrease in adjusted income over the same period last year was primarily due increased salaries and wages expense $1.7 million due to a budgeted 4% administrative salary increase as well as an increase in part-time faculty due to increased enrollment.

(5) *U.T.S.M.C. Dallas* – The $2.3 million (406.8%) increase in adjusted income over the same period last year was primarily due to a $900,000 increase in royalty income, a $1.2 million increase in net professional fees as bad debt expenses are lower and a $2.8 million increase in gift contributions for operations. This $2.8 million is due to increased gifts of $2 million in the areas of Continuing Education Program and the Alliance for Cellular Signaling and increased pledges of $800,000. Offsetting the increased revenues were increased expenses for service and maintenance contracts as well as purchases of furnishings and equipment for $1.1 million.

(6) *U.T.M.B. Galveston* – The $3.8 million net loss year-to-date is primarily due to the national shortage of nurses and other patient care providers. Demand for hospital services continues to be high, and as a result, *U.T.M.B. Galveston* must rely heavily on expensive contract nursing and overtime to meet staffing demands. Also, significant competition among hospitals in the Houston and Galveston market is driving up labor costs. The high cost of medical implants, pharmaceuticals and other medical supplies continues to challenge the hospitals and clinics. Annual payment increases on government-sponsored programs (Medicare and Medicaid) continue to be less than overall medical inflation.

(7) *U.T.H.S.C. San Antonio* – The $3.4 million (135.9%) increase in adjusted income over the same period last year was primarily due to a $1.9 million increase in fee for service revenue, which fluctuates based on patient volume and services performed. Operating expenses are lower than normal due to the conversion to PeopleSoft, which caused departments to delay or halt spending activity during the month of September.

(8) *U.T.M.D. Anderson* – The $10.8 million (189.1%) increase in the adjusted income over the same period last year was due to increased operating revenues of $27.9 million versus increased operating expenses of $17.7 million. Net sales and services of hospitals increased by $20.7 million primarily due to volume from increased patient days, bone marrow transplant admissions and surgery hours. Other areas of increase include inpatient admissions, outpatient billable visits and surgery cases. Additionally, strategic price revisions were instituted in September to better reflect the prevailing market for services in the Houston area.

(9) *U.T.H.C. Tyler* – The $231,000 net loss year-to-date is primarily due to a $332,000 increases in expenses for salaries and wages due to merit increases and overtime due to increased patient volume and a $141,000 increase in contract labor expense, also due to increased patient volume.

GLOSSARY OF TERMS

OPERATING REVENUES :

STUDENT TUITION AND FEES – *All student tuition and fee revenues earned at the U.T. component institution for educational purposes.*

SPONSORED PROGRAMS – *Funding received from local, state and federal governments or private agencies, organizations or individuals. Includes amounts received for services performed on grants, contracts, and agreements from these entities for current operations. This also includes indirect cost recoveries and pass-through federal and state grants.*

NET SALES AND SERVICES OF EDUCATIONAL ACTIVITIES – *Revenues that are related to the conduct of instruction, research, and public service and revenues from activities that exist to provide an instructional and laboratory experience for students that create goods and services that may be sold.*

NET SALES AND SERVICES OF HOSPITALS – *Revenues (net of discounts, allowances, and bad debt expense) generated from U.T. health institution's daily patient care, special or other services, as well as revenues from health clinics that are part of a hospital.*

NET PROFESSIONAL FEES – *Revenues (net of discounts, allowances, and bad debt expense) derived from the fees charged by the professional staffs at U.T. health institutions as part of the Medical Practice Plans. These revenues are also identified as Practice Plan income. Examples of such fees could include doctor's fees for clinic visits, medical and dental procedures, professional opinions, and anatomical procedures, such as analysis of specimens after a surgical procedure, etc.*

NET AUXILIARY ENTERPRISES – *Revenues derived from a service to students, faculty, or staff in which a fee is charged that is directly related to, although not necessarily equal to the cost of the service (e.g., bookstores, dormitories, dining halls, snack bars, inter-collegiate athletic programs, etc.).*

OTHER OPERATING REVENUES – *Other revenues generated from sales or services provided to meet current fiscal year operating expenses, which are not included in the preceding categories (e.g., certified non-profit healthcare company revenues (quarterly), donated drugs, interest on student loans, patent and royalty income, etc.).*

TOTAL OPERATING REVENUES – *U.T. component institutionally generated funding needed to meet current fiscal year operating expenses.*

OPERATING EXPENSES:

SALARIES AND WAGES – *Expenses for all salaries and wages of individuals employed by the institution including full-time, part-time, longevity, hourly, seasonal, etc.*

EMPLOYEE BENEFITS AND RELATED COSTS – *Expenses for all employee benefits paid by the institution or paid by the state on behalf of the institution.*

PROFESSIONAL FEES AND CONTRACTED SERVICES – *Payments for services rendered on a fee, contract, or other basis by a person, firm, corporation, or company recognized as possessing a high degree of learning and responsibility. Includes such items as services of a consultant, legal counsel, financial or audit fees, medical contracted services, guest lecturers (not employees) and expert witnesses.*

OTHER CONTRACTED SERVICES – *Payments for services rendered on a contractual basis by a person, firm, corporation or company that posses a lesser degree of learning and responsibility than that required for Professional Fees and Contracted Services. Includes such items as temporary employment expenses, fully insured medical plans expenses, janitorial services, dry cleaning services, etc.*

SCHOLARSHIPS AND FELLOWSHIPS – *Payments made for scholarship grants to students authorized by law.*

TRAVEL – *Payments for travel costs incurred during travel by employees, board or commission members and elected/appointed officials on state business. Includes payments made directly to public transportation companies or credit card issuers by state agencies for travel expenses of its employees, officials and board members.*

MATERIALS AND SUPPLIES – *Payments for consumable items. Includes, but is not limited to: computer consumables, office supplies, paper products, soap, lights, plants, fuels and lubricants, chemicals and gasses, medical supplies and copier supplies. Also includes postal services, and subscriptions and other publications not for permanent retention.*

UTILITIES – *Payments for the purchase of electricity, natural gas, water, thermal energy and waste disposal.*

TELECOMMUNICATIONS - *Electronically transmitted communications services (telephone, internet, computation center services, etc.).*

REPAIRS AND MAINTENANCE – *Payments for the maintenance and repair of equipment, furnishings and motor vehicles. Includes, but is* *__not__* *limited to repair and maintenance to copy machines, furnishings, equipment – including medical and laboratory equipment, office equipment and aircraft. Also includes payments for the maintenance and repair of buildings and other plant facilities.*

RENTALS AND LEASES – *Payments for rentals or leases of furnishings and equipment, vehicles, land and office buildings (all rental of space).*

PRINTING AND REPRODUCTION – *Printing and reproduction costs associated with the printing/copying of the institution's documents and publications.*

BAD DEBT EXPENSE – *Expenses incurred by the university related to nonrevenue receivables such as non-payment of student loans.*

