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FOR
MEETING OF THE BOARD

Board Meeting: 7/8/2005
Austin, Texas

11.	**U. T. System: UTIMCO review and discussion of asset allocation for U. T. System endowment funds**	*11:20 a.m.* *Chairman Hunt* *Mr. Boldt*	11
C.	ADJOURN JOINT MEETING AND CONTINUE BOARD OF REGENTS' MEETING	*12:15 p.m.*	
D.	WORKING LUNCH		
12.	**U. T. System Board of Regents: Announcement of a new Task Force**	*12:30 p.m.*	12
13.	**U. T. System: Review of Fiscal Year 2006 Significant Budget Issues affecting the U. T. Institutions**	*12:35 p.m.* **Discussion** *Chancellor Yudof*	12
14.	**U. T. System Board of Regents: Adoption of Regents' *Rules and Regulations*, Series 20204, related to determining and documenting compensation**	*12:50 p.m.* **Action**	12
15.	**U. T. System Board of Regents: Proposed Appointment of Regental Representatives to U. T. Austin Intercollegiate Athletics Council for Men and Intercollegiate Athletics Council for Women Effective September 1, 2005**	*12:55 p.m.* **Action**	16
16.	**U. T. Austin: Request for approval of the reorganization of the John A. and Katherine G. Jackson School of Geosciences**	*1:00 p.m.* **Action** *President Faulkner*	17
17.	**U. T. Dallas: Creation of an Advisory Council for the new Cecil H. and Ida Green Center for Systems Biology Science (Regents' *Rules and Regulations*, Series 60302, regarding advisory councils)**	*1:10 p.m.* **Action** *Dr. Hobson Wildenthal, UTD*	19
18.	**U. T. System: Approval to authorize requirement of criminal background checks of applicants and students of clinical programs and charge necessary fees**	*1:15 p.m.* **Action** *Dr. Shine* *Dr. Sullivan*	20
19.	**U. T. M. D. Anderson Cancer Center: Authorization to extend the term of the leaseback to the U.S. Government Department of Defense of approximately 18 acres of land and improvements located at 1850 and 1902 Old Spanish Trail, Houston, Harris County, Texas (DOD Site); and finding of public purpose**	*1:25 p.m.* **Action** *President Mendelsohn* *Ms. Mayne*	21

E. RECONVENE BOARD OF REGENTS' MEETING TO RECESS TO EXECUTIVE SESSION PURSUANT TO *TEXAS GOVERNMENT CODE*, CHAPTER 551 — *1:30 p.m.*

1. Consultation with Attorney Regarding Legal Matters or Pending and/or Contemplated Litigation or Settlement Offers - Section 551.071

   U. T. Medical Branch - Galveston: Discussion and appropriate action regarding Settlement Agreement and Institutional Compliance Agreement between the Office of Inspector General of the Department of Health and Human Services and The University of Texas Medical Branch at Galveston — *1:35 p.m.* *Mr. Burgdorf*

2. Negotiated Contracts for Prospective Gifts or Donations - Section 551.073

   U. T. M. D. Anderson Cancer Center: Consideration of negotiated contract for prospective gift involving naming opportunity — *1:45 p.m.* *President Mendelsohn*

F. RECONVENE IN OPEN SESSION FOR ACTION ON EXECUTIVE SESSION ITEMS, THEN RECESS TO EXECUTIVE SESSION

3. Personnel Matters Relating to Appointment, Employment, Evaluation, Assignment, Duties, Discipline, or Dismissal of Officers or Employees - Section 551.074

   U. T. System: Consideration of individual personnel matters relating to appointment, employment, evaluation, compensation, assignment, and duties of presidents (academic and health institutions), U. T. System Administration officers (Executive Vice Chancellors and Vice Chancellors), other officers reporting directly to the Board (Chancellor, Counsel and Secretary, and Director of Audits), and U. T. System employees — *1:55 p.m.* *Chancellor Yudof* *Dr. Shine* *Dr. Sullivan*

G. RECONVENE IN OPEN SESSION TO ADJOURN — *5:00 p.m. approximately*

1. **Introduction of UTIMCO Directors**

2. **<u>U. T. System: Discussion and appropriate action regarding Centralization of Operating Funds</u>**

Executive Vice Chancellor Kelley will discuss U. T. System funds using materials attached on Pages 2.1 – 2.11.

RECOMMENDATION

The Chancellor concurs in the recommendation of the Executive Vice Chancellor for Business Affairs that the U. T. System Board of Regents

a. approve the concept of a proposal to centralize the investment of campus cash reserves in the U. T. System Office of Finance and UTIMCO. Asset allocation decisions will rest with the Board of Regents as recommended by the Executive Vice Chancellor for Business Affairs, the U. T. System Office of Finance, and UTIMCO. Campus business officers will no longer be accountable for investment returns on these assets; accountability for the returns will reside with the Executive Vice Chancellor for Business Affairs. A formal policy describing the new process and a proposed asset allocation for the new portfolio will be presented to the Board for review and approval at the August 11, 2005 meeting of the Board.

b. approve a policy that allows the Board to share in the increased investment returns expected from centralization. The sharing would occur only when annual investment returns exceed the Consumer Price Index (CPI) plus 3%, with 90% of those excess returns being retained by the campuses and 10% being retained centrally. Any funds retained centrally would be used exclusively for strategic initiatives that benefit the U. T. institutions and all expenditures from those funds would require approval of the Board of Regents.

BACKGROUND INFORMATION

Currently, each institution business officer is responsible for investing institutional cash reserves selected from four fund options provided by UTIMCO, a money market fund, a short/intermediate term debt fund, a bond index fund, and an equity index fund. Individually, each campus has real liquidity needs and a strong incentive to preserve capital. Investment expertise and philosophy vary from campus to campus and many campuses lack the human resources and cash reserves necessary to develop a comprehensive investment strategy. As a result, U. T. System's overall investment portfolio for cash reserves is inefficient and does not take full advantage of U. T. System's collective investment strength.

If the U. T. System consolidates all campus cash reserves into a single investment pool, liquidity requirements could be dramatically reduced and an investment portfolio would be created with a longer time horizon and increased expected returns. Analogous to the centralized debt program, there is true value that can be added through centralization that is not available in the current environment of delegated investment allocation decision-making. Furthermore, the consolidation of campus cash reserves provides an opportunity to explore the multiple banking relationships throughout the U. T. System and determine if there are ways to increase efficiency and lower costs for these services. To that end, the U. T. System Office of Finance will collaborate with the campuses to review existing banking relationships. Comments and recommendations derived from this review will be presented to the Board in Spring 2006.

The exhibits, attached on Pages 2.6 – 2.11, help illustrate the impact of the centralized investment approach and the revenue sharing proposal. Exhibits A through D compare the actual returns earned by the campuses for each of the last four years to a projected return using a proxy portfolio reflecting a possible centralized asset allocation. Exhibits A through D also show the amount that would be retained centrally if the campuses received 90% of the annual return above the CPI plus 3%. Exhibit E summarizes the four-year results and Exhibit F illustrates the four-year comparative benefit had the U. T. System utilized the proxy portfolio. (Please note that the asset allocation assumptions are merely illustrative of a sample portfolio. A proposed asset allocation will be developed with help from a group of campus business officers, the Office of Finance, and UTIMCO, and then must be reviewed and approved by the Board of Regents.)

The exhibits demonstrate both the increased volatility of a longer term investment strategy and the potential increased returns. For example, in the most recent year the return on campus investments averaged 2.0% and generated $62 million compared to a proxy return of 8.5% which would have generated $261 million. If the revenue sharing proposal were implemented, the U. T. System would have retained $9.6 million while the campuses would still have more than tripled their return, earning $251 million. The second most recent year is even more dramatic with campuses netting an additional $443 million.

However, the data from three and four years ago exemplify the variability of this approach; in those years the actual returns were higher than what the campuses would have earned using the proxy investment portfolio. In other words, the campuses would have earned $83 million less had the centralized approach been implemented during those years. (Please note that campuses often utilize these investment returns to fund recurring operational needs and many have been willing to sacrifice higher returns for lower volatility. Indeed, a longer term investment strategy may make it more difficult, in some years, to manage the funding of campus operations.) Nonetheless, as Exhibit F shows, even with the two challenging years included in this analysis, the overall positive impact of the centralized approach (implemented with the revenue sharing proposal) would have been $548 million for the campuses directly with another $56 million retained by the Board of Regents for strategic initiatives.

UTIMCO
Assets Under Management

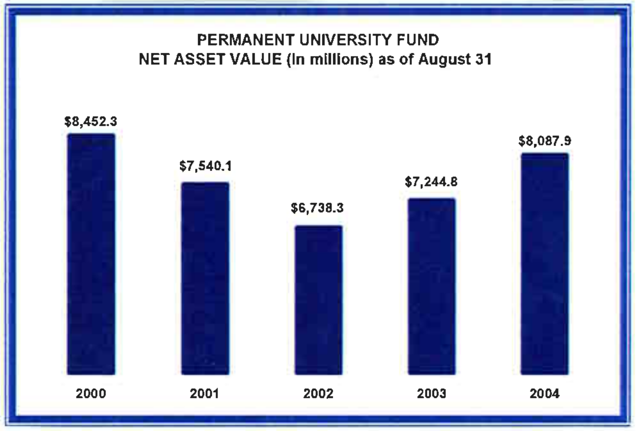
	Endowment Funds				Operating Funds			Total
			U.T. Funds					
	Permanent University Fund (PUF)	Permanent Health Fund (PHF) (1)	Long Term Fund (LTF) (1)	Separately Invested Funds (SIF)	Short Term Funds (STF)	Short Intermediate Term Fund (SITF)	Institutional Index Funds (IIFs)	
		(1) General Endowment Fund (GEF)						
Time Horizon	Long 5-30 years	Long 5-30 years	Long 5-30 years	Short-Long 0-30 years	Short 0-120 days	Short/Inter 1-5 years	Long 5-30 years	
Relative Importance of Objectives								
Liquidity	Low	Low	Low	N/A	High	Moderate	Moderate	
Income	Low	Low	Low	N/A	Low	Moderate	Low	
Safety of Principal	Moderate	Moderate	Moderate	N/A	High	Moderate	Moderate	
Growth of Income	High	High	High	N/A	Low	Moderate	High	
Growth of Principal	High	High	High	N/A	Low	Moderate	High	
Asset Allocation								
Cash equivalents	2%	1%	1%	N/A	100%	15%	0%	
Fixed Income	16%	16%	16%	N/A	0%	85%	0%	
Domestic Public Equities	27%	27%	27%	N/A	0%	0%	100%	
International Public Equities	16%	16%	16%	N/A	0%	0%	0%	
Private Capital	10%	10%	10%	N/A	0%	0%	0%	
Hedge	24%	25%	25%	N/A	0%	0%	0%	
Commodities	5%	5%	5%	N/A	0%	0%	0%	

(1) **As of March 1, 2001 the PHF and LTF are invested in the General Endowment Fund (GEF). GEF serves as the investment pool for the PHF and LTF.**

http://www.utimco.org/funds/AllFunds/assetsundermngt.pdf
Prepared by UTIMCO
July 2005

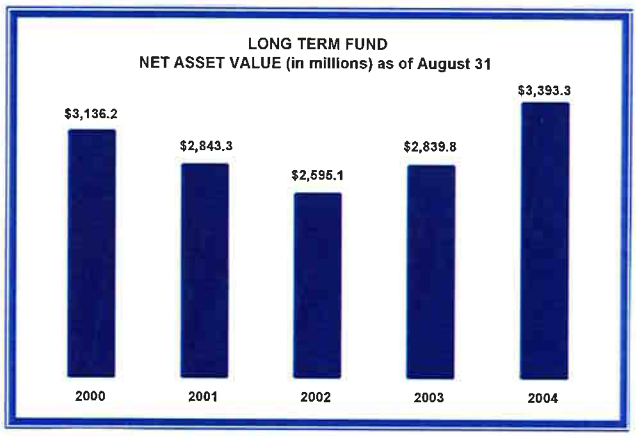
U. T. System Endowment Funds

The bar charts below present a snapshot of the change in value of the U. T. System endowment funds since August 31, 2000. As of May 31, 2005, the value of these funds equaled approximately $13.3 billion.



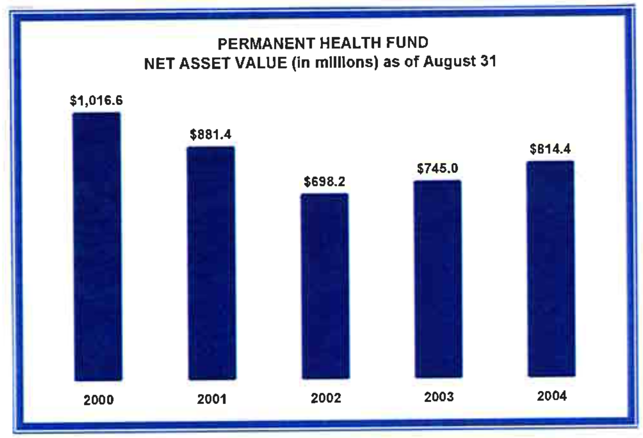
Permanent University Fund

The Permanent University Fund (PUF) is a state endowment fund contributing to the support of 18 institutions and 6 agencies of The University of Texas System and The Texas A&M University System.



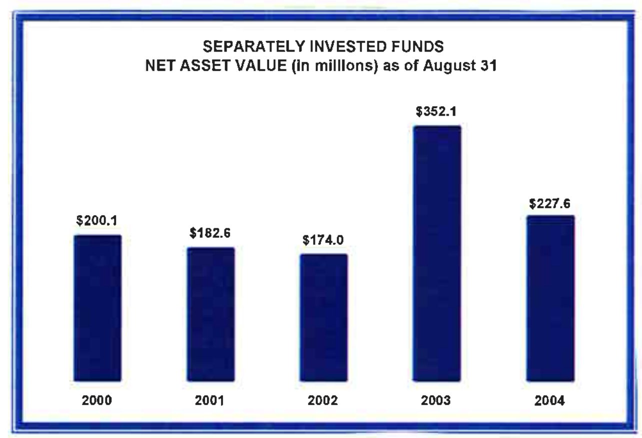
Long Term Fund

The UT System Long Term Fund (LTF) is an internal UT System mutual fund for the pooled investment of over 6,500 privately raised endowments and other long-term funds of the 15 institutions of the UT System. As of March 1, 2001, the LTF purchased units in the newly created General Endowment Fund in exchange for its contribution of investment assets.



Permanent Health Fund

The Permanent Health Fund (PHF) is an internal UT System mutual fund for the pooled investment of state endowment funds for health-related institutions of higher education, created August 30, 1999 with proceeds from state tobacco litigation. As of March 1, 2001, the PHF purchased units in the newly created General Endowment Fund in exchange for its contribution of investment assets.