CLAIMS AND LOSSES – *Payments for claims from self-insurance programs. Other claims for settlements and judgments are considered nonoperating expenses.*

FEDERAL SPONSORED PROGRAMS PASS-THROUGHS – *Pass-throughs to other Texas state agencies, including other universities, of federal grants and contracts.*

STATE SPONSORED PROGRAMS PASS-THROUGHS – *Pass-throughs to other Texas state agencies, including Texas universities.*

DEPRECIATION AND AMORTIZATION – *Estimated depreciation and amortization expense.*

OTHER OPERATING EXPENSES – *Other operating expenses not identified in other line items above (e.g., certified non-profit healthcare company expenses (quarterly), property taxes, insurance premiums, credit card fees, hazardous waste disposal expenses, meetings and conferences, etc.).*

TOTAL OPERATING EXPENSES – *Total operating expenses for U.T. System component institution.*

OPERATING LOSS – *Total operating revenues less total operating expenses before other nonoperating adjustments like state appropriations.*

__OTHER NONOPERATING ADJUSTMENTS__:

STATE APPROPRIATIONS – *Appropriations from the State General Revenue fund, which supplement the U.T. component institutional revenue in meeting operating expenses, such as faculty salaries, utilities, and institutional support. Also includes Higher Education Assistance Funds (HEAF), which is a source of state appropriated general revenue to U.T. Brownsville and U.T. Pan American. HEAF funds are appropriated for construction, library and equipment expenses for Texas public universities that do not benefit from the Permanent University Fund (PUF) bond proceeds.*

GIFT CONTRIBUTIONS FOR OPERATIONS – *Consist of public and private unrestricted gifts used in current operations. Excludes gifts for capital acquisition and endowment gifts.*

NET INVESTMENT INCOME – *Interest and dividend income, including realized gains and losses on endowments excluding fair market value adjustments to short and long-term investments held by an institution. Also includes non-mandatory transfers of Long Term Fund distributions.*

INTEREST EXPENSE ON CAPITAL ASSET FINANCINGS – *Interest expenses associated with bond and note borrowings utilized to finance capital improvement projects by an institution. This consists of the interest portion of mandatory debt service transfers under the Revenue Financing System and Tuition Revenue bond programs.*

NET OTHER NONOPERATING ADJUSTMENTS – *Sum of the other nonoperating adjustments.*

ADJUSTED INCOME (LOSS) – *Total operating revenues less total operating expenses plus net other nonoperating adjustments.*

ADJUSTED MARGIN (as a percentage) – *Percentage of Adjusted Income (Loss) divided by Total Operating Revenues plus Net Nonoperating Adjustments less Interest Expense on Capital Asset Financings.*

UNAUDITED
The University of Texas System Administration
Comparison of Operating Results and Margin
For the Two Months Ending October 31, 2002

	October Year-to-Date FY 2003	October Year-to-Date FY 2002	Variance of Current Year-to-Date to Prior Year-to-Date	Fluctuation Percentage
Operating Revenues				
Net Sales and Services of Educational Activities	$7,474,071	$394,210	$7,079,861	1,795.96%
Other Operating Revenues	2,368,211	1,477,214	890,997	60.32%
Total Operating Revenues	**9,842,282**	**1,871,424**	**7,970,858**	**425.92%**
Operating Expenses				
Salaries and Wages	2,408,580	2,888,948	(480,368)	-16.63%
Employee Benefits and Related Costs	1,117,505	926,932	190,573	20.56%
Professional Fees and Contracted Services	1,418,833	1,336,664	82,169	6.15%
Other Contracted Services	4,095,673	(3,620,973)	7,716,646	213.11%
Travel	237,543	161,302	76,241	47.27%
Materials and Supplies	1,265,840	312,364	953,476	305.25%
Utilities	5,442	6,532	(1,090)	-16.69%
Telecommunications	58,298	118,267	(59,969)	-50.71%
Repairs and Maintenance	19,754	50,747	(30,993)	-61.07%
Rentals and Leases	213,370	99,093	114,277	115.32%
Printing and Reproduction	67,568	55,234	12,334	22.33%
Claims and Losses	0	2,584,554	(2,584,554)	-100.00%
Depreciation and Amortization	264,566	198,402	66,164	33.35%
Other Operating Expenses	2,243,363	534,730	1,708,633	319.53%
Total Operating Expenses	**13,416,335**	**5,652,796**	**7,763,539**	**137.34%**
Operating Loss	**(3,574,053)**	**(3,781,372)**	**207,319**	**5.48%**
Other Nonoperating Adjustments				
State Appropriations	166,052	145,952	20,100	13.77%
Gift Contributions for Operations	69,400	41,065	28,335	69.00%
Net Investment Income	(133,596,459)	(85,431,593)	(48,164,866)	-56.38%
Interest Expense on Capital Asset Financings	(4,756)	(5,016)	260	5.18%
Net Other Nonoperating Adjustments	**(133,365,763)**	**(85,249,592)**	**(48,116,171)**	**-56.44%**
Adjusted Income (Loss)	**$(136,939,816)**	**$(89,030,964)**	**$(47,908,852)**	**-53.81%**
Adjusted Margin (as a percentage)	**110.87%**	**106.79%**		

UNAUDITED

The University of Texas at Arlington

Comparison of Operating Results and Margin

For the Two Months Ending October 31, 2002

	October Year-to-Date FY 2003	October Year-to-Date FY 2002	Variance of Current Year-to-Date to Prior Year-to-Date	Fluctuation Percentage
Operating Revenues				
Student Tuition and Fees	$17,251,619	$14,294,609	$2,957,010	20.69%
Sponsored Programs	11,303,158	8,320,419	2,982,739	35.85%
Net Sales and Services of Educational Activities	1,039,191	694,187	345,004	49.70%
Net Auxiliary Enterprises	2,373,359	2,365,547	7,812	0.33%
Other Operating Revenues	1,098,402	495,226	603,176	121.80%
Total Operating Revenues	**33,065,729**	**26,169,988**	**6,895,741**	**26.35%**
Operating Expenses				
Salaries and Wages	21,781,456	20,088,502	1,692,954	8.43%
Employee Benefits and Related Costs	5,373,554	4,870,569	502,985	10.33%
Professional Fees and Contracted Services	287,494	220,601	66,893	30.32%
Other Contracted Services	943,214	637,673	305,541	47.91%
Scholarships and Fellowships	13,106,012	9,596,591	3,509,421	36.57%
Travel	336,053	297,921	38,132	12.80%
Materials and Supplies	2,159,539	1,784,946	374,593	20.99%
Utilities	751,965	1,137,347	(385,382)	-33.88%
Telecommunications	381,830	318,773	63,057	19.78%
Repairs and Maintenance	792,426	965,558	(173,132)	-17.93%
Rentals and Leases	445,162	265,430	179,732	67.71%
Printing and Reproduction	330,926	322,971	7,955	2.46%
Depreciation and Amortization	1,452,532	1,212,010	240,522	19.84%
Other Operating Expenses	942,268	889,298	52,970	5.96%
Total Operating Expenses	**49,084,431**	**42,608,190**	**6,476,241**	**15.20%**
Operating Loss	**(16,018,702)**	**(16,438,202)**	**419,500**	**2.55%**
Other Nonoperating Adjustments				
State Appropriations	17,920,124	17,367,470	552,654	3.18%
Gift Contributions for Operations	202,735	310,400	(107,665)	-34.69%
Net Investment Income	464,603	389,272	75,331	19.35%
Interest Expense on Capital Asset Financings	(762,200)	(741,224)	(20,976)	-2.83%
Net Other Nonoperating Adjustments	**17,825,262**	**17,325,918**	**499,344**	**2.88%**

Adjusted Income (Loss)	**$1,806,560**	**$887,716**	**$918,844**	**103.51%**
Adjusted Margin (as a percentage)	**3.50%**	**2.01%**		

UNAUDITED
The University of Texas at Austin
Comparison of Operating Results and Margin
For the Two Months Ending October 31, 2002

	October Year-to-Date FY 2003	October Year-to-Date FY 2002	Variance of Current Year-to-Date to Prior Year-to-Date	Fluctuation Percentage
Operating Revenues				
Student Tuition and Fees	$64,304,030	$55,877,908	$8,426,122	15.08%
Sponsored Programs	68,239,383	59,171,671	9,067,712	15.32%
Net Sales and Services of Educational Activities	13,879,569	12,778,807	1,100,762	8.61%
Net Auxiliary Enterprises	27,756,433	25,970,724	1,785,709	6.88%
Other Operating Revenues	21,716,881	19,331,913	2,384,968	12.34%
Total Operating Revenues	**195,896,296**	**173,131,023**	**22,765,273**	**13.15%**
Operating Expenses				
Salaries and Wages	126,019,355	118,347,994	7,671,361	6.48%
Employee Benefits and Related Costs	27,258,202	24,788,220	2,469,982	9.96%
Professional Fees and Contracted Services	3,509,144	3,480,182	28,962	0.83%
Other Contracted Services	7,924,310	7,708,839	215,471	2.80%
Scholarships and Fellowships	46,615,894	40,294,647	6,321,247	15.69%
Travel	3,896,386	3,078,923	817,463	26.55%
Materials and Supplies	15,620,166	13,509,509	2,110,657	15.62%
Utilities	6,599,524	6,124,950	474,574	7.75%
Telecommunications	1,678,030	1,321,105	356,925	27.02%
Repairs and Maintenance	2,716,296	2,132,315	583,981	27.39%
Rentals and Leases	2,223,414	2,511,209	(287,795)	-11.46%
Printing and Reproduction	2,214,311	1,974,639	239,672	12.14%
Federal Sponsored Programs Pass-Throughs	2,367,720	1,831,906	535,814	29.25%
State Sponsored Programs Pass-Throughs	589,935	337,178	252,757	74.96%
Depreciation and Amortization	12,005,831	11,409,587	596,244	5.23%
Other Operating Expenses	6,474,060	6,495,500	(21,440)	-0.33%
Total Operating Expenses	**267,712,578**	**245,346,703**	**22,365,875**	**9.12%**
Operating Loss	**(71,816,282)**	**(72,215,680)**	**399,398**	**0.55%**
Other Nonoperating Adjustments				
State Appropriations	56,048,745	55,658,870	389,875	0.70%
Gift Contributions for Operations	7,267,810	9,084,692	(1,816,882)	-20.00%
Net Investment Income	14,848,827	14,269,758	579,069	4.06%
Interest Expense on Capital Asset Financings	(2,709,718)	(2,832,762)	123,044	4.34%
Net Other Nonoperating Adjustments	**75,455,664**	**76,180,558**	**(724,894)**	**-0.95%**
Adjusted Income (Loss)	**$3,639,382**	**$3,964,878**	**$(325,496)**	**-8.21%**
Adjusted Margin (as a percentage)	**1.33%**	**1.57%**		

UNAUDITED
The University of Texas at Brownsville
Comparison of Operating Results and Margin
For the Two Months Ending October 31, 2002

	October Year-to-Date FY 2003	October Year-to-Date FY 2002	Variance of Current Year-to-Date to Prior Year-to-Date	Fluctuation Percentage
Operating Revenues				
Student Tuition and Fees	$1,414,241	$1,167,578	$246,663	21.13%
Sponsored Programs	19,825,597	17,356,700	2,468,897	14.22%
Net Sales and Services of Educational Activities	848,852	739,351	109,501	14.81%
Net Auxiliary Enterprises	39,706	31,117	8,589	27.60%
Other Operating Revenues	5,739	3,144	2,595	82.54%
Total Operating Revenues	**22,134,135**	**19,297,890**	**2,836,245**	**14.70%**
Operating Expenses				
Salaries and Wages	6,529,414	5,941,240	588,174	9.90%
Employee Benefits and Related Costs	1,237,107	1,102,369	134,738	12.22%
Professional Fees and Contracted Services	286,921	255,016	31,905	12.51%
Scholarships and Fellowships	13,613,436	10,900,722	2,712,714	24.89%
Travel	96,666	70,770	25,896	36.59%
Materials and Supplies	714,017	602,562	111,455	18.50%
Utilities	178,738	133,912	44,826	33.47%
Telecommunications	275,643	220,225	55,418	25.16%
Repairs and Maintenance	208,217	56,590	151,627	267.94%
Rentals and Leases	332,891	407,501	(74,610)	-18.31%
Printing and Reproduction	61,193	76,688	(15,495)	-20.21%
Depreciation and Amortization	520,173	321,010	199,163	62.04%
Other Operating Expenses	1,254,041	1,234,712	19,329	1.57%
Total Operating Expenses	**25,308,457**	**21,323,317**	**3,985,140**	**18.69%**
Operating Loss	**(3,174,322)**	**(2,025,427)**	**(1,148,895)**	**-56.72%**
Other Nonoperating Adjustments				
State Appropriations	3,802,267	3,428,956	373,311	10.89%
Gift Contributions for Operations	21,552	0	21,552	0.00%
Net Investment Income	36,041	88,780	(52,739)	-59.40%
Interest Expense on Capital Asset Financings	(203,292)	(214,314)	11,022	5.14%
Net Other Nonoperating Adjustments	**3,656,568**	**3,303,422**	**353,146**	**10.69%**
Adjusted Income (Loss)	**$482,246**	**$1,277,995**	**$(795,749)**	**-62.27%**
Adjusted Margin (as a percentage)	**1.86%**	**5.60%**		

UNAUDITED
The University of Texas at Dallas
Comparison of Operating Results and Margin
For the Two Months Ending October 31, 2002