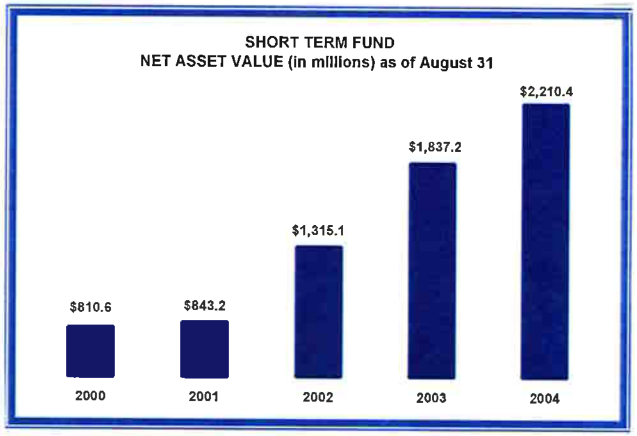
Separately Invested Funds

The UT System Separately Invested Funds (SIFs) consist of over 225 privately raised endowments and charitable trusts where the nature of the underlying asset or donor restrictions preclude investment in the LTF.

http://www.utimco.org/funds/AllFunds/FundsataGlance1.pdf
Prepared by UTIMCO

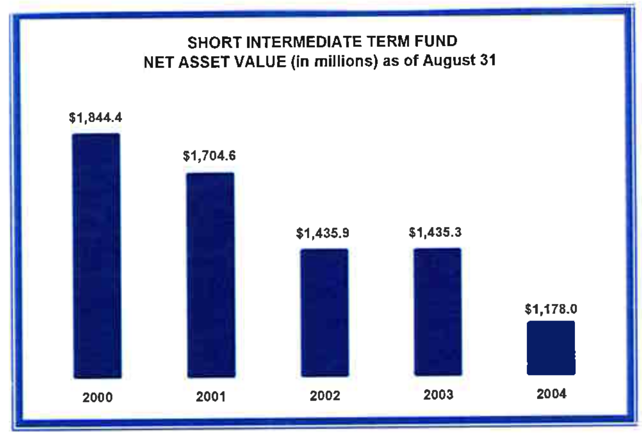
U. T. System Operating Funds

The bar charts below present a snapshot of the change in value of the operating funds since August 31, 2000. As of May 31, 2005, the value of these funds equaled nearly $3.8 billion.



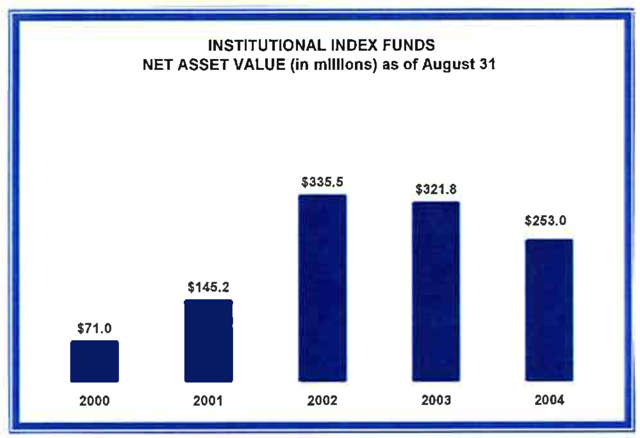
Short Term Fund

The UT System Short Term Fund (STF) is a money market mutual fund consisting of the working capital and other operating fund balances held by UT System institutions with an investment horizon of less than one year.



Short Intermediate Term Fund

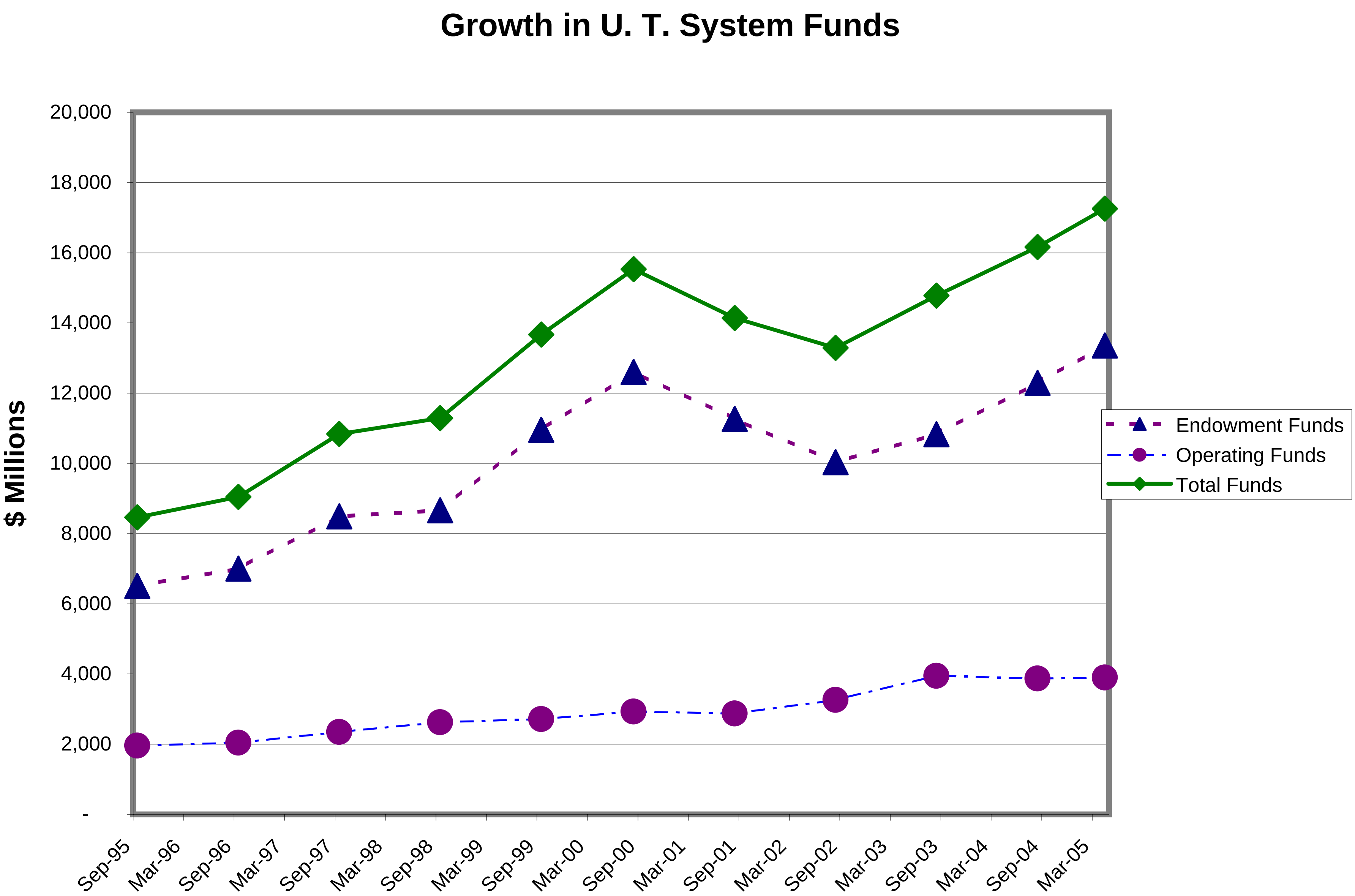
The UT System Short Intermediate Term Fund (SITF) is an internal UT System mutual fund for the pooled investment of the operating funds held by UT System institutions with an investment horizon greater than one year.



Institutional Index Funds

The Institutional Index Funds (IIFs) consist of a U.S. equity index fund and a U.S. debt index fund for the investment of UT System institutions' permanent working capital and long-term capital reserves.

http://www.utimco.org/funds/AllFunds/FundsataGlance1.pdf
Prepared by UTIMCO



Prepared by Office of Finance 6/27/2005

Proposed Centralization of U. T. System Operating Funds
Benefit/Cost Analysis

<u>Assumptions</u>

Operating Funds Allocated between Two Investment Pools:

Short Term Fund:	**15%**
Long Term Reserve Fund:	**85%**

Long Term Reserve Fund -- Proxy Asset Allocation:

Domestic Equities	**20%**
Global Ex-US Equities	**10%**
Absolute Return Hedge Funds	**15%**
Directional Hedge Funds	**10%**
Commodities	**3%**
REITS	**7%**
Traditional Fixed Income	**25%**
TIPS	**10%**
CASH	**0%**
TOTAL FUND	**100%**

HURDLE RATE	**CPI+3%**

BENEFIT SHARING ABOVE HURDLE RATE:	
Institution Share	**90%**
U. T. System Share	**10%**

Proposed Centralization of U. T. System Operating Funds
Benefit/(Cost) Analysis
Exhibit A

Comparison for Individual U. T. System Institutions of
Operating Funds Actual Returns Versus Centralized Proxy Portfolio Returns

Year Ending 2/28/05

	Average Balance	Actual Return		Proxy Return		Benefit of Centralization	Revenue Sharing Threshold	Revenue Split	
Institution	$	%	$	%	$			Institution	System
Arlington	104,137,200	1.5%	1,538,955	8.6%	8,910,637	7,371,683	5,569,173	8,576,491	334,146
Austin	800,202,990	1.5%	11,911,812	8.4%	67,046,570	55,134,758	42,794,207	64,621,334	2,425,236
Brownsville	22,977,230	1.3%	290,090	8.2%	1,894,788	1,604,698	1,228,804	1,828,189	66,598
Dallas	96,429,957	1.3%	1,234,847	8.8%	8,461,711	7,226,864	5,156,996	8,131,239	330,472
El Paso	44,942,505	1.3%	596,699	8.7%	3,895,830	3,299,131	2,403,489	3,746,596	149,234
HC Tyler	25,610,388	1.4%	351,171	8.4%	2,147,574	1,796,403	1,369,623	2,069,779	77,795
HSC Houston	177,749,744	1.3%	2,247,356	8.6%	15,310,439	13,063,082	9,505,912	14,729,986	580,453
HSC San Antonio	158,421,941	1.2%	1,941,644	8.7%	13,835,193	11,893,549	8,472,277	13,298,901	536,292
M.D. Anderson	671,554,268	3.4%	22,721,962	8.5%	56,947,066	34,225,104	35,914,178	54,843,778	2,103,289
MB Galveston	308,543,228	1.4%	4,289,147	8.3%	25,683,880	21,394,733	16,500,642	24,765,556	918,324
Pan Am	58,447,540	1.7%	981,027	8.2%	4,790,740	3,809,712	3,125,727	4,624,238	166,501
Permian Basin	6,121,606	2.4%	147,143	8.6%	526,945	379,802	327,379	506,989	19,957
San Antonio	94,361,650	1.4%	1,315,276	8.8%	8,300,258	6,984,981	5,046,384	7,974,870	325,387
SWMC Dallas	495,207,718	2.6%	13,122,578	8.4%	41,762,421	28,639,843	26,483,307	40,234,509	1,527,911
Tyler	17,689,787	1.6%	275,373	8.9%	1,575,129	1,299,756	946,035	1,512,220	62,909
TOTAL/AVERAGE	**3,082,397,750**	**2.0%**	**62,965,080**	**8.5%**	**261,089,179**	**198,124,099**	**164,844,132**	**251,464,675**	**9,624,505**

Office of Business Affairs
July 2005

Exhibit B

Comparison for Individual U. T. System Institutions of
Operating Funds Actual Returns Versus Centralized Proxy Portfolio Returns

Year Ending 2/28/04									
	Average Balance	**Actual Return**		**Proxy Return**		**Benefit of Centralization**	**Revenue Sharing Threshold**	**Revenue Split**	
Institution	**$**	**%**	**$**	**%**	**$**			**Institution**	**System**
Arlington	86,479,315	1.3%	1,141,208	20.1%	17,380,293	16,239,085	3,533,351	15,995,599	1,384,694
Austin	763,435,372	2.7%	20,374,307	20.0%	152,869,853	132,495,545	31,192,262	140,702,094	12,167,759
Brownsville	19,370,842	1.6%	308,117	19.5%	3,768,013	3,459,896	791,449	3,470,357	297,656
Dallas	72,622,692	2.3%	1,640,475	20.0%	14,546,701	12,906,225	2,967,201	13,388,751	1,157,950
El Paso	37,496,752	1.6%	594,568	19.8%	7,420,337	6,825,769	1,532,033	6,831,507	588,830
HC Tyler	22,086,703	1.6%	358,385	20.6%	4,547,276	4,188,891	902,413	4,182,790	364,486
HSC Houston	177,848,563	1.9%	3,458,416	20.1%	35,669,796	32,211,380	7,266,494	32,829,466	2,840,330
HSC San Antonio	149,951,982	2.4%	3,535,928	20.1%	30,166,083	26,630,155	6,126,703	27,762,145	2,403,938
M.D. Anderson	691,535,135	5.3%	36,374,439	20.1%	139,119,855	102,745,416	28,254,579	128,033,327	11,086,528
MB Galveston	279,040,534	1.4%	4,025,023	20.0%	55,943,250	51,918,227	11,400,972	51,489,023	4,454,228
Pan Am	56,664,694	3.0%	1,691,456	20.1%	11,415,951	9,724,496	2,315,193	10,505,875	910,076
Permian Basin	7,350,066	2.6%	189,614	19.8%	1,456,655	1,267,042	300,307	1,341,021	115,635
San Antonio	73,948,815	1.8%	1,356,626	20.2%	14,918,048	13,561,422	3,021,383	13,728,382	1,189,666
SWMC Dallas	478,118,469	4.9%	23,471,800	20.0%	95,831,308	72,359,508	19,534,851	88,201,662	7,629,646
Tyler	17,104,685	1.1%	190,003	20.2%	3,450,484	3,260,481	698,859	3,175,322	275,162
TOTAL/AVERAGE	**2,933,054,619**	**3.4%**	**98,710,365**	**20.1%**	**588,503,903**	**489,793,538**	**119,838,050**	**541,637,318**	**46,866,585**