	October Year-to-Date FY 2003	October Year-to-Date FY 2002	Variance of Current Year-to-Date to Prior Year-to-Date	Fluctuation Percentage
Operating Revenues				
Student Tuition and Fees	$11,550,453	$10,780,347	$770,106	7.14%
Sponsored Programs	7,532,084	4,631,204	2,900,880	62.64%
Net Sales and Services of Educational Activities	704,681	889,145	(184,464)	-20.75%
Net Auxiliary Enterprises	766,756	657,101	109,655	16.69%
Other Operating Revenues	837,161	376,387	460,774	122.42%
Total Operating Revenues	**21,391,135**	**17,334,184**	**4,056,951**	**23.40%**
Operating Expenses				
Salaries and Wages	16,104,228	14,225,155	1,879,073	13.21%
Employee Benefits and Related Costs	3,650,097	3,058,060	592,037	19.36%
Professional Fees and Contracted Services	346,603	264,089	82,514	31.24%
Other Contracted Services	868,727	586,560	282,167	48.11%
Scholarships and Fellowships	6,722,154	6,577,984	144,170	2.19%
Travel	315,882	320,135	(4,253)	-1.33%
Materials and Supplies	2,627,551	1,629,715	997,836	61.23%
Utilities	662,991	721,683	(58,692)	-8.13%
Telecommunications	264,960	181,564	83,396	45.93%
Repairs and Maintenance	474,883	559,751	(84,868)	-15.16%
Rentals and Leases	272,167	138,186	133,981	96.96%
Printing and Reproduction	96,786	68,229	28,557	41.85%
Depreciation and Amortization	1,355,000	1,455,885	(100,885)	-6.93%
Other Operating Expenses	957,240	1,149,550	(192,310)	-16.73%
Total Operating Expenses	**34,719,269**	**30,936,546**	**3,782,723**	**12.23%**
Operating Loss	**(13,328,134)**	**(13,602,362)**	**274,228**	**2.02%**
Other Nonoperating Adjustments				
State Appropriations	11,194,522	11,092,593	101,929	0.92%
Gift Contributions for Operations	469,535	491,563	(22,028)	-4.48%
Net Investment Income	1,270,303	1,495,024	(224,721)	-15.03%
Interest Expense on Capital Asset Financings	(475,710)	(404,208)	(71,502)	-17.69%
Net Other Nonoperating Adjustments	**12,458,650**	**12,674,972**	**(216,322)**	**-1.71%**
Adjusted Income (Loss)	**$(869,484)**	**$(927,390)**	**$57,906**	**6.24%**
Adjusted Margin (as a percentage)	**-2.53%**	**-3.05%**		

UNAUDITED
The University of Texas at El Paso
Comparison of Operating Results and Margin
For the Two Months Ending October 31, 2002

	October Year-to-Date FY 2003	October Year-to-Date FY 2002	Variance of Current Year-to-Date to Prior Year-to-Date	Fluctuation Percentage
Operating Revenues				
Student Tuition and Fees	$9,454,545	$7,991,114	$1,463,431	18.31%
Sponsored Programs	18,853,859	17,015,778	1,838,081	10.80%
Net Sales and Services of Educational Activities	720,816	603,903	116,913	19.36%
Net Auxiliary Enterprises	5,309,664	3,711,032	1,598,632	43.08%
Other Operating Revenues	8,429	7,368	1,061	14.40%
Total Operating Revenues	**34,347,313**	**29,329,195**	**5,018,118**	**17.11%**
Operating Expenses				
Salaries and Wages	17,623,322	16,593,322	1,030,000	6.21%
Employee Benefits and Related Costs	4,157,006	3,537,937	619,069	17.50%
Professional Fees and Contracted Services	1,196,432	1,352,390	(155,958)	-11.53%
Other Contracted Services	495,369	1,164,858	(669,489)	-57.47%
Scholarships and Fellowships	16,269,929	13,007,303	3,262,626	25.08%
Travel	1,407,443	972,045	435,398	44.79%
Materials and Supplies	2,881,002	2,288,071	592,931	25.91%
Utilities	997,750	696,928	300,822	43.16%
Telecommunications	263,978	166,519	97,459	58.53%
Repairs and Maintenance	814,666	1,011,853	(197,187)	-19.49%
Rentals and Leases	215,220	176,002	39,218	22.28%
Printing and Reproduction	108,689	168,684	(59,995)	-35.57%
Federal Sponsored Programs Pass-Throughs	666,066	957,132	(291,066)	-30.41%
Depreciation and Amortization	1,531,348	1,951,537	(420,189)	-21.53%
Other Operating Expenses	1,429,314	1,127,585	301,729	26.76%
Total Operating Expenses	**50,057,534**	**45,172,166**	**4,885,368**	**10.81%**
Operating Loss	**(15,710,221)**	**(15,842,971)**	**132,750**	**0.84%**
Other Nonoperating Adjustments				
State Appropriations	14,350,261	13,209,370	1,140,891	8.64%
Gift Contributions for Operations	1,120,578	865,157	255,421	29.52%
Net Investment Income	1,008,332	1,004,953	3,379	0.34%
Interest Expense on Capital Asset Financings	(599,390)	(602,406)	3,016	0.50%
Net Other Nonoperating Adjustments	**15,879,781**	**14,477,074**	**1,402,707**	**9.69%**
Adjusted Income (Loss)	**$169,560**	**$(1,365,897)**	**$1,535,457**	**112.41%**
Adjusted Margin (as a percentage)	**0.33%**	**-3.08%**		

UNAUDITED
The University of Texas-Pan American
Comparison of Operating Results and Margin
For the Two Months Ending October 31, 2002

	October Year-to-Date FY 2003	October Year-to-Date FY 2002	Variance of Current Year-to-Date to Prior Year-to-Date	Fluctuation Percentage
Operating Revenues				
Student Tuition and Fees	$7,397,134	$6,037,034	$1,360,100	22.53%
Sponsored Programs	18,963,306	13,156,666	5,806,640	44.13%
Net Sales and Services of Educational Activities	1,745,158	1,121,029	624,129	55.67%
Net Auxiliary Enterprises	710,496	899,066	(188,570)	-20.97%
Other Operating Revenues	36,499	40,685	(4,186)	-10.29%
Total Operating Revenues	**28,852,593**	**21,254,480**	**7,598,113**	**35.75%**
Operating Expenses				
Salaries and Wages	10,705,323	10,156,836	548,487	5.40%
Employee Benefits and Related Costs	2,546,276	2,421,263	125,013	5.16%
Professional Fees and Contracted Services	104,424	53,833	50,591	93.98%
Other Contracted Services	545,441	221,145	324,296	146.64%
Scholarships and Fellowships	18,065,928	13,789,608	4,276,320	31.01%
Travel	379,072	231,235	147,837	63.93%
Materials and Supplies	1,956,471	1,421,061	535,410	37.68%
Utilities	795,364	826,479	(31,115)	-3.76%
Telecommunications	115,800	64,323	51,477	80.03%
Repairs and Maintenance	149,691	124,687	25,004	20.05%
Rentals and Leases	61,920	48,553	13,367	27.53%
Printing and Reproduction	107,466	65,456	42,010	64.18%
Depreciation and Amortization	1,722,998	910,972	812,026	89.14%
Other Operating Expenses	1,050,873	920,316	130,557	14.19%
Total Operating Expenses	**38,307,047**	**31,255,767**	**7,051,280**	**22.56%**
Operating Loss	**(9,454,454)**	**(10,001,287)**	**546,833**	**5.47%**
Other Nonoperating Adjustments				
State Appropriations	10,172,776	10,167,844	4,932	0.05%
Gift Contributions for Operations	268,714	240,545	28,169	11.71%
Net Investment Income	331,713	314,212	17,501	5.57%
Interest Expense on Capital Asset Financings	(540,725)	(520,778)	(19,947)	-3.83%
Net Other Nonoperating Adjustments	**10,232,478**	**10,201,823**	**30,655**	**0.30%**
Adjusted Income (Loss)	**$778,024**	**$200,536**	**$577,488**	**287.97%**
Adjusted Margin (as a percentage)	**1.96%**	**0.63%**		

UNAUDITED
The University of Texas of the Permian Basin
Comparison of Operating Results and Margin
For the Two Months Ending October 31, 2002

	October Year-to-Date FY 2003	October Year-to-Date FY 2002	Variance of Current Year-to-Date to Prior Year-to-Date	Fluctuation Percentage
Operating Revenues				
Student Tuition and Fees	$1,083,882	$1,054,732	$29,150	2.76%
Sponsored Programs	1,506,567	1,391,360	115,207	8.28%
Net Sales and Services of Educational Activities	40,667	95,305	(54,638)	-57.33%
Net Auxiliary Enterprises	191,406	22,261	169,145	759.83%
Other Operating Revenues	16,959	39,740	(22,781)	-57.33%
Total Operating Revenues	**2,839,481**	**2,603,398**	**236,083**	**9.07%**
Operating Expenses				
Salaries and Wages	2,061,880	1,836,003	225,877	12.30%
Employee Benefits and Related Costs	427,393	412,558	14,835	3.60%
Professional Fees and Contracted Services	97,254	114,194	(16,940)	-14.83%
Other Contracted Services	179,955	120,224	59,731	49.68%
Scholarships and Fellowships	1,348,000	1,179,500	168,500	14.29%
Travel	89,930	95,529	(5,599)	-5.86%
Materials and Supplies	348,223	269,495	78,728	29.21%
Utilities	229,556	291,661	(62,105)	-21.29%
Telecommunications	59,666	31,688	27,978	88.29%
Repairs and Maintenance	71,464	162,547	(91,083)	-56.03%
Rentals and Leases	25,157	47,780	(22,623)	-47.35%
Printing and Reproduction	79,548	49,971	29,577	59.19%
Depreciation and Amortization	214,338	201,292	13,046	6.48%
Other Operating Expenses	146,811	111,486	35,325	31.69%
Total Operating Expenses	**5,379,175**	**4,923,928**	**455,247**	**9.25%**
Operating Loss	**(2,539,694)**	**(2,320,530)**	**(219,164)**	**-9.44%**
Other Nonoperating Adjustments				
State Appropriations	2,672,498	2,335,540	336,958	14.43%
Gift Contributions for Operations	121,908	53,036	68,872	129.86%
Net Investment Income	65,036	85,334	(20,298)	-23.79%
Interest Expense on Capital Asset Financings	(158,399)	(204,286)	45,887	22.46%
Net Other Nonoperating Adjustments	**2,701,043**	**2,269,624**	**431,419**	**19.01%**
Adjusted Income (Loss)	**$161,349**	**$(50,906)**	**$212,255**	**416.95%**
Adjusted Margin (as a percentage)	**2.83%**	**-1.00%**		

UNAUDITED
The University of Texas at San Antonio
Comparison of Operating Results and Margin
For the Two Months Ending October 31, 2002

	October Year-to-Date FY 2003	October Year-to-Date FY 2002	Variance of Current Year-to-Date to Prior Year-to-Date	Fluctuation Percentage
Operating Revenues				
Student Tuition and Fees	$13,814,064	$10,992,894	$2,821,170	25.66%
Sponsored Programs	14,583,250	11,024,687	3,558,563	32.28%
Net Sales and Services of Educational Activities	403,240	336,174	67,066	19.95%
Net Auxiliary Enterprises	693,704	542,543	151,161	27.86%
Other Operating Revenues	58,368	63,853	(5,485)	-8.59%
Total Operating Revenues	**29,552,626**	**22,960,151**	**6,592,475**	**28.71%**
Operating Expenses				
Salaries and Wages	16,918,933	15,184,984	1,733,949	11.42%
Employee Benefits and Related Costs	3,370,865	2,874,087	496,778	17.28%
Professional Fees and Contracted Services	305,137	215,167	89,970	41.81%
Other Contracted Services	281,716	237,765	43,951	18.49%
Scholarships and Fellowships	14,444,603	10,446,981	3,997,622	38.27%
Travel	596,037	408,338	187,699	45.97%
Materials and Supplies	1,386,036	994,924	391,112	39.31%
Utilities	700,866	711,267	(10,401)	-1.46%
Telecommunications	286,930	338,708	(51,778)	-15.29%
Repairs and Maintenance	520,102	488,556	31,546	6.46%
Rentals and Leases	324,753	134,773	189,980	140.96%
Printing and Reproduction	224,551	224,816	(265)	-0.12%
Federal Sponsored Programs Pass-Throughs	701,790	156,978	544,812	347.06%
State Sponsored Programs Pass-Throughs	25,811	61,385	(35,574)	-57.95%
Depreciation and Amortization	2,020,519	2,109,240	(88,721)	-4.21%
Other Operating Expenses	423,132	636,409	(213,277)	-33.51%
Total Operating Expenses	**42,531,781**	**35,224,378**	**7,307,403**	**20.75%**
Operating Loss	**(12,979,155)**	**(12,264,227)**	**(714,928)**	**-5.83%**
Other Nonoperating Adjustments				
State Appropriations	13,549,486	13,122,178	427,308	3.26%
Gift Contributions for Operations	194,154	676,072	(481,918)	-71.28%
Net Investment Income	570,162	581,061	(10,899)	-1.88%
Interest Expense on Capital Asset Financings	(1,145,229)	(1,097,024)	(48,205)	-4.39%
Net Other Nonoperating Adjustments	**13,168,573**	**13,282,287**	**(113,714)**	**-0.86%**
Adjusted Income (Loss)	**$189,418**	**$1,018,060**	**$(828,642)**	**-81.39%**
Adjusted Margin (as a percentage)	**0.43%**	**2.73%**		

UNAUDITED
The University of Texas at Tyler
Comparison of Operating Results and Margin
For the Two Months Ending October 31, 2002