Office of Business Affairs
July 2005

Exhibit C

Comparison for Individual U. T. System Institutions of

Operating Funds Actual Returns Versus Centralized Proxy Portfolio Returns

Year Ending 2/28/03

	Average Balance	Actual Return		Proxy Return		Benefit/(Cost) of	Revenue Sharing	Revenue Split	
Institution	**$**	**%**	**$**	**%**	**$**	**Centralization**	**Threshold**	**Institution**	**System**
Arlington	71,831,287	1.9%	1,395,254	0.5%	356,410	(1,038,844)	3,882,425	356,410	-
Austin	668,035,897	4.1%	27,168,264	0.6%	4,071,241	(23,097,023)	36,106,817	4,071,241	-
Brownsville	15,896,383	1.8%	285,378	-0.3%	(51,164)	(336,542)	859,187	(51,164)	-
Dallas	63,638,341	2.5%	1,575,974	0.4%	276,577	(1,299,397)	3,439,602	276,577	-
El Paso	35,632,086	2.1%	761,234	0.1%	52,998	(708,236)	1,925,886	52,998	-
HC Tyler	14,894,522	2.1%	318,421	1.9%	278,302	(40,119)	805,037	278,302	-
HSC Houston	163,861,101	2.4%	3,978,921	0.7%	1,122,124	(2,856,798)	8,856,564	1,122,124	-
HSC San Antonio	136,474,522	2.7%	3,651,582	0.3%	349,056	(3,302,526)	7,376,341	349,056	-
M.D. Anderson	585,836,939	1.1%	6,326,403	1.0%	5,990,127	(336,276)	31,664,028	5,990,127	-
MB Galveston	262,927,141	2.0%	5,286,072	1.6%	4,182,179	(1,103,893)	14,211,006	4,182,179	-
Pan Am	54,671,523	1.8%	965,816	0.9%	508,994	(456,821)	2,954,953	508,994	-
Permian Basin	7,568,553	0.8%	57,401	0.0%	(993)	(58,394)	409,074	(993)	-
San Antonio	68,954,552	2.3%	1,612,590	0.5%	350,384	(1,262,206)	3,726,940	350,384	-
SWMC Dallas	471,752,691	1.1%	5,088,137	0.7%	3,240,546	(1,847,591)	25,497,864	3,240,546	-
Tyler	15,887,285	1.7%	272,434	0.4%	62,295	(210,139)	858,695	62,295	-
TOTAL/AVERAGE	**2,637,862,824**	**2.2%**	**58,743,880**	**0.8%**	**20,789,075**	**(37,954,805)**	**142,574,420**	**20,789,075**	**-**

Office of Business Affairs
July 2005

Exhibit D

Comparison for Individual U. T. System Institutions of

Operating Funds Actual Returns Versus Centralized Proxy Portfolio Returns

Year Ending 2/28/02

	Average Balance	Actual Return		Proxy Return		Benefit/(Cost) of Centralization	Revenue Sharing Threshold	Revenue Split	
Institution	**$**	**%**	**$**	**%**	**$**			**Institution**	**System**
Arlington	59,813,373	4.0%	2,376,560	2.1%	1,263,709	(1,112,851)	2,337,542	1,263,709	-
Austin	560,983,173	4.9%	27,581,265	2.6%	14,365,543	(13,215,722)	21,923,554	14,365,543	-
Brownsville	12,610,349	3.6%	456,496	2.0%	247,692	(208,804)	492,820	247,692	-
Dallas	53,889,585	4.8%	2,588,228	2.5%	1,342,613	(1,245,615)	2,106,037	1,342,613	-
El Paso	36,584,253	4.3%	1,569,247	2.5%	905,142	(664,105)	1,429,734	905,142	-
HC Tyler	13,087,610	3.6%	468,638	2.3%	297,269	(171,369)	511,472	297,269	-
HSC Houston	160,066,160	4.8%	7,603,227	2.5%	3,960,976	(3,642,251)	6,255,480	3,960,976	-
HSC San Antonio	114,883,590	5.1%	5,819,926	2.3%	2,625,421	(3,194,505)	4,489,719	2,625,421	-
M.D. Anderson	596,706,494	4.5%	27,098,959	2.6%	15,719,904	(11,379,055)	23,319,642	15,719,904	-
MB Galveston	245,977,161	4.2%	10,272,171	3.5%	8,597,382	(1,674,789)	9,612,933	8,597,382	-
Pan Am	52,943,216	4.5%	2,384,176	2.8%	1,462,691	(921,485)	2,069,052	1,462,691	-
Permian Basin	6,339,278	3.1%	198,492	2.3%	143,077	(55,415)	247,743	143,077	-
San Antonio	60,711,823	4.3%	2,604,393	2.5%	1,519,187	(1,085,206)	2,372,654	1,519,187	-
SWMC Dallas	461,157,105	3.9%	18,030,978	2.4%	11,264,104	(6,766,874)	18,022,292	11,264,104	-
Tyler	13,146,096	3.7%	488,430	2.4%	314,561	(173,869)	513,757	314,561	-
TOTAL/AVERAGE	**2,448,899,266**	**4.5%**	**109,541,186**	**2.6%**	**64,029,269**	**(45,511,915)**	**95,704,429**	**64,029,269**	**-**

Office of Business Affairs
July 2005

Exhibit E

Four-Year Estimated Impact of Centralized Operating Funds Revenue Split

	03/01/04-02/28/05		03/01/03-02/28/04		03/01/02-02/28/03		03/01/01-02/28/02		Total over 4 Years	
	Institutions	System	Institutions	System	Institutions	System	Institutions	System	Institutions	System
Arlington	8,576,491	334,146	15,995,599	1,384,694	356,410	-	1,263,709	-	**26,192,209**	**1,718,841**
Austin	64,621,334	2,425,236	140,702,094	12,167,759	4,071,241	-	14,365,543	-	**223,760,211**	**14,592,995**
Brownsville	1,828,189	66,598	3,470,357	297,656	(51,164)	-	247,692	-	**5,495,074**	**364,255**
Dallas	8,131,239	330,472	13,388,751	1,157,950	276,577	-	1,342,613	-	**23,139,180**	**1,488,422**
El Paso	3,746,596	149,234	6,831,507	588,830	52,998	-	905,142	-	**11,536,242**	**738,064**
HC Tyler	2,069,779	77,795	4,182,790	364,486	278,302	-	297,269	-	**6,828,139**	**442,281**
HSC Houston	14,729,986	580,453	32,829,466	2,840,330	1,122,124	-	3,960,976	-	**52,642,551**	**3,420,783**
HSC San Antonio	13,298,901	536,292	27,762,145	2,403,938	349,056	-	2,625,421	-	**44,035,523**	**2,940,230**
M.D. Anderson	54,843,778	2,103,289	128,033,327	11,086,528	5,990,127	-	15,719,904	-	**204,587,135**	**13,189,817**
MB Galveston	24,765,556	918,324	51,489,023	4,454,228	4,182,179	-	8,597,382	-	**89,034,139**	**5,372,552**
Pan Am	4,624,238	166,501	10,505,875	910,076	508,994	-	1,462,691	-	**17,101,799**	**1,076,577**
Permian Basin	506,989	19,957	1,341,021	115,635	(993)	-	143,077	-	**1,990,093**	**135,591**
San Antonio	7,974,870	325,387	13,728,382	1,189,666	350,384	-	1,519,187	-	**23,572,823**	**1,515,054**
SWMC Dallas	40,234,509	1,527,911	88,201,662	7,629,646	3,240,546	-	11,264,104	-	**142,940,821**	**9,157,557**
Tyler	1,512,220	62,909	3,175,322	275,162	62,295	-	314,561	-	**5,064,397**	**338,072**
TOTAL	**$ 251,464,675**	**$ 9,624,505**	**$ 541,637,318**	**$ 46,866,585**	**$ 20,789,075**	**$ -**	**$ 64,029,269**	**$ -**	**$ 877,920,337**	**$ 56,491,090**

Office of Business Affairs
July 2005

Summary Benefits of Centralization to Institutions

Exhibit F

Summary Benefit of Centralization -- Four Years Ending 2/28/05					
			Revenue Split		Benefit of Centralization to Institutions
	Actual Return	**Proxy Return**	**Institutions**	**System**	
Arlington	6,451,977	27,911,050	26,192,209	1,718,841	**19,740,232**
Austin	87,035,648	238,353,207	223,760,211	14,592,996	**136,724,563**
Brownsville	1,340,081	5,859,329	5,495,074	364,255	**4,154,993**
Dallas	7,039,524	24,627,601	23,139,180	1,488,421	**16,099,656**
El Paso	3,521,747	12,274,307	11,536,242	738,065	**8,014,495**
HC Tyler	1,496,615	7,270,420	6,828,139	442,281	**5,331,524**
HSC Houston	17,287,921	56,063,334	52,642,551	3,420,783	**35,354,630**
HSC San Antonio	14,949,079	46,975,753	44,035,523	2,940,230	**29,086,444**
M.D. Anderson	92,521,763	217,776,952	204,587,135	13,189,817	**112,065,372**
MB Galveston	23,872,412	94,406,691	89,034,139	5,372,552	**65,161,727**
Pan Am	6,022,475	18,178,376	17,101,799	1,076,577	**11,079,324**
Permian Basin	592,650	2,125,685	1,990,093	135,592	**1,397,443**
San Antonio	6,888,885	25,087,876	23,572,823	1,515,053	**16,683,938**
SWMC Dallas	59,713,492	152,098,378	142,940,821	9,157,557	**83,227,329**
Tyler	1,226,240	5,402,469	5,064,397	338,072	**3,838,157**
TOTAL	**$ 329,960,509**	**$ 934,411,428**	**$ 877,920,336**	**$ 56,491,092**	**$ 547,959,827**

Office of Business Affairs
July 2005

3. U. T. System Board of Regents: Legal and Fiduciary Issues Overview

REPORT

Vice Chancellor and General Counsel Burgdorf and Mr. Chris Brown, Baker Botts LLP, will make a brief presentation concerning the legal issues and fiduciary responsibilities related to funds under the control and management of the U. T. System Board of Regents. Background materials are attached on Pages 3.1 – 3.2.

Fiduciary Duties Regarding Investment Management

Barry Burgdorf
Vice Chancellor and General Counsel

Christopher T. Brown
Baker Botts L.L.P.

July 8, 2005

Board of Regents

- ***Ultimate fiduciary*** **for investment of PUF, endowment, and other funds.**
- ***"Prudent Investor" standard*** **- investments a prudent investor exercising reasonable care would make, taking into account all relevant circumstances and investment of portfolio as a whole.**
- ***Adequate supervision*** **- Board must be satisfied with competence and selection of investment management and personnel, performance, risk levels, absence of conflicts, etc.**

2

UTIMCO Board

- **Directors of non-profit corporation - 501(c)(3)**
  - ***Duty of care***
  - ***Duty of loyalty***
- ***Dedicated focus* on investment policies of Board of Regents**
- ***Adequate supervision* of investment management**

3

Statutes and Contracts

- **Texas Constitution - PUF**
- **Uniform Management of Institutional Funds Act (UMIFA) - endowment funds**
- **UTIMCO Statute - Scope and governance of UTIMCO as agent of Board**
- **Investment Management Services Agreement with UTIMCO - delegated responsibilities, reporting, budget, etc.**
- **Other Contracts - Comptroller, etc.**

4

4. U. T. System: Oversight Resources

REPORT

Chancellor Yudof will provide a brief overview of the investment oversight function at U. T. System Administration. Mr. Philip Aldridge will introduce key internal and external members of the oversight team from U. T. System Administration, Ennis Knupp + Associates, Baker Botts LLP, and Ernst & Young.

5. U. T. System: Investment Policy Goals and Objectives

REPORT

Executive Vice Chancellor Kelley will lead a discussion of investment policy goals and objectives using a PowerPoint attached on Pages 4.1 – 4.3.

The University of Texas System

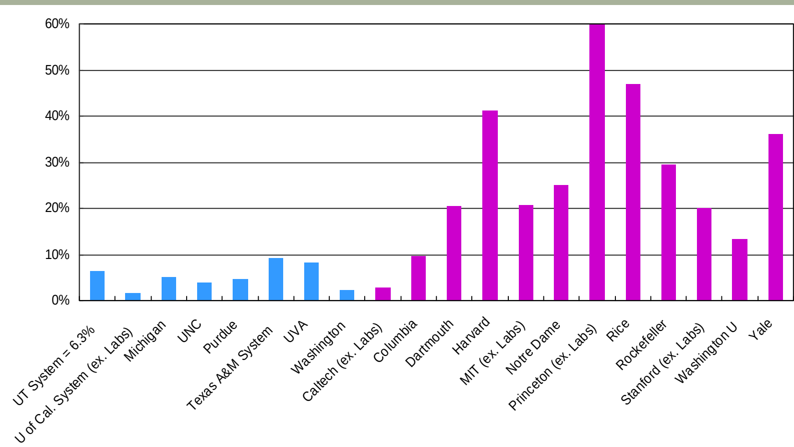
U. T. System Board of Regents

Investment Policy

Goals and Objectives

July 8, 2005

Dependence on Endowment Funds for Operations:
Average Endowment Distributions
as a Percent of Operating Expenditures for AAA/AA+ Peers

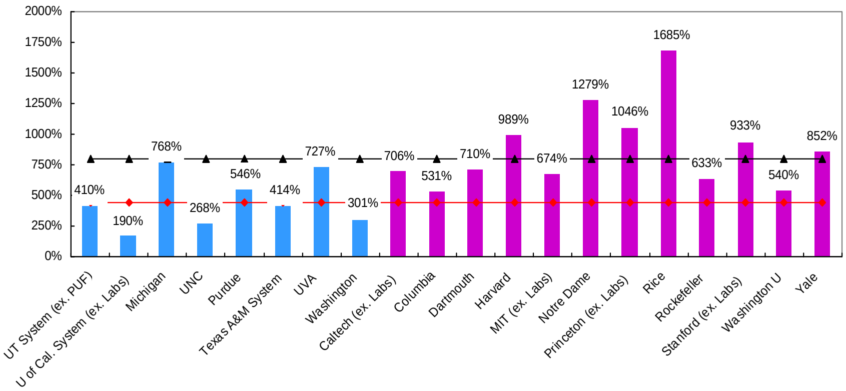


•Calculated as 4.75% of endowment fund balances at 6/30/04 as a percentage of operating expenses in 2004.
•Endowment fund balance data reported by NACUBO as of June 30, 2004.
•Operating expense data for peers provided by Morgan Stanley for 2004.