	October Year-to-Date FY 2003	October Year-to-Date FY 2002	Variance of Current Year-to-Date to Prior Year-to-Date	Fluctuation Percentage
Operating Revenues				
Student Tuition and Fees	$1,773,240	$1,622,210	$151,030	9.31%
Sponsored Programs	2,524,379	1,359,370	1,165,009	85.70%
Net Sales and Services of Educational Activities	92,411	55,237	37,174	67.30%
Net Auxiliary Enterprises	216,846	157,884	58,962	37.35%
Other Operating Revenues	87,166	31,038	56,128	180.84%
Total Operating Revenues	**4,694,042**	**3,225,739**	**1,468,303**	**45.52%**
Operating Expenses				
Salaries and Wages	3,705,702	3,333,179	372,523	11.18%
Employee Benefits and Related Costs	712,939	618,595	94,344	15.25%
Professional Fees and Contracted Services	126,799	149,786	(22,987)	-15.35%
Other Contracted Services	228,753	214,381	14,372	6.70%
Scholarships and Fellowships	2,275,487	1,203,613	1,071,874	89.05%
Travel	116,941	95,499	21,442	22.45%
Materials and Supplies	528,756	244,891	283,865	115.91%
Utilities	116,982	165,803	(48,821)	-29.45%
Telecommunications	65,445	60,795	4,650	7.65%
Repairs and Maintenance	208,697	100,308	108,389	108.06%
Rentals and Leases	16,760	9,364	7,396	78.98%
Printing and Reproduction	162,180	67,287	94,893	141.03%
Depreciation and Amortization	450,000	400,000	50,000	12.50%
Other Operating Expenses	226,988	177,417	49,571	27.94%
Total Operating Expenses	**8,942,429**	**6,840,918**	**2,101,511**	**30.72%**
Operating Loss	**(4,248,387)**	**(3,615,179)**	**(633,208)**	**-17.52%**
Other Nonoperating Adjustments				
State Appropriations	4,494,687	4,297,626	197,061	4.59%
Gift Contributions for Operations	87,588	53,429	34,159	63.93%
Net Investment Income	132,831	140,212	(7,381)	-5.26%
Interest Expense on Capital Asset Financings	(136,130)	(113,224)	(22,906)	-20.23%
Net Other Nonoperating Adjustments	**4,578,976**	**4,378,043**	**200,933**	**4.59%**
Adjusted Income (Loss)	**$330,589**	**$762,864**	**$(432,275)**	**-56.66%**
Adjusted Margin (as a percentage)	**3.51%**	**9.89%**		

UNAUDITED

The University of Texas Southwestern Medical Center at Dallas

Comparison of Operating Results and Margin

For the Two Months Ending October 31, 2002

	October Year-to-Date FY 2003	October Year-to-Date FY 2002	Variance of Current Year-to-Date to Prior Year-to-Date	Fluctuation Percentage
Operating Revenues				
Student Tuition and Fees	$4,088,562	$3,731,261	$357,301	9.58%
Sponsored Programs	51,086,739	46,475,653	4,611,086	9.92%
Net Sales and Services of Educational Activities	11,896,111	10,046,739	1,849,372	18.41%
Net Professional Fees	21,924,727	20,720,718	1,204,009	5.81%
Net Auxiliary Enterprises	1,375,542	1,228,266	147,276	11.99%
Other Operating Revenues	1,097,558	1,163,606	(66,048)	-5.68%
Total Operating Revenues	**91,469,239**	**83,366,243**	**8,102,996**	**9.72%**
Operating Expenses				
Salaries and Wages	60,473,582	55,450,698	5,022,884	9.06%
Employee Benefits and Related Costs	16,891,544	16,525,735	365,809	2.21%
Professional Fees and Contracted Services	5,255,681	4,899,246	356,435	7.28%
Other Contracted Services	7,271,857	6,459,176	812,681	12.58%
Scholarships and Fellowships	2,771,197	2,485,698	285,499	11.49%
Travel	950,820	725,349	225,471	31.08%
Materials and Supplies	13,459,177	11,257,649	2,201,528	19.56%
Utilities	2,138,228	2,503,607	(365,379)	-14.59%
Telecommunications	840,168	523,016	317,152	60.64%
Repairs and Maintenance	215,213	371,006	(155,793)	-41.99%
Rentals and Leases	823,238	1,014,942	(191,704)	-18.89%
Printing and Reproduction	372,232	402,387	(30,155)	-7.49%
Federal Sponsored Programs Pass-Throughs	22,788	332,696	(309,908)	-93.15%
Depreciation and Amortization	4,688,186	4,581,163	107,023	2.34%
Other Operating Expenses	3,696,884	3,673,716	23,168	0.63%
Total Operating Expenses	**119,870,795**	**111,206,084**	**8,664,711**	**7.79%**
Operating Loss	**(28,401,556)**	**(27,839,841)**	**(561,715)**	**-2.02%**
Other Nonoperating Adjustments				
State Appropriations	19,299,856	18,731,882	567,974	3.03%
Gift Contributions for Operations	4,971,922	2,189,963	2,781,959	127.03%
Net Investment Income	7,589,642	7,678,142	(88,500)	-1.15%
Interest Expense on Capital Asset Financings	(1,730,606)	(1,323,880)	(406,726)	-30.72%
Net Other Nonoperating Adjustments	**30,130,814**	**27,276,107**	**2,854,707**	**10.47%**
Adjusted Income (Loss)	**$1,729,258**	**$(563,734)**	**$2,292,992**	**406.75%**
Adjusted Margin (as a percentage)	**1.40%**	**-0.50%**		

UNAUDITED
The University of Texas Medical Branch at Galveston
Comparison of Operating Results and Margin
For the Two Months Ending October 31, 2002