2

Total Resources to Debt Ratio for AAA/AA+ Peers – Fiscal Year 2004

Total Resources to Debt Ratio = $\frac{\text{Total Net Assets Less Net Investment in Plant}}{\text{Debt Outstanding}}$



Source: Morgan Stanley

PUF and GEF: Investment Policy Objectives

Current Endowment Objectives:

1. **To Preserve Purchasing Power of assets and distributions over rolling ten-year periods or longer**
   - **Earn an average annual REAL return**
   - **At least equal to target distribution rate**
   - **PLUS annual expense rate**

2. **To Earn Competitive Returns, over rolling five-year periods or longer, in excess of:**
   - **Policy Portfolio benchmark**
   - **Median returns of college & university endowments greater than $1 billion**

PUF and GEF: Distribution Policies, MAR

PUF Target Distribution Rate

4.75% + inflation (3%) + Expenses (.35%)

GEF Target Distribution Rate (LTF)

3.5 to 5.5% max

Minimum Acceptable Return (MAR)

8.1%

PUF and GEF: Current Approved Policy Portfolio

Permanent University Fund Investment Policy Statement (continued)

EXHIBIT A

POLICY TARGETS, RANGES AND PERFORMANCE OBJECTIVES

	Percent of Portfolio (%)		
Asset Category	**Policy Targets**	**Policy Ranges**	**Benchmarks**
US Equities:	**25.0**	**15 to 45**	Combination benchmark: 80% Russell 3000 Index plus 20% Wilshire Associates Real Estate Securities Index
Traditional US Equities	20.0	15 to 45	Russell 3000 Index
REITS	5.0	0 to 10	Dow Jones Wilshire Real Estate Securities Index
Global ex US Equities:			MSCI All Country World Index ex US
Non-US Developed Equity	10.0	5 to 15	
Emerging Markets Equity	7.0	0 to 10	
Total Equity	**42.0**	**20 to 60**	
Equity Hedge Funds	10.0	5 to 15	90 Day T-Bills + 4%
Absolute Return Hedge Funds	15.0	10 to 20	90 Day T-Bills + 3%
Total Hedge Funds	**25.0**	**15 to 25**	
Venture Capital	6.0	0 to 10	
Private Equity	9.0	5 to 15	
Total Private Capital	**15.0**	**5 to 15**	Venture Economics' Periodic IRR Index
Commodities	**3.0**	**0 to 5**	GSCI minus 1%
Fixed Income:	**15.0**	**10 to 30**	Combination benchmark: 66.7% Lehman Brothers Aggregate Bond Index plus 33.3% Lehman Brothers US Tips Index
Traditional Fixed Income	10.0	10 to 30	Lehman Brothers Aggregate Bond Index
TIPS	5.0	0 to 10	Lehman Brothers US Tips Index
Cash	**0.0**	**0 to 5**	90 Day T-Bills

Expected Annual Return = 8.36%

Downside Deviation (Risk) = 4.22%

Standard Deviation = 10.3%

6. <u>U. T. System: Consultant's Report on Investment Objectives and Performance</u>

<u>REPORT</u>

Mr. Steve Voss and Mr. Mike Sebastian, Ennis Knupp + Associates, will discuss investment objectives and performance of U. T. System funds following the PowerPoint attached on Pages 5.1 – 5.6.

Discussion on Investment Objectives and Performance

Mr. Steve Voss & Mr. Mike Sebastian
July 8, 2005

Best Practice in Investment Objectives

Objectives should be set to help accomplish the following:

- The endowments should provide for the financial needs of the stakeholders
  - Should be driver of investment policy
- Investment policy should be implemented efficiently and successfully
  - Encourages cost-consciousness and successful active management
- The System should be competitive with other institutions with the endowments as it is in other areas
  - Accomplished by achieving the first two objectives. Peer rankings provide a check on the other objectives.

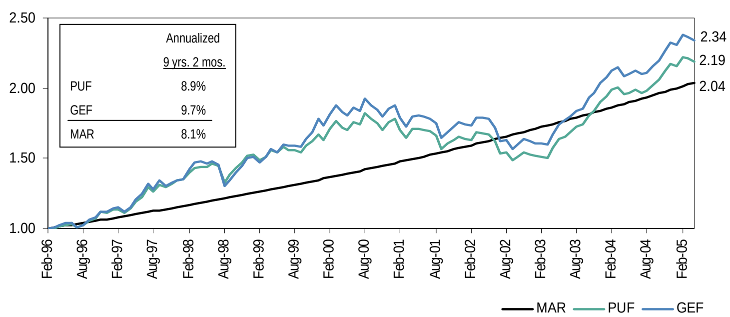
Current Investment Objectives

- "The primary investment objective for each fund [the PUF and the GEF] shall be to preserve the purchasing power of fund assets and annual distributions by earning an average annual real return over rolling ten-year periods or longer at least equal to the target distribution rate of such fund plus the annual expected expense."
- "The secondary fund objective is to generate a fund return in excess of the Policy Portfolio benchmark and the median return of the universe of the college and university endowments with assets greater than $1 billion as reported by Cambridge Associates over rolling five-year periods or longer."

ENNISKNUPP

Performance Relative to Minimum Acceptable Return (8.1%)

Growth of $1
9 Years 2 Months Ending 4/30/2005

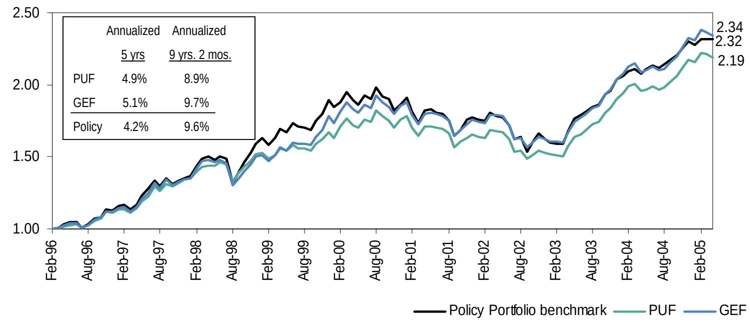


Objective: Preserve the purchasing power of fund assets and annual distributions by earning an average annual real return over rolling ten-year periods or longer at least equal to the target distribution rate of such funds plus the annual expected expense.

ENNISKNUPP

Performance Relative to Policy Portfolio Benchmark

Growth of $1
9 Years 2 Months Ending 4/30/2005

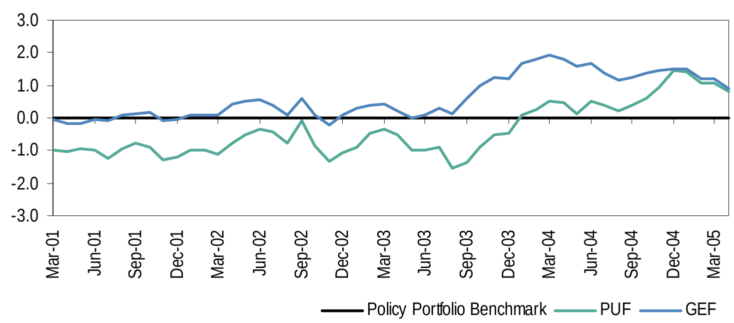


Objective: Generate a fund return in excess of the Policy Portfolio benchmark over rolling five-year periods or longer.

ENNISKNUPP

Relative Performance vs. Policy Portfolio Benchmark - Rolling 5 Year Periods

Rolling 5 Year Periods Ending 4/30/2005

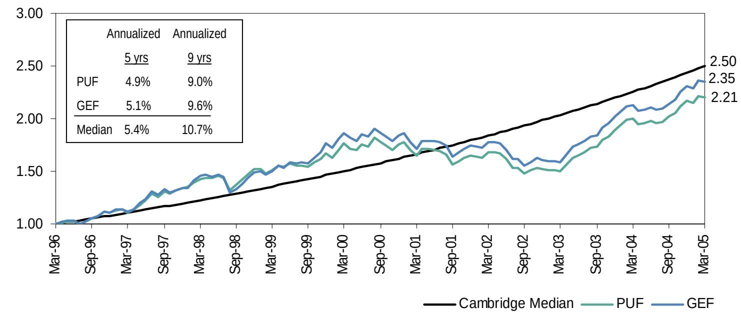


Objective: Generate a fund return in excess of the Policy Portfolio benchmark over rolling five-year periods or longer.

ENNISKNUPP

Performance Relative to Cambridge Median Return for University Endowments > $1 Billion*

Growth of $1
9 Years Ending 3/31/2005



***Objective**: Generate a fund return in excess of the median return of the universe of the college and university endowments with assets greater than $1 billion as reported by Cambridge Associates over rolling five-year periods or longer.*

ENNISKNUPP

* Universe data is available only for quarterly periods; as a result, the first two months of UTIMCO performance have been dropped.

PUF Asset Allocation as of May 31, 2005

	Actual Weight	Policy Weight	Policy Range	In Compliance (Yes/No)
Traditional U.S. Equities	21.6%	20%	15-45%	Yes
REITs	5.3	5	0-10	Yes
U.S. Equity	26.9	25	15-45	Yes
Non-U.S. Developed Equity	14.0	10	5-15	Yes
Emerging Markets Equity	2.4	7	0-10	Yes
Global ex-U.S. Equity	16.4	17	5-25	Yes
Total Traditional Equity	43.3	42	20-60	Yes
Equity Hedge Funds	10.0	10	5-15	Yes
Absolute Return Hedge Funds	14.4	15	10-20	Yes
Total Hedge Funds	24.4	25	15-25	Yes
Venture Capital	1.5	6	0-10	Yes
Private Equity	8.4	9	5-15	Yes
Total Private Capital	9.9	15	5-15	Yes
Commodities	4.7	3	0-5	Yes
Traditional Fixed Income	11.1	10	10-30	Yes
TIPS	4.6	5	0-10	Yes
Total Fixed Income	15.7	15	10-30	Yes
Cash	2.0	--	0-5	Yes
Total Permanent University Fund	100.0%	100%	--	--

ENNISKNUPP

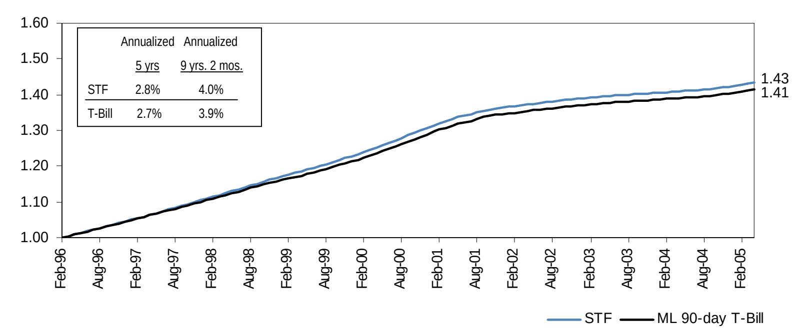
GEF Asset Allocation as of May 31, 2005

	Actual Weight	Policy Weight	Policy Range	In Compliance (Yes/No)
Traditional U.S. Equities	21.2%	20%	15-45%	Yes
REITs	5.2	5	0-10	Yes
U.S. Equity	26.4	25	15-45	Yes
Non-U.S. Developed Equity	14.0	10	5-15	Yes
Emerging Markets Equity	2.7	7	0-10	Yes
Global ex-U.S. Equity	16.7	17	5-25	Yes
Total Traditional Equity	43.1	42	20-60	Yes
Equity Hedge Funds	10.0	10	5-15	Yes
Absolute Return Hedge Funds	14.8	15	10-20	Yes
Total Hedge Funds	24.8	25	15-25	Yes
Venture Capital	2.0	6	0-10	Yes
Private Equity	8.6	9	5-15	Yes
Total Private Capital	10.6	15	5-15	Yes
Commodities	4.8	3	0-5	Yes
Traditional Fixed Income	11.4	10	10-30	Yes
TIPS	4.6	5	0-10	Yes
Total Fixed Income	16.0	15	10-30	Yes
Cash	0.7	--	0-5	Yes
Total Permanent University Fund	100.0%	100%	--	--

ENNISKNUPP

STF Performance Relative to Benchmark

Growth of $1
9 Years 2 Months Ending 4/30/2005

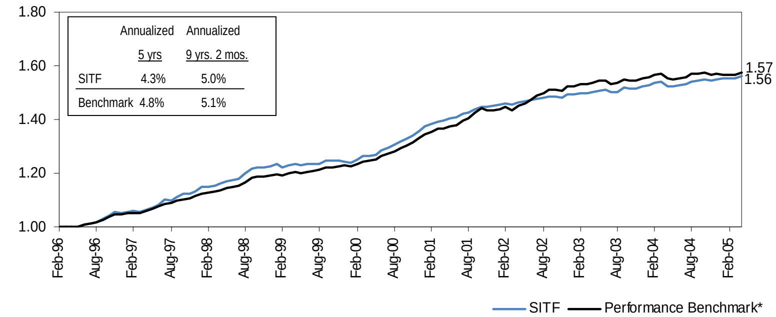


***Objective**: Maximize current income consistent with the absolute preservation of capital and maintenance of adequate STF liquidity. The STF shall seek to maintain a net asset value of $1.00.*

ENNISKNUPP

SITF Performance Relative to Benchmark

Growth of $1
9 Years 2 Months Ending 4/30/2005



***Objective**: A fund return over a market cycle in excess of the U.T. System Short Term Fund ("STF") and the Merrill Lynch 1-3 Year Treasury Index.*

*Returns for this benchmark from inception through July 31, 2004, have been supplied by UTIMCO. The composition of the benchmark is understood as including six government bond components obtained from Bloomberg in a weighted average composite. Beginning August 1, 2004 returns are those of the Merrill Lynch 1-3 Year Treasury Index

Definition of Terms

- **Minimum Acceptable Return (MAR) –** The Minimum Acceptable Return as defined by the University of Texas System Investment Policy Statement is 5.1%. This target was derived by adding the current target distribution rate for the endowment (4.75%) to the annual expected expense (0.35%). 5.1% represents a real return target; this report uses an 8.1% target to account for inflation.

- **Policy Portfolio Benchmark –** Policy Portfolio return data presented in this report prior to the inception of Ennis Knupp + Associates' relationship with The University of Texas System consists of policy returns provided by UTIMCO at the relationship's inception (2003). In January of 2004, UTIMCO restated historical policy returns based on newly approved policy targets. The Policy Portfolio presented in the report does not reflect this restatement.

7. U. T. System: Discussion and appropriate action regarding Investment Performance Reporting including proposed Restatement of Historical Endowment Policy Portfolio Returns and proposed Investment Performance Reporting Error Correction Policy

Executive Vice Chancellor Kelley will present the proposed Restatement of Historical Endowment Policy Portfolio Returns and the proposed Investment Performance Reporting Error Correction Policy using background material set forth on Pages 7.1 – 7.8.

RECOMMENDATION

The Chancellor concurs in the recommendation of the Executive Vice Chancellor for Business Affairs that the Board approve the Restatement of Historical Endowment Policy Portfolio Returns, together with complete and accurate disclosure, in substantially the form set forth on Pages 7.3 – 7.4.

The Chancellor further concurs in the recommendation of the Executive Vice Chancellor for Business Affairs that the Board adopt the Investment Performance Reporting Error Correction Policy, set forth on Pages 7.5 – 7.8, to be an exhibit to Investment Policy Statements for all U. T. System funds managed by UTIMCO.

BACKGROUND INFORMATION

1. Disclosure of the procedures used to restate endowment policy portfolio investment performance prior to January 2004 is provided on Pages 7.3 – 7.4, together with the reasons for the changes and the policy portfolio (benchmark) returns prior to restatement.

   The following footnote appears with published performance results that include presentation of restated historical benchmark performance:

   > Policy Portfolio returns for the PUF and GEF were restated in 2004 to correct two technical errors in benchmark construction and calculation and to replace the private capital asset benchmark in previously reported Policy Portfolio returns. Results were restated for all prior periods beginning June 1993. Complete details of the restatement as well as prior Policy Portfolio returns are available on the web site at www.UTIMCO.org or upon request.

   The link in this footnote on the UTIMCO web site will lead to disclosure describing the details of the restatement, as well as prior Policy Portfolio returns in the form substantially as presented on Pages 7.3 – 7.4. The same disclosure will be provided to anyone requesting the information.

2. The purpose of the Investment Performance Reporting Error Correction Policy ("Error Correction Policy"), set forth on Pages 7.5 – 7.8, is to ensure consistency and accuracy of reported performance data by providing guidance to handle all types of errors in presentation of actual and benchmark investment performance statistics for all U. T. System funds. The policy, derived from guidelines recently published by the CFA Institute [formerly Association of Investment Management Research (AIMR)], was approved by the UTIMCO Board at the Board's June 16, 2005 meeting.

This policy addresses situations where errors in investment performance data (including benchmarks) are discovered and also addresses the process for documenting and correcting errors. It defines situations where investment performance reported by UTIMCO must be retroactively changed; how such restatement should be documented; and when and for whom restated numbers should be republished.

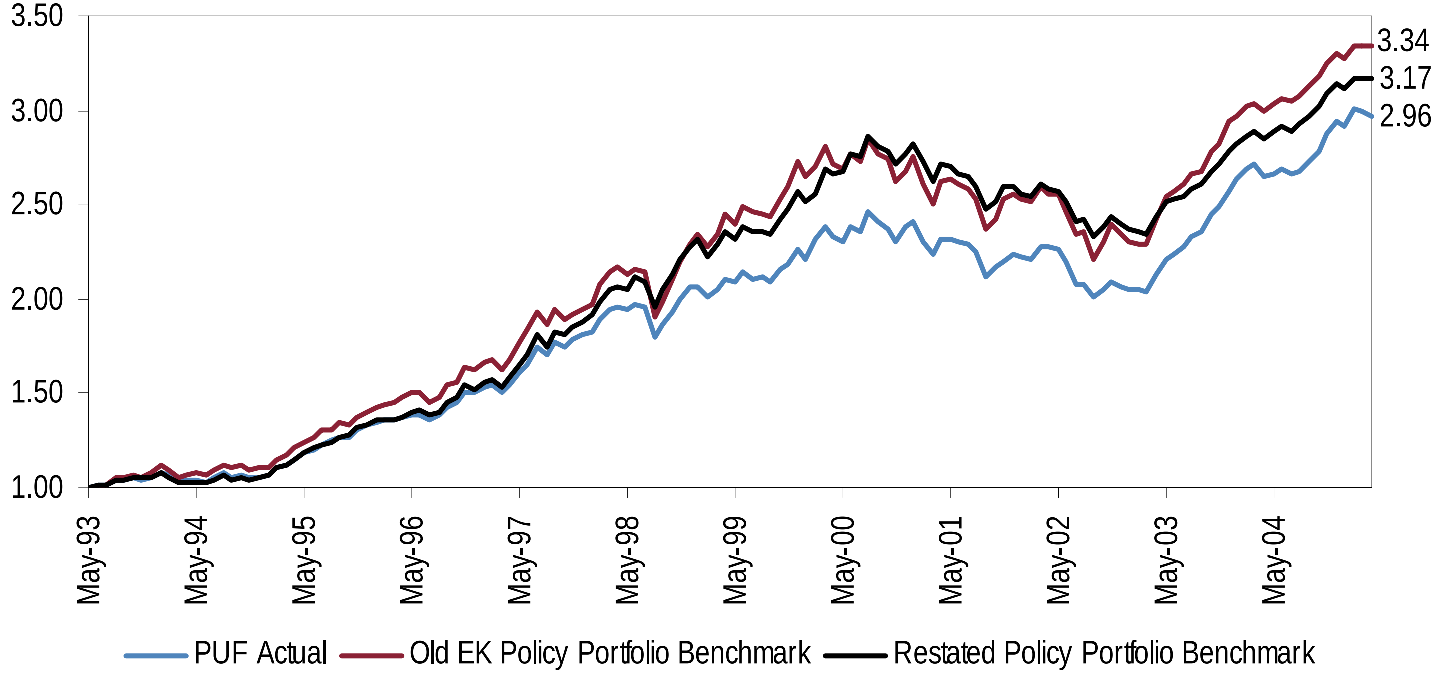
A determination that a chosen externally published benchmark for a given asset class, portfolio, fund, or composite is inappropriate, inconsistent with investment goals and policies, or no longer suitable for any reason (as opposed to misstated, miscalculated, or presented incorrectly) does not constitute an "error" for purposes of this policy. The policy clarifies that the U. T. System Board will make the final determination as to whether or not a proposed restatement and republication should be made in cases where a benchmark is replaced for reasons other than an actual error.

PUF Impact of Restatement:

Actual Performance History versus
Old Policy Benchmark and Restated Policy Benchmark

Growth of $1

11 Years 11 Months Ending 4/30/2005



Prepared by EnnisKnupp + Associates

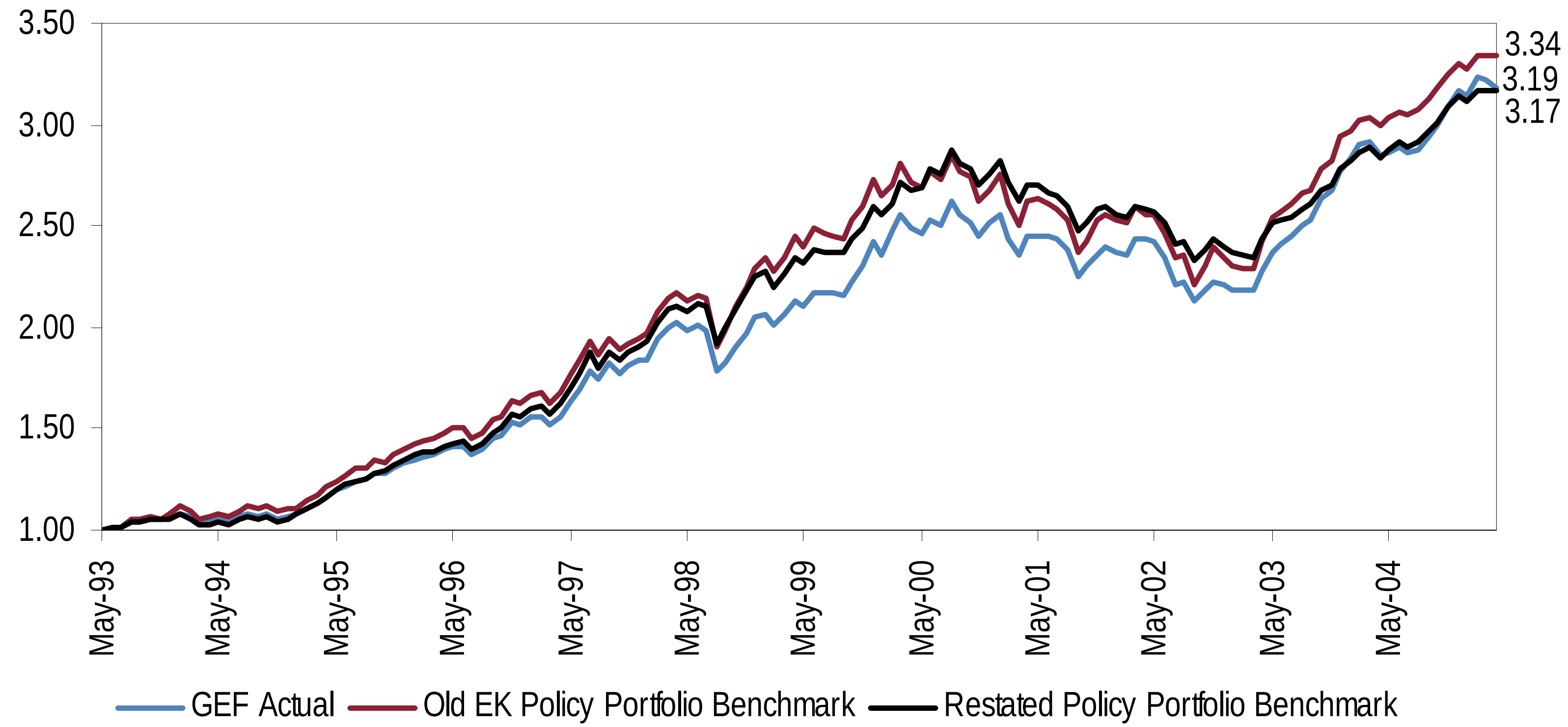
June 2005

GEF Impact of Restatement:

Actual Performance History versus
Old Policy Benchmark and Restated Policy Benchmark

Growth of $1

11 Years 11 Months Ending 4/30/2005



Prepared by EnnisKnupp + Associates

June 2005

UTIMCO Restatement of Historical
Endowment Policy Portfolio Returns:
Investment Performance Reporting Disclosure

The following disclosure will appear as a footnote to published performance results that include presentation of historical benchmarks:
Policy Portfolio returns for the PUF and GEF were restated in 2004 to correct two technical errors in benchmark construction and calculation and to replace the private capital asset benchmark in previously reported Policy Portfolio returns. Results were restated for all prior periods beginning June, 1993. Complete details of the restatement as well as prior Policy Portfolio returns are available on the web site at www.UTIMCO.org or upon request.

A link will be provided on the UTIMCO web site to disclosure in substantially the following form to describe the details of the restatement as well as prior Policy Portfolio returns:

Procedures Used to Restate Prior Policy Portfolio Returns

Policy Portfolio returns for all periods beginning June 1993 were restated in 2004 to correct two technical errors in benchmark construction and calculation and to replace the private capital asset benchmark in previously reported Policy Portfolio returns as follows:

1. UTIMCO began publishing Policy Portfolio returns in 1997. At that time, Policy Portfolio returns for periods prior to 1997 were calculated using the policy asset allocation targets in place in 1997 rather than the actual approved allocations in prior years. In addition, when changes were made in asset allocation targets subsequent to 1997, those changes were implemented immediately in calculating Policy Portfolio returns, despite that fact that the changes might take years to actually implement especially in less liquid asset categories. As a result, prior Policy Portfolio returns did not accurately reflect either the true Asset Allocation Policies in place at each point in time in history or the practical implementation of those Policies. In order to correct these errors, UTIMCO analyzed Board of Regents minutes, UTIMCO Board minutes, and actual quarterly asset statements for the PUF and GEF/LTF for the period 1992 through 2003. Changes in Policy Allocations for liquid asset categories such as public equities and bonds were implemented almost immediately in the LTF/GEF's Policy Portfolio. However, changes in allocations to the LTF/GEF's private equity and hedge funds were phased in on a straight-line basis over time periods that were deemed reasonable to reflect the actual time it would take to implement those changes in the actual endowment portfolios. The PUF was phased-in more closely aligned with actual asset allocation due to the restraints placed on it from the distribution requirements. A senior consultant at Cambridge Associates reviewed the phase in procedures and found them to be reasonable.
2. Since the time it began reporting Policy Portfolio returns in 1997, UTIMCO has reported a single Policy Portfolio return for each time period for comparison to both the PUF and GEF/LTF. However, prior to Texas State Proposition 17 in 1999, the PUF asset allocation was constrained by the necessity to maintain a relatively level annual distribution which could be paid only out of current income. Proposition 17 converted the PUF to a so-called "total return" basis in which distributions could be paid out of either income or principal. The GEF/LTF had paid distributions on a "total return" basis since 1987. In a period of generally declining interest rates over the late 1990's, the PUF was forced into asset allocation positions that differed substantially from stated Investment Policy Targets which were apparently set without consideration of the income requirements (there was no differentiation in Asset Allocation Policy for the PUF and the GEF/LTF) in order to meet income requirements to pay distributions. To correct this error in Policy Portfolio construction, the phase-in process described above was done differently for the PUF Policy Portfolio than for the GEF/LTF Policy Portfolio, resulting in different returns for the two benchmarks. Phase-ins for the PUF were defined to more closely mirror the actual holdings in the PUF since the need to generate current income sometimes precluded a smooth linear phase-in as used in the

case of the GEF/LTF. A senior consultant from Cambridge Associates reviewed the assumptions for both the PUF and GEF/LTF and found them to be appropriate.

3. Like many investors in the private capital asset category, UTIMCO has had difficulty determining an appropriate benchmark for the asset category. Over the 1993 through 2004 time period, UTIMCO has used at various times a flat 17% benchmark, a Wilshire 5000 +4% benchmark, and has recently adopted the Venture Economics Periodic IRR Index to evaluate actual private capital performance. Both the flat 17% benchmark and the Wilshire 5000 + 4% proxy benchmark have serious flaws. An essential trait of any appropriate benchmark is that returns for the benchmark should have a high degree of correlation with the actual returns of the portfolio to which the benchmark is being used as a comparison. As the table below indicates, the flat 17% and Wilshire 5000 + 4% benchmarks fail this essential test, especially over shorter time frames. These correlation measures were calculated from actual data over the 1993 to 2003 time period.

Correlation Coefficients	UTIMCO and Venture Economics	UTIMCO and Wilshire +4%	UTIMCO and 17%
1 Year	0.9229	0.5162	0.0000
3 Years	0.8931	0.8882	0.0291
5 Years	0.9520	0.9710	0.0000

While the Wilshire proxy benchmark might be appropriate for longer term time periods such as 5 to 10 years, it is clearly not appropriate over shorter time periods such as one year. The flat 17% benchmark is not appropriate over any time period. On the other hand, the Venture Economics Index passes this important test over all time periods. Since we know that this Index has been a good benchmark over the ten year period that historical results are provided by the statistics above, the Venture Economics Index has been applied retroactively as the private capital asset category benchmark.

The composite result of the restatements of historical Policy Portfolio returns are indicated in the table below. The table also presents Policy Portfolio returns under the prior methods of calculation.