	October Year-to-Date FY 2003	October Year-to-Date FY 2002	Variance of Current Year-to-Date to Prior Year-to-Date	Fluctuation Percentage
Operating Revenues				
Student Tuition and Fees	$1,596,201	$1,108,484	$487,717	44.00%
Sponsored Programs	23,503,925	20,034,210	3,469,715	17.32%
Net Sales and Services of Educational Activities	0	71,132	(71,132)	-100.00%
Net Sales and Services of Hospitals	96,331,760	89,536,824	6,794,936	7.59%
Net Professional Fees	20,918,608	19,844,498	1,074,110	5.41%
Net Auxiliary Enterprises	1,538,195	1,443,599	94,596	6.55%
Other Operating Revenues	11,707,617	10,497,215	1,210,402	11.53%
Total Operating Revenues	**155,596,306**	**142,535,962**	**13,060,344**	**9.16%**
Operating Expenses				
Salaries and Wages	105,932,886	99,080,612	6,852,274	6.92%
Employee Benefits and Related Costs	27,084,412	25,985,006	1,099,406	4.23%
Professional Fees and Contracted Services	2,712,893	2,398,617	314,276	13.10%
Other Contracted Services	12,339,989	11,565,628	774,361	6.70%
Scholarships and Fellowships	583,228	419,902	163,326	38.90%
Travel	874,835	815,569	59,266	7.27%
Materials and Supplies	23,582,922	22,930,927	651,995	2.84%
Utilities	3,756,759	3,302,725	454,034	13.75%
Telecommunications	1,660,470	1,555,776	104,694	6.73%
Repairs and Maintenance	3,066,772	2,885,649	181,123	6.28%
Rentals and Leases	1,659,860	1,729,825	(69,965)	-4.04%
Printing and Reproduction	359,685	315,710	43,975	13.93%
Federal Sponsored Programs Pass-Throughs	403,575	274,492	129,083	47.03%
Depreciation and Amortization	8,008,502	8,600,790	(592,288)	-6.89%
Other Operating Expenses	20,460,775	18,747,180	1,713,595	9.14%
Total Operating Expenses	**212,487,563**	**200,608,408**	**11,879,155**	**5.92%**
Operating Loss	**(56,891,257)**	**(58,072,446)**	**1,181,189**	**2.03%**
Other Nonoperating Adjustments				
State Appropriations	48,508,244	49,095,054	(586,810)	-1.20%
Gift Contributions for Operations	422,646	1,177,136	(754,490)	-64.10%
Net Investment Income	4,550,016	4,117,178	432,838	10.51%
Interest Expense on Capital Asset Financings	(367,092)	(303,010)	(64,082)	-21.15%
Net Other Nonoperating Adjustments	**53,113,814**	**54,086,358**	**(972,544)**	**-1.80%**
Adjusted Income (Loss)	**$(3,777,443)**	**$(3,986,088)**	**$208,645**	**5.23%**
Adjusted Margin (as a percentage)	**-1.81%**	**-2.02%**		

UNAUDITED

The University of Texas Health Science Center at Houston

Comparison of Operating Results and Margin

For the Two Months Ending October 31, 2002

	October Year-to-Date FY 2003	October Year-to-Date FY 2002	Variance of Current Year-to-Date to Prior Year-to-Date	Fluctuation Percentage
Operating Revenues				
Student Tuition and Fees	$1,969,255	$1,890,244	$79,011	4.18%
Sponsored Programs	35,086,100	28,666,975	6,419,125	22.39%
Net Sales and Services of Educational Activities	1,829,406	1,544,479	284,927	18.45%
Net Sales and Services of Hospitals	4,763,514	5,298,769	(535,255)	-10.10%
Net Professional Fees	15,146,340	13,914,883	1,231,457	8.85%
Net Auxiliary Enterprises	2,212,542	2,211,739	803	0.04%
Other Operating Revenues	17,343,543	16,450,725	892,818	5.43%
Total Operating Revenues	**78,350,700**	**69,977,814**	**8,372,886**	**11.97%**
Operating Expenses				
Salaries and Wages	50,623,534	46,557,117	4,066,417	8.73%
Employee Benefits and Related Costs	13,984,598	11,317,228	2,667,370	23.57%
Professional Fees and Contracted Services	8,189,267	7,900,470	288,797	3.66%
Other Contracted Services	5,365,519	4,567,462	798,057	17.47%
Scholarships and Fellowships	250,135	241,518	8,617	3.57%
Travel	569,121	650,485	(81,364)	-12.51%
Materials and Supplies	4,486,122	3,186,183	1,299,939	40.80%
Utilities	776,143	825,360	(49,217)	-5.96%
Telecommunications	593,498	322,807	270,691	83.86%
Repairs and Maintenance	1,371,107	2,448,523	(1,077,416)	-44.00%
Rentals and Leases	1,147,615	707,171	440,444	62.28%
Printing and Reproduction	799,077	915,609	(116,532)	-12.73%
Federal Sponsored Programs Pass-Throughs	1,100,642	410,209	690,433	168.31%
State Sponsored Programs Pass-Throughs	0	271,186	(271,186)	-100.00%
Depreciation and Amortization	2,400,248	2,685,516	(285,268)	-10.62%
Other Operating Expenses	8,608,675	8,325,694	282,981	3.40%
Total Operating Expenses	**100,265,301**	**91,332,538**	**8,932,763**	**9.78%**
Operating Loss	**(21,914,601)**	**(21,354,724)**	**(559,877)**	**-2.62%**
Other Nonoperating Adjustments				
State Appropriations	23,228,995	22,853,370	375,625	1.64%
Gift Contributions for Operations	160,823	89,088	71,735	80.52%
Net Investment Income	1,401,039	973,881	427,158	43.86%
Interest Expense on Capital Asset Financings	(845,464)	(935,052)	89,588	9.58%
Net Other Nonoperating Adjustments	**23,945,393**	**22,981,287**	**964,106**	**4.20%**
Adjusted Income (Loss)	**$2,030,792**	**$1,626,563**	**$404,229**	**24.85%**
Adjusted Margin (as a percentage)	**1.97%**	**1.73%**		

UNAUDITED

The University of Texas Health Science Center at San Antonio

Comparison of Operating Results and Margin

For the Two Months Ending October 31, 2002

	October Year-to-Date FY 2003	October Year-to-Date FY 2002	Variance of Current Year-to-Date to Prior Year-to-Date	Fluctuation Percentage
Operating Revenues				
Student Tuition and Fees	$2,275,333	$1,975,668	$299,665	15.17%
Sponsored Programs	18,210,297	16,702,852	1,507,445	9.03%
Net Sales and Services of Educational Activities	187,123	180,621	6,502	3.60%
Net Professional Fees	19,468,043	16,057,930	3,410,113	21.24%
Net Auxiliary Enterprises	259,750	136,498	123,252	90.30%
Other Operating Revenues	8,173,632	9,833,367	(1,659,735)	-16.88%
Total Operating Revenues	**48,574,178**	**44,886,936**	**3,687,242**	**8.21%**
Operating Expenses				
Salaries and Wages	37,156,226	35,485,607	1,670,619	4.71%
Employee Benefits and Related Costs	7,420,477	8,050,301	(629,824)	-7.82%
Professional Fees and Contracted Services	1,431,073	1,434,465	(3,392)	-0.24%
Other Contracted Services	1,504,439	1,715,569	(211,130)	-12.31%
Scholarships and Fellowships	1,027,783	554,054	473,729	85.50%
Travel	410,533	429,944	(19,411)	-4.51%
Materials and Supplies	2,840,503	3,050,345	(209,842)	-6.88%
Utilities	631,850	609,997	21,853	3.58%
Telecommunications	992,634	1,494,037	(501,403)	-33.56%
Repairs and Maintenance	119,887	153,809	(33,922)	-22.05%
Rentals and Leases	480,751	224,281	256,470	114.35%
Printing and Reproduction	136,022	188,575	(52,553)	-27.87%
Federal Sponsored Programs Pass-Throughs	177,166	124,361	52,805	42.46%
Depreciation and Amortization	2,433,333	2,739,746	(306,413)	-11.18%
Other Operating Expenses	13,820,047	13,243,780	576,267	4.35%
Total Operating Expenses	**70,582,724**	**69,498,871**	**1,083,853**	**1.56%**
Operating Loss	**(22,008,546)**	**(24,611,935)**	**2,603,389**	**10.58%**
Other Nonoperating Adjustments				
State Appropriations	25,373,154	24,632,742	740,412	3.01%
Gift Contributions for Operations	1,241,487	1,056,482	185,005	17.51%
Net Investment Income	2,155,001	2,384,513	(229,512)	-9.63%
Interest Expense on Capital Asset Financings	(827,754)	(946,206)	118,452	12.52%
Net Other Nonoperating Adjustments	**27,941,888**	**27,127,531**	**814,357**	**3.00%**
Adjusted Income (Loss)	**$5,933,342**	**$2,515,596**	**$3,417,746**	**135.86%**
Adjusted Margin (as a percentage)	**7.67%**	**3.45%**		

UNAUDITED
The University of Texas M. D. Anderson Cancer Center
Comparison of Operating Results and Margin
For the Two Months Ending October 31, 2002

	October Year-to-Date FY 2003	October Year-to-Date FY 2002	Variance of Current Year-to-Date to Prior Year-to-Date	Fluctuation Percentage
Operating Revenues				
Student Tuition and Fees	$16,009	$4,724	$11,285	238.89%
Sponsored Programs	24,617,638	22,801,164	1,816,474	7.97%
Net Sales and Services of Hospitals	142,803,048	122,063,940	20,739,108	16.99%
Net Professional Fees	30,752,573	26,192,615	4,559,958	17.41%
Net Auxiliary Enterprises	2,624,070	2,853,109	(229,039)	-8.03%
Other Operating Revenues	4,595,622	3,588,030	1,007,592	28.08%
Total Operating Revenues	**205,408,960**	**177,503,582**	**27,905,378**	**15.72%**
Operating Expenses				
Salaries and Wages	114,148,372	104,112,901	10,035,471	9.64%
Employee Benefits and Related Costs	32,298,494	28,292,183	4,006,311	14.16%
Professional Fees and Contracted Services	1,843,495	2,145,235	(301,740)	-14.07%
Other Contracted Services	7,477,156	7,592,544	(115,388)	-1.52%
Travel	1,951,208	1,345,058	606,150	45.06%
Materials and Supplies	46,974,325	46,172,880	801,445	1.74%
Utilities	5,001,143	4,645,992	355,151	7.64%
Telecommunications	1,290,873	617,268	673,605	109.13%
Repairs and Maintenance	2,987,854	3,322,556	(334,702)	-10.07%
Rentals and Leases	3,633,732	1,846,936	1,786,796	96.74%
Printing and Reproduction	723,933	458,758	265,175	57.80%
Federal Sponsored Programs Pass-Throughs	(184,849)	522,945	(707,794)	-135.35%
Depreciation and Amortization	11,774,378	11,326,206	448,172	3.96%
Other Operating Expenses	5,136,421	4,956,751	179,670	3.62%
Total Operating Expenses	**235,056,535**	**217,358,213**	**17,698,322**	**8.14%**
Operating Loss	**(29,647,575)**	**(39,854,631)**	**10,207,056**	**25.61%**
Other Nonoperating Adjustments				
State Appropriations	26,107,563	26,600,818	(493,255)	-1.85%
Gift Contributions for Operations	14,972,915	11,999,943	2,972,972	24.77%
Net Investment Income	5,848,886	7,880,931	(2,032,045)	-25.78%
Interest Expense on Capital Asset Financings	(823,416)	(934,604)	111,188	11.90%
Net Other Nonoperating Adjustments	**46,105,948**	**45,547,088**	**558,860**	**1.23%**
Adjusted Income (Loss)	**$16,458,373**	**$5,692,457**	**$10,765,916**	**189.13%**
Adjusted Margin (as a percentage)	**6.52%**	**2.54%**		

UNAUDITED
The University of Texas Health Center at Tyler
Comparison of Operating Results and Margin
For the Two Months Ending October 31, 2002

	October Year-to-Date FY 2003	October Year-to-Date FY 2002	Variance of Current Year-to-Date to Prior Year-to-Date	Fluctuation Percentage
Operating Revenues				
Sponsored Programs	$666,563	$769,449	$(102,886)	-13.37%
Net Sales and Services of Educational Activities	197,752	207,872	(10,120)	-4.87%
Net Sales and Services of Hospitals	9,166,764	7,896,992	1,269,772	16.08%
Net Professional Fees	2,341,704	2,248,153	93,551	4.16%
Net Auxiliary Enterprises	136,495	160,477	(23,982)	-14.94%
Other Operating Revenues	404,202	475,791	(71,589)	-15.05%
Total Operating Revenues	**12,913,480**	**11,758,734**	**1,154,746**	**9.82%**
Operating Expenses				
Salaries and Wages	10,065,402	9,733,477	331,925	3.41%
Employee Benefits and Related Costs	2,471,556	2,237,739	233,817	10.45%
Professional Fees and Contracted Services	772,244	351,888	420,356	119.46%
Other Contracted Services	633,461	319,364	314,097	98.35%
Travel	67,910	78,070	(10,160)	-13.01%
Materials and Supplies	2,557,755	2,302,136	255,619	11.10%
Utilities	350,896	385,485	(34,589)	-8.97%
Telecommunications	108,542	94,902	13,640	14.37%
Repairs and Maintenance	295,340	321,566	(26,226)	-8.16%
Rentals and Leases	361,590	245,324	116,266	47.39%
Printing and Reproduction	166,931	131,092	35,839	27.34%
Federal Sponsored Programs Pass-Throughs	10,043	35,755	(25,712)	-71.91%
Depreciation and Amortization	566,967	667,434	(100,467)	-15.05%
Other Operating Expenses	732,567	804,966	(72,399)	-8.99%
Total Operating Expenses	**19,161,204**	**17,709,198**	**1,452,006**	**8.20%**
Operating Loss	**(6,247,724)**	**(5,950,464)**	**(297,260)**	**-5.00%**
Other Nonoperating Adjustments				
State Appropriations	5,551,988	5,425,804	126,184	2.33%
Gift Contributions for Operations	14,878	22,735	(7,857)	-34.56%
Net Investment Income	477,364	448,859	28,505	6.35%
Interest Expense on Capital Asset Financings	(27,389)	(6,652)	(20,737)	-311.74%
Net Other Nonoperating Adjustments	**6,016,841**	**5,890,746**	**126,095**	**2.14%**
Adjusted Income (Loss)	**$(230,883)**	**$(59,718)**	**$(171,165)**	**-286.62%**
Adjusted Margin (as a percentage)	**-1.22%**	**-0.34%**		