UTIMCO Performance Summary							
	Periods Ended February 28, 2005 (Returns for Periods Longer Than One Year Are Annualized)						
	One Month	**Three Months**	**Six Months**	**One Year**	**Three Years**	**Five Years**	**Ten Years**
Permanent University Fund	**3.13**	**4.83**	**12.40**	**11.67**	**10.85**	**5.39**	**10.58**
Permanent University Fund Policy Portfolio	**1.69**	**2.65**	**8.36**	**10.62**	**7.60**	**4.35**	**11.12**
General Endowment Fund	**3.13**	**4.79**	**12.54**	**11.72**	**11.11**	**N/A**	**N/A**
Permanent Health Fund	**3.15**	**4.79**	**12.50**	**11.67**	**10.99**	**5.34**	**N/A**
Long Term Fund	**3.15**	**4.80**	**12.51**	**11.67**	**11.03**	**5.45**	**11.25**
General Endowment Fund Policy Portfolio	**1.69**	**2.65**	**8.36**	**10.62**	**7.60**	**3.94**	**11.02**
Policy Portfolio Before Restatement	**1.69**	**2.65**	**8.36**	**10.62**	**9.19**	**3.93**	**11.09**

Revised June 2005
By U. T. System Department of Finance
and UTIMCO

DRAFT
The University of Texas System
Investment Performance Reporting Error Correction Policy

Purpose

The purpose of this Investment Performance Reporting Error Correction Policy ("Error Correction Policy") is to ensure continued consistency and accuracy of reported performance data by providing guidance to handle all types of errors in presentation of investment performance statistics. The performance data subject to this policy are relied upon by UTIMCO directors and advisors, The University of Texas System Board of Regents ("U. T. System Board"), System Administration staff, development officers, donors, legislators, consultants, third party verifiers, auditors, members of the public, and other consumers of investment performance information for funds under the management and control of the U. T. System Board. This Error Correction Policy addresses situations where errors are discovered and the process for documenting and correcting errors.

Scope

This policy applies to all types of errors in presentation of actual and benchmark investment performance reporting for fund portfolios (endowment and operating), asset classes, and third party investment manager portfolios. It defines:

1. Situations in which investment performance data (including benchmarks) reported by UTIMCO must be retroactively changed;
2. How such restatement should be documented; and
3. When and for whom restated numbers should be republished.

A determination that a chosen externally published benchmark for a given asset class, portfolio, fund, or composite in the investment performance presentation is inappropriate, inconsistent with investment goals and policies, or no longer suitable for any reason, as opposed to misstated, miscalculated, or presented incorrectly, does not constitute an "error" for purposes of this policy. The U. T. System Board will make the final determination as to whether or not a proposed restatement and republication should be made in cases where a benchmark is replaced for reasons other than an actual error.

Types of Errors in Presentation of Investment Performance Data

Presentation errors that must be corrected and that could result in restatement and republication of investment performance data include, but are not limited to, the following types:

- Reconciliation errors
- Calculation errors
- Valuation errors
- Benchmark reporting presentation errors
- Other types of errors.

Reconciliation errors (differences) between UTIMCO's records and raw data from an outside source, such as a third party investment manager or custodian, can result in an erroneous calculation of a rate of return and/or risk statistics. Errors can be caused by, but are not limited to:

- Missed trades, processed against the wrong account or not correctly registered on one or more systems.
- Mishandling of corporate actions, missed completely or simply not processed correctly.
- Missed cash flows.
- Differences in carrying values for securities that aren't actively traded or for which manual prices are entered.
- Exchange rate discrepancies.

Calculation errors are defined as inaccuracies in numerical calculations resulting from a mathematical, accounting, statistical, or software error.

Valuation errors can result from pricing problems for securities that are not actively traded or for which market prices are not available.

Benchmark reporting presentation errors may result when index returns (customized or externally published) are weighted incorrectly for policy portfolios.

Other types of errors in presentation of investment performance statistics include, but are not limited to, incorrect allocation of portfolios to composites/funds, misstated composite dispersion, or other disclosures and/or presentation statistics.

<u>Definitions</u>

Restatement shall be defined as the correction of data presented in monthly and/or quarterly investment performance reports, accompanied by a detailed footnote explaining the date, the reasons for, and the impact of the change.

Republishing is defined as making best efforts to redistribute corrected data to parties who may have relied upon the incorrect information, including but not limited to UTIMCO directors and advisors, U. T. System Board and staff, development officers, donors, legislators, consultants, third party verifiers, auditors, and members of the public. A disclosure, including the date, reasons for, and impact of the change, must be provided to attempt to ensure that relevant parties fully understand the change.

Risk statistics include, but are not limited to, standard deviation of returns and downside risk measures for asset classes, portfolios, and/or funds.

Materiality: Materiality in terms of the size and impact of an error will vary for different asset types (e.g., equities, fixed income, emerging markets), reporting periods (e.g., monthly, quarterly, or annual returns), and qualitative circumstances. Assessing materiality of an error in performance measurement requires that management, their custodians, consultants, independent verifiers, and auditors consider not only the size of the misstatement but also the qualitative significance of the information to the investment performance report taken as a whole. Situations may arise where a reasonable person would conclude that a matter is material even though it is quantitatively small relative to the financial statements or investment performance reporting taken as a whole. Examples of considerations that may make a relatively “small” investment performance reporting error material include but are not limited to the following:

- If the error arises from an estimate, what degree of imprecision is inherent in the estimate?
- Does the misstatement hide a failure to meet goals or expectations for the enterprise?
- Does the misstatement mask a change in earnings or other trends?
- Does the error change a loss into income, or vice versa?
- Does the error concern a component, fund, asset class, or other portion of the business that has been identified as playing a significant role in operations?
- Does the error affect compliance with investment policy statements, regulatory or other contractual requirements?
- Does the error have the effect of increasing management compensation – e.g., by satisfying requirements for the award of bonuses or other forms of incentive compensation?
- Does the error involve concealment of an unlawful transaction?

Aggregating and Netting Errors: In determining whether multiple errors cause the investment performance to be materially misstated, errors should be evaluated both individually and in the aggregate in light of quantitative and qualitative factors to judge whether they materially misstate the investment performance overall.

The Error Correction Process

The Error Correction Process strives to provide simple, unambiguous steps to correct and document errors, and to disseminate the corrected information to all interested parties. The process includes the following steps:

1. ***Report the error immediately to the UTIMCO Chief Compliance Officer***, together with the calculation of its impact.

2. ***Determine if the error is material:*** The Chief Compliance Officer will be responsible to recalculate the investment performance presentation and risk statistics to estimate the impact of the error and to gather all relevant facts and circumstances that could influence the determination of materiality.

3. ***Document the original figure, corrected figure, and action taken.*** UTIMCO staff must disclose the date, the reasons for, and the impact of any change to attempt to ensure that relevant parties who may have relied on the investment performance reporting fully understand it. Potentially relevant parties who require disclosure of corrected performance data include but are not limited to UTIMCO directors and advisors, U. T. System Board and staff, development officers, donors, legislators, consultants, third party verifiers, auditors, and members of the public.

4. ***Restate and republish the affected data.*** When an error, as defined above, is discovered in the presentation of Actual Investment Performance Data and/or Benchmark Investment Performance Data for an individual portfolio, an asset class, or at the total fund level, the data

will be restated and republished immediately to all parties who may have relied upon the incorrect information, unless all three of the following circumstances apply:

a. A correction will have little or no impact on previously reported numbers because the error is calculated to be "immaterial" based on both quantitative measures and qualitative facts and circumstances as described above; and
b. The error will be captured and corrected in an immediately subsequent reporting period; and
c. Risk statistics derived from investment performance returns will not be materially impacted.

5. ***Benchmark Change:*** In the event of a benchmark change, if a custom benchmark or combination of multiple benchmarks is used, staff must also provide written disclosure to all relevant parties, describing the benchmark creation and re-balancing process.

8. U. T. System: UTIMCO Cost Study

REPORT

Mr. Matt Lincoln, Cambridge Associates, will present a study of the cost efficiency of the investment services that UTIMCO provides to the U. T. System as outlined in a memo attached on Pages 8.1 – 8.9.

C | A

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M E M O R A N D U M

TO: Board of Regents
University of Texas System

FROM: Matthew D. Lincoln
Shannon J. Thomas

DATE: May 5, 2005

RE: UTIMCO Cost Study

Executive Summary

Cambridge Associates conducted a study of the cost efficiency of the investment services that UTIMCO provides to the University of Texas System. The costs of investment services were evaluated in total and in two sub-categories: investment oversight expenses and asset management costs. Investment oversight expenses included costs of internal investment supervision (e.g. internal staff costs related to investment policy development and monitoring, selection and monitoring of investment managers, etc.), external investment supervision (e.g. external consulting fees, performance reporting fees, etc.), custody, legal, and accounting/audit fees. Asset management costs included both external manager fees and, where available, the asset management costs of internally-managed assets.

The study compared UTIMCO's investment costs with those reported by a peer group of 16 universities with investment assets ranging from $986 million to $59 billion. Oversight costs were reported directly by the survey participants for the fiscal year ending June 30, 2004. External asset management fees for the peer group were estimated based on FY 2004 asset allocation and normative asset class management fees for institutional investors. Of the participants in the study, eight were private institutions and eight were public institutions. The study's methodology is discussed in detail below.

The results of our study indicate that the costs of investment services (including both oversight and asset management and stated as a percent of assets) provided by UTIMCO to the University of Texas System are below the peer group median.

Highlights of the study's results are as follows:

- UTIMCO's total investment costs (including both oversight and asset management), measured as a percent of total investment assets, were 23% below the median of the full peer group, 13% below the median of the public university sub-group and 31% below the median for the private university sub-group.

- UTIMCO's total oversight costs, measured as a percent of total assets, were 8% below the median of the peer group as a whole and 25% below the median for the public university sub-group and 8% below the private university sub-group median.

- UTIMCO's total external asset management fees, measured as a percent of externally-managed assets, were equal to the median of the full peer group, 18% above the median fee of the public university sub-group, and 25% below the median of the private university sub-group.

The following memorandum describes the study's methodology and findings in more detail.

I. STUDY METHODOLOGY

We divided our analysis of UTIMCO's costs into two parts: investment oversight costs and asset management costs. In both cases, we compared UTIMCO's costs with those of a peer group of sixteen university investment offices. The final step was to compare UTIMCO's total investment costs, combining oversight and asset management costs, with the total investment costs of the peer group. The study's methodology is discussed below.

Investment Oversight Cost Analysis

The analysis of investment oversight costs compared UTIMCO's costs with those of a peer group of sixteen universities with investment assets ranging from $986 million to $59 billion. The peer group, listed below, included eight public universities and eight private universities. Market values of the investment assets supervised by the investment offices of each institution are shown in the table below, as of June 30, 2004.

Table 1

Private Institutions	**Assets ($millions)**	**Public Institutions**	**Assets ($millions)**
Chicago, University of	4,443	California, University of	58,541
Duke University	5,367	Illinois and Foundation, University of	1,731
Emory University	6,645	Michigan, University of	6,201
Massachusetts Institute of Technology	9,332	Minnesota, University of	986
Northwestern University	4,272	Pennsylvania State University	2,248
Pennsylvania, University of	4,556	Pittsburgh, University of	1,827
Stanford University	9,970	University of North Carolina at Chapel Hill	1,444
Washington University (St. Louis)	4,807	Washington, University of	1,888

Investment oversight cost data was collected from each institution by a research team within Cambridge Associates, which specializes in conducting surveys of this type. The survey form is designed to capture all costs, except for external asset management fees, related to the oversight and management of all investment assets for which the investment office has responsibility. The survey collected cost data for four groups of activities: investment supervision costs, custody fees, legal expenses and accounting/auditing expenses. In addition, the survey requested that respondents report any costs not included in these categories and report a comprehensive total oversight cost. The survey requested respondents to include expenses paid through soft-dollar payments as well as those paid directly. Our research staff reviewed responses and followed up with survey participants to clarify any apparent discrepancies.

Although our research team has attempted to collect data in as comprehensive, accurate and uniform way as possible, certain discrepancies and inaccuracies may exist in the data. Every institution accounts for its costs somewhat differently. In particular, the methodology used to allocate costs among different activities varies from one university to another. In addition, certain functions such as accounting/auditing and legal may be provided by a different department within the university and the method used to allocate these costs to the investment office may vary from one university to another. However, approximately 90% of oversight costs are derived from investment supervision and custody activities. These costs are generally easily identifiable.

The final step of this part of the analysis was to compare UTIMCO's investment oversight costs with those of the peer group. In each case, oversight costs were stated as a percent of total investment assets supervised by each institution's investment office as of June 30, 2004, with those of the peer group.

Asset Management Fee Analysis

The methodology for comparing external asset management fee costs was less direct. Unfortunately, university investment offices generally do not routinely account for investment manager fees in a comprehensive or uniform way. This is the case, in part, because some fees are paid to managers directly while others are deducted from managed accounts, mutual funds or partnership net asset values on a daily, monthly or quarterly basis. In addition, some manager fee structures include a portion of investment gains, often referred to as an incentive fee or a "carried interest". Accounting for incentive fee costs is extremely complex as they are often subject to earning a specified return, or "hurdle rate," and may be subject to "claw-back" provisions if at a later date it becomes clear that the hurdle rate or some other condition has not been satisfied. For these reasons, it would be very time consuming and costly to collect accurate, comprehensive manager fee data from a significant peer group of large university investment offices.

As it was impractical to collect actual external management fee data for this study, we estimated external manager fees for our peer group institutions based on reported asset allocation for FY 2004 and normative institutional asset class manager fees. The asset class management fee assumptions, expressed as a percent of managed assets, used in this analysis are summarized below in Table 2.

Table 2

Asset Class	**Management Fee Assumption (%)**
Domestic Equity	0.43
Global Equity	0.45
Fixed Income	0.21
Cash	0.10
Real Estate	1.90
Hedge Funds	1.15
Oil and Gas	1.75
Timber	1.25
Commodities	0.45
Venture Capital and Private Equity	2.64

These asset class fee assumptions were initially derived from a report (dated December 14, 2004) prepared for the University of Texas System by Ennis Knupp + Associates, entitled “UTIMCO Expenses”. Ennis Knupp based its estimates on third-party sources and their internal client data. We conducted an independent review of Ennis Knupp’s estimates and made the following adjustments. Ennis Knupp based its Venture/Private Equity fee on committed capital rather than actual invested capital, whereas our estimation process is based only on actual investment amounts. As committed capital generally exceeds invested capital by approximately 30%, we increased Ennis Knupp’s Venture/Private Equity fee assumption by 30%, from 2.03% to 2.64%. Ennis Knupp based its estimate of Hedge Fund fees of 1.5% on an external database of over 4,000 hedge funds. Hedge fund fees have increased significantly over the past few years. Our internal review concluded that institutional investors with established Hedge Fund allocations generally had lower average fees, primarily because they initiated investments before the recent fee increases. Based on these factors, we reduced the Hedge Fund fee assumption from 1.5% to 1.15%. Finally, we developed fee assumptions for Cash, Real Estate, Energy and Commodities based on our own manager research and databases.

Our analysis of external management fees for Hedge Fund, Venture Capital/Private Equity and Energy asset classes intentionally excluded consideration of “carried interest” or incentive compensation for both UTIMCO and the peer group. UTIMCO, like most institutions, invests in Hedge Funds and Venture/Private Equity funds primarily through limited partnerships in which all investors pay the same fee. The purpose of this study is to determine if the management fees paid by UTIMCO are cost-competitive relative to fees paid by other, similar institutions. Presumably, UTIMCO would want its asset management fees to be lower than those of the peer group. However, the opposite is the case for incentive fees. For every dollar of incentive fee paid, investors generally realize between $2.33 and $4.00 of investment gains. The size of incentive fees increase only when gains increase. Hence, *UTIMCO would want to pay higher incentive fees than the peer group as that would mean it was invested in partnerships that were earning higher net investment returns*. Including Hedge Fund, Venture/Private Equity and Energy partnership incentive fees in this analysis would not be consistent with the purpose of the study.

As distinct from private partnerships, separately-managed stock and bond accounts generally charge “asset-based” management fees calculated as a percent of the market value of account assets. UTIMCO has chosen to structure its fee arrangements with certain stock and bond managers as a combination of a lower asset-based fee and an incentive fee payable if the account’s performance exceeds a specified benchmark. Such fee structures serve to better align the interests of the manager with those of UTIMCO, but may result in higher fees than would be due under a pure asset-based fee structure if the account’s returns exceed the benchmark. In this case, it is not clear that paying higher incentive fees means that UTIMCO is earning a higher net return. A traditional asset-based fee structure would generally result in a higher fee when the manager underperformed its benchmark, but a lower fee when the manager produced returns exceeding its performance objective. Because of this lack of clarity, our analysis has included incentive fees for all asset classes except Hedge Funds, Venture/Private Equity and Energy.

As a test of our external management fee methodology, we compared estimated fees based on the asset class fee assumptions listed above with the actual fees paid by four institutional funds for which we have accurate external management fee data. The results of this comparison indicated that our external management fee estimation methodology provided a reasonable estimate of the actual average fees incurred by the test group.

While our analysis relied on estimated external asset management fees for the peer group, it used actual external asset management fee data for UTIMCO, as reported by UTIMCO for the 2003-04 fiscal year[1], the most recent period for which comprehensive fee data was available. The total dollar amount of fees paid, excluding Hedge Fund and Venture/Private Equity incentive fees, was stated as a percent of the average market value of externally-managed assets as of June 30, 2003 and June 30, 2004.[2] UTIMCO's external asset management fee was then compared with the estimated fees of the peer group, also stated as a percent of externally-managed assets (excluding Hedge Fund and Venture/Private equity incentive fees).

Our study also considered the management costs of internally-managed assets. We requested the size of internally managed assets and related management costs as part of our survey of public universities. As discussed below, only four of the eight public institutions reported that they manage assets internally and only one of these was able to allocate the specific costs of internal asset management. In the case of the other three institutions, we believe the costs of internal asset management were included in their oversight costs. Internal asset management costs were included in the calculation of total investment costs for UTIMCO and the peer group institutions.

Total Investment Cost Comparison

The final step of our analysis was to combine investment oversight expenses with external asset management fees and, where applicable, allocated internal asset management costs. This total represents an all-inclusive investment cost for each university. This analysis combined the actual dollar amount of oversight costs reported by each institution with the dollar amount of asset management fees based on estimated fees and reported asset values as of June 30, 2004. In order to make asset management fee amounts comparable, we multiplied UTIMCO's asset management fee (stated as a percent of assets) times the market value of its externally-managed assets as of June 30, 2004.

II. STUDY RESULTS

As noted, the study analyzed investment oversight costs, asset management fees and then total investment costs. The results are discussed below.

Investment Oversight Costs

Table 3 below summarizes UTIMCO's total investment oversight costs and costs within each of five activity groups with the median cost for the full peer group of sixteen universities and the medians for the sub-groups of eight public universities and eight private universities. In each case, costs are stated as basis points (hundredths of one percent) of total investment assets supervised by each university's investment office.

[1] Management fees were for the 2004 fiscal year except for the management fees for oil and gas and venture capital/private equity which were for calendar year 2003. Oil and gas and venture/private equity fees for calendar year 2004 are not yet available.
[2] The average market value for calendar year 2003 was used for oil and gas and venture capital/private equity.

Table 3

	Investment Supervision		Custody		Legal	Accounting/ Audit	Total
	Internal Costs	External Costs	As % of Custody Assets	As % of Total Assets			
UTIMCO	***4.68***	***0.97***	***1.62***	***0.69***	***0.33***	***0.31***	***6.97***
Median - Universe	5.29	1.06	2.73	1.64	0.26	0.43	7.60
Median - Private	5.35	0.53	1.57	1.25	0.26	0.30	7.56
Median - Public	4.74	1.20	3.52	2.07	0.25	0.53	9.28

As the table indicates, UTIMCO's total oversight costs of 6.97 basis points (or 0.0697% of total investment assets) are 8% lower than the 7.60 basis point median cost of the full peer group. UTIMCO's total costs are also below the total cost medians of both the private and public university sub-groups. Further, UTIMCO's costs are below the full peer group median in four of the five activity areas. In the single largest activity category, Investment Supervision, UTIMCO's combined internal and external costs of 5.65 basis points were 11% below the peer group's 6.35 basis point median. UTIMCO's costs exceeded the peer group median in the Legal cost category.

Internal Investment Supervision costs are primarily internal staff costs related to establishing and monitoring investment policies and hiring and monitoring managers. External Investment Supervision costs are primarily investment consulting and performance measurement fees. Custody costs are reported both as a percent of assets actually held by the custodian and as a percent of total assets. Legal and accounting/audit expenses combine both internal and external costs and are reported as a percent of total assets.

This data indicates that the total costs of UTIMCO's oversight services, measured as a percent of assets, are lower than the peer group median.

Asset Management Fees

External asset management fees vary widely depending on an institution's asset allocation strategy. Although large institutions can realize economies of scale in the management of publicly-traded stocks and bonds, it is much more difficult to realize meaningful economies of scale in alternative asset classes such as private equity, hedge funds, private real estate, etc. In these asset classes, institutional investors generally invest through partnership vehicles in which all investors pay the same fee. It is simply a fact that a fund's investment management fees increase as its allocation to alternative asset classes increases.

Table 4 below compares UTIMCO's total asset allocation with the median total asset allocation for the peer group as a whole, and with the medians for the public and private university sub-groups as of June 30, 2004.

Table 4

Asset Allocation for Total Assets

	***UTIMCO* (%)**	**Median -Universe (%)**	**Median –Private (%)**	**Median –Public (%)**
U.S. Equity	***22.5***	25.2	26.6	22.9
Global Equity	***15.8***	14.1	15.9	11.4
Bonds	***16.1***	25.1	14.0	38.7
Cash	***15.9***	4.3	4.3	3.8
Real Estate	***4.3***	3.0	4.4	2.7
Hedge Funds	***15.4***	13.1	14.4	9.5
Oil & Gas	***0.1***	1.2	1.3	0.8
Timber	***0.0***	0.0	0.0	0.0
Commodities	***2.4***	0.0	0.0	0.0
VC/PE	***7.5***	6.9	9.2	5.9
Other	***0.0***	0.4	2.2	0.0

As illustrated below in Table 4a, based on externally-managed assets only, UTIMCO's total allocation to alternative assets (i.e. real estate, hedge funds, oil and gas, timber, venture capital, private equity, and commodities) is 8% larger than that of the full peer group median, 3% above that of the private university median and 13% above that of the public university median. As alternative asset management fees are substantially higher than the fees for the management of publicly-traded securities, one should expect UTIMCO's external management fees to be higher than the full peer group median, close to those of the private university median and higher than those of the public university sub-group.

Table 4a

Asset Allocation for Externally-Managed Assets

	***UTIMCO* (%)**	**Median -Universe (%)**	**Median –Private (%)**	**Median –Public (%)**
U.S. Equity	***22.6***	27.7	30.3	23.1
Global Equity	***17.4***	15.7	18.4	12.3
Bonds	***7.1***	23.4	12.1	29.6
Cash	***19.9***	2.5	3.7	1.5
Real Estate	***0.0***	2.8	2.8	2.7
Hedge Funds	***21.2***	13.9	16.6	10.6
Oil & Gas	***0.1***	1.0	0.9	1.0
Timber	***0.0***	0.0	0.0	0.0
Commodities	***1.7***	0.0	0.0	0.0
VC/PE	***10.1***	7.1	9.5	6.0

As Table 5 indicates, UTIMCO's aggregate external management fees, stated as a percent of externally-managed assets, were equal to the median estimated fees for the full peer group, 25% below the private university median and 18% above the public university median. This data indicates that UTIMCO's external management fees are competitive with those of the peer group, especially when the differences in allocations to high-cost alternative assets are taken into account.

Table 5

	UTIMCO	**Full Universe**	**Private Universities**	**Public Universities**
External Management Fees (%)	***0. 69***	0.69	0.92	0.58

We also compared UTIMCO's external management fees by asset class, stated as a percent of assets managed, to the asset class fee assumptions reflecting industry norms for institutional investors.

Table 6

Asset Class	**Management Fee Assumption (%)**	**UTIMCO Fee (%)**
Domestic Equity	0.43	0.31
Global Equity	0.45	0.52
Fixed Income	0.21	0.30
Cash	0.10	0.10
Real Estate	1.90	-
Hedge Funds[2]	1.15	0.93
Oil and Gas[2]	1.75	2.00
Timber	1.25	-
Commodities	0.45	0.38
Venture Capital and Private Equity[2]	2.64	2.71

[2] Incentive fees excluded for Hedge Funds, Venture/Private Equity and Energy, but included in all the other asset classes.

As this data indicates, UTIMCO's asset class external management fees are below industry norms in domestic equity, hedge funds, and commodities. Fees for fixed income and global equity management were both 7 basis points above the industry norm. In the Venture/Private Equity asset class, UTIMCO's fees are 5 basis points, or less than 2%, above the norm. Fees for Oil and Gas were 14% higher than the median. As discussed in the prior section "Study Methodology," the analysis included incentives fees paid to marketable stock and bond managers, but excluded incentive fees paid to Hedge Funds, Venture/Private Equity and Energy funds.

The study also attempted to evaluate the asset management costs of internally-managed assets. Only four of the eight public universities reported internally-managed assets and only one was able to identify the specific costs of managing these assets. For the three institutions that reported internally-managed assets but were not able to allocate costs, the assets were predominantly fixed income and cash securities which generally have very low management costs. We believe these costs were included in Internal Oversight costs.

The one institution that was able to provide specific internal asset management costs reported costs that were less than 1 basis point of total internally-managed assets compared to UTIMCO's internal asset management costs of 3 basis points. It is worth noting that the survey respondent's internally managed assets were more than 450% larger than UTIMCO's internally managed assets. Given the limited peer group and the differences in assets, we could not draw a conclusion from this portion of the study. Internal asset management costs were included in the calculation of total investment costs discussed below.

Total Investment Costs

Table 7 summarizes UTIMCO's total investment costs on an "all-inclusive" basis, stated as a percent of total investment assets as of June 30, 2004. This total includes all oversight costs, external management fees and, where applicable, internal asset management fees.

Table 7

	UTIMCO	**Full Universe**	**Private Universities**	**Public Universities**
Total Investment Costs (%)	***0.57***	0.74	0.82	0.65

UTIMCO's total investment costs, 0.57% of total investment assets, were 23% below the full peer group median, 31% below the private university sub-group median and 13% below the public university median.

Summary Conclusion

This study analyzed the cost of the investment oversight and asset management services that UTIMCO provides the University of Texas System. UTIMCO's total investment oversight and asset management costs, stated as a percent of investment assets, were compared with the costs of a peer group of sixteen large public and private universities. The costs were also evaluated in two components: investment oversight expenses and asset management fees. The analysis resulted in the following findings:

- UTIMCO's total investment costs, combining oversight costs, external asset management costs and internal asset management costs, were 23% below the median for the full peer group, 31% below the medians for the private university peer group and 13% below the median for the public university sub-group.

- UTIMCO's investment oversight costs were 8% below the median cost for the full peer group, 25% below the median cost of the public university sub-group and 8% below the private university peer group.

- UTIMCO's external asset management fees, measured as a percent of externally-managed assets, were equal to the median estimated external asset management fee, 25% below the private university median and 18% above the public university median.

These findings indicate that UTIMCO's comprehensive costs are below the median comprehensive costs of the university peer group. These comprehensive costs include the combined costs of investment oversight and asset management, measured as a percent of each institution's total investment assets.

B. CONVENE JOINT MEETING: BOARD OF REGENTS AND UTIMCO BOARD OF DIRECTORS

9. U. T. System: UTIMCO Organization

REPORT

UTIMCO Chairman Hunt and Mr. Boldt will outline the organizational structure of UTIMCO using a PowerPoint on Pages 9.1 – 9.7.

Joint Meeting of
UT System Board of Regents
UTIMCO Board of Directors

UTIMCO Organization

Bob L. Boldt

July, 2005

UTIMCO Board Members

Woody L. Hunt Regent, UT System	Chairman
H. Scott Caven Regent, UT System	Vice Chairman
Mark G. Yudof Chancellor	Vice Chairman for Policy
Clint D. Carlson Outside Director	
J. Philip Ferguson Outside Director	
Erle Nye Regent, Texas A&M University System	
Robert B. Rowling Regent, UT System	
Charles W. Tate Outside Director	
R.D. Burck Advisory Director	

July, 2005 2

UTIMCO Board Committees

Audit & Ethics Committee	Compensation Committee	Risk Committee
Erle Nye, Chairman	J. Philip Ferguson, Chairman	H. Scott Caven, Chairman
Robert Rowling	Clint Carlson	Woody Hunt
Woody Hunt	Robert Rowling	Charles Tate

UTIMCO Consultants and Service Providers

Investment Consultant: Cambridge Associates LLC

Consultant to Chairman of UTIMCO Board: Dr. Keith Brown

Legal Counsel: Vinson & Elkins LLP

External Auditor: Ernst & Young LLP

Master Custodian: Mellon Trust

External Managers and Partners:
- Public Markets: 21 Managers
- Marketable Alternatives: 23 Managers for 26 Funds
- Private Capital: 82 Partners for 142 Partnerships

UTIMCO Mission Statement

For our clients:

UTIMCO will provide competitive, innovative and effective asset management and financial advisory services to our clients within the University of Texas and Texas A&M Systems.

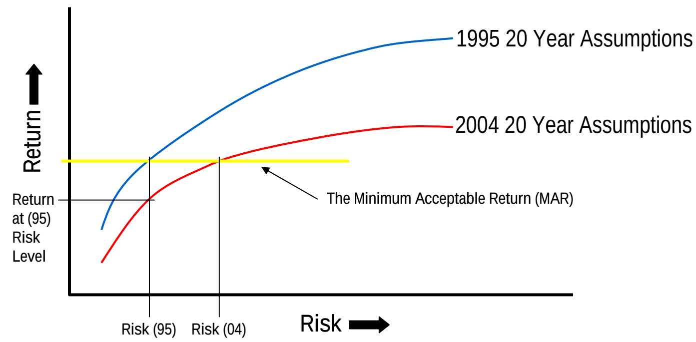
For the community:

UTIMCO accepts its responsibilities as the manager for the largest public endowment fund in the United States and will act as a leader to advance endowment fund management practices at both public and private endowments.

Our Strategic Objectives

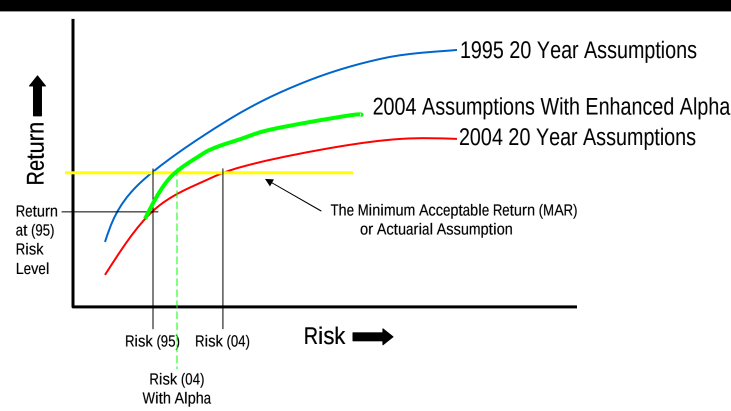
- Earn $200 million in Value-Added Per Year,
- Be Recognized as One of the Five Best Managed Endowments in the United States,
- Earn High Satisfaction Ratings From Our Clients for:
  - Investment Skill
  - Innovation
  - Communication

The New Low Returns World



- The Only Choices are to: Increase Risk or Learn to Live With Below Minimum Returns ?

The Value-Added Alternative



- A Successful Focus on Alpha Could Allow Minimum Return Assumptions to be Retained at Only Slight Risk Increase
- This Process has Been Underway at Endowments for More Than 10 Years

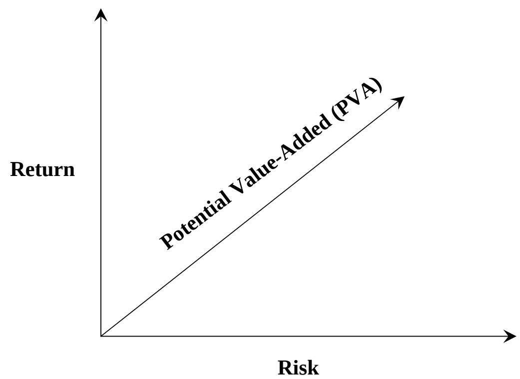
How Will UTIMCO Cope With This New Tough Environment?

- The most appropriate approach for UTIMCO is to:
  - Focus on those asset classes and markets where we can add value,
  - Find and retain the best external managers to invest the bulk of UTIMCO assets,
  - Supplement external managers with internal management in specific niches with specific objectives,
  - Create a very solid risk management and risk budgeting platform as the backbone for the entire investment process,
  - Use creative strategies to overcome the disadvantages of size, and take advantage of our size wherever possible,
  - Create a specialist organizational structure to implement the strategy.
- The foundation of the approach is value-added, what we term PVA ….

Focus on High PVA Opportunities

- Potential Value-Added (PVA) is the opportunity to increase returns beyond those generally available in an asset class through active management.
- PVA takes two forms:
  - PVA by an active manager is the result of effective security selection usually based on extensive research and analysis skills,
  - PVA by staff can result from a wide range of sources including skill in manager selection, term negotiations, manager monitoring, responses to periodic special opportunities in the markets, and risk control.
- Our objective at UTIMCO is to focus on high PVA opportunities, developing or purchasing the skills necessary to earn attractive returns.
- PVA is the most fundamental building block of our investment approach at UTIMCO.

A Third Dimension of Asset Class Analysis

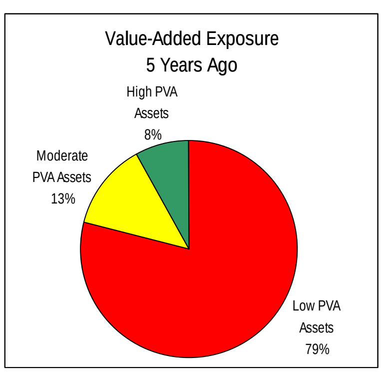


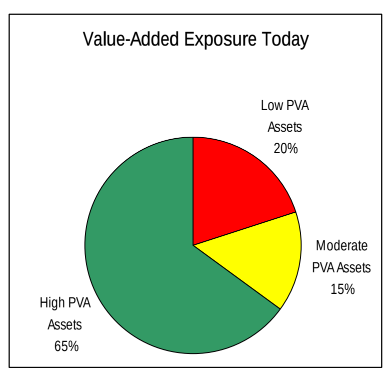
This is an important enhancement to traditional asset class analysis because asset categories vary widely in PVA ….

High PVA Asset Categories Include:
- ✓ Venture Capital
- ✓ Private Equity
- ✓ Hedge Funds
- ✓ Emerging Markets
- ✓ Small Capitalization Domestic and International Equity

Low PVA Asset Categories Include:
- ✓ Domestic Fixed Income
- ✓ Large Capitalization Domestic and International Equity
- ✓ Passive Management of Public Securities

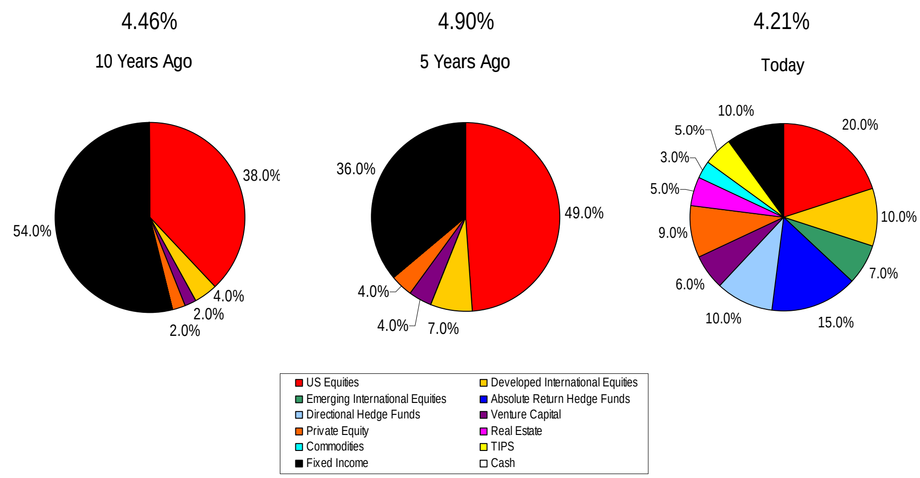
PVA Has Changed Dramatically at UTIMCO



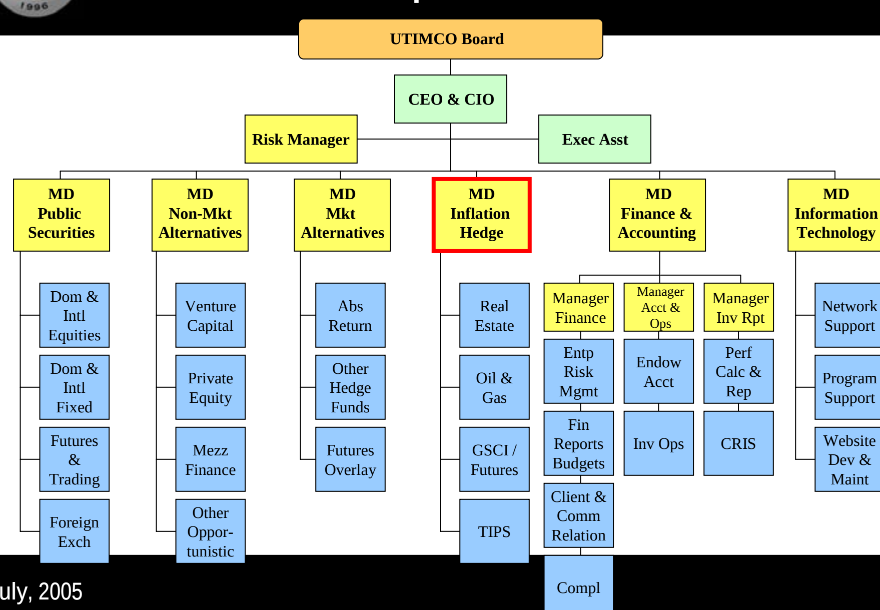


Asset Allocation Policy Has Changed Substantially Over the Past 10 Years

Downside Risk at 8.1% Target



UTIMCO's Specialist Structure



10. U. T. System: Observations by investment consultants on asset allocation for U. T. System endowment funds

REPORT

Mr. Steve Voss, Ennis Knupp + Associates, and Mr. Bruce Myers, Cambridge Associates, will lead a discussion of asset allocation for U. T. System endowment funds, using PowerPoints attached on Pages 10.1 – 10.3 and 10.4 – 10.12, respectively.

Discussion on Asset Allocation

Mr. Steve Voss

July 8, 2005

ENNISKNUPP

Overview of Process

UTIMCO employed a methodical and innovative process

- Approach similar to that used in 2003
- Logical steps (assumptions, constraints, decision factors)
- Innovative multi-step modeling process

EnnisKnupp Assessment

In aggregate, we believe that UTIMCO's process is sound and reasonable

Future Considerations

Start with a joint meeting so Board of Regents can set objectives

ENNISKNUPP

Asset Class Assumptions

- Assumptions are similar to those used in 2003 study
- Process was somewhat opaque to us in some areas
- Assumptions are reasonable and similar to EnnisKnupp's

ENNISKNUPP

Translating Process Into Policy

A number of "decision factors" were used to guide the policy-setting process

- Maintain real value of endowments and distributions
- Outperform policy and peers
- Minimize risk and illiquidity

UTIMCO Board chose among candidate portfolios based on their rankings according to these decision factors, as weighted by the UTIMCO Board

EnnisKnupp Assessment

Proposed decision factors were reasonable, but ideally decision factors would mirror investment objectives defined by Board of Regents

ENNISKNUPP

Asset Allocation Policy

- Proposed policy target allocations are contemporary and similar to those of other institutions with similar financial objectives
- Allowable ranges are wide
- Benchmarks are generally reasonable, but could be streamlined

ENNISKNUPP

CAMBRIDGE ASSOCIATES LLC

The University of Texas Board of Regents

Asset Allocation Review

Mr. Bruce Myers

July 8, 2005

1

CAMBRIDGE ASSOCIATES LLC

The University of Texas System Board of Regents
Asset Allocation Review

- Review of the Building Blocks of Asset Allocation
- Putting it all Together
- Reflections on Practices of Peer Institutions

2

CAMBRIDGE ASSOCIATES LLC

The University of Texas System Board of Regents
Asset Allocation Review

BUILDING BLOCKS OF ASSET ALLOCATION

CAMBRIDGE ASSOCIATES LLC

Building Blocks of Asset Allocation

- ***Maintain high allocation to equities (broadly defined)***
- Hedge against disasters
- Diversify equity allocation to add return and reduce volatility

CAMBRIDGE ASSOCIATES LLC

Building Blocks of Asset Allocation

Maintain High Equity Ownership

- In the long run, equities are the dominant asset class: real rate of return on U.S. equities since 1900 has been 6.6%, the real return on bonds for the same period was 2.4% and for cash 1.1%.
- You make more money as an owner than you do as a lender.
- A dollar invested in equities in 1900 would be worth $829 today (inflation adjusted). Same dollar invested in bonds would be worth $12.52 (also adjusted for inflation).

5

CAMBRIDGE ASSOCIATES LLC

Building Blocks of Asset Allocation

Maintain High Equity Ownership

- So why not hold 100% in Equities?
  - In all the 5-year periods since 1900, equities have outperformed bonds 74% of the time.
  - Put another way: there is a 1 in 4 chance of encountering a 5-year period when bonds outperform equities

6

CAMBRIDGE ASSOCIATES LLC

Building Blocks of Asset Allocation

- Maintain high allocation to equities (broadly defined)
- ***Hedge against disasters***
- Diversify equity allocation to add return and reduce volatility

7

CAMBRIDGE ASSOCIATES LLC

Building Blocks of Asset Allocation

Hedge Against Disasters

- Two disaster scenarios threaten institutions with high equity allocations:
  - Periods of prolonged economic contraction (deflation)
  - Periods of *unexpected* jumps in the rate of inflation

8

CAMBRIDGE ASSOCIATES LLC

Building Blocks of Asset Allocation

Hedge Against Disasters

A baker's dozen of painful periods for U.S. Equity:

	Period	Real 3-Year AACR	"Cause"
1.	1929-31	-22.9	Deflation
2.	1930-32	-19.8	Deflation
3.	2000-02	-16.6	?
4.	1972-74	-16.1	Inflation
5.	1916-18	-13.3	Inflation
6.	1973-75	-13.0	Inflation
7.	1917-19	-11.4	Inflation
8.	1939-41	-10.8	Deflation
9.	1946-48	-8.5	Inflation
10.	1940-42	-7.3	Inflation
11.	1915-17	-5.9	Inflation
12.	1937-39	-5.0	Deflation
13.	1918-20	-4.9	Inflation

CAMBRIDGE ASSOCIATES LLC

Building Blocks of Asset Allocation

- Maintain high allocation to equities (broadly defined)
- Hedge against disasters
- ***Diversify equity allocation to add return and reduce volatility***

C | A
CAMBRIDGE ASSOCIATES LLC

Building Blocks of Asset Allocation

Diversify equity allocation to add return and reduce volatility

- Market leadership rotates
  - Different classes of equity or manager strategies provide different patterns of returns
  - Cycles are certain but difficult to predict
- Less efficient markets create opportunity for skillful managers to add value

11

C | A
CAMBRIDGE ASSOCIATES LLC

The University of Texas System Board of Regents
Asset Allocation Review

PUTTING IT ALL TOGETHER

12

CAMBRIDGE ASSOCIATES LLC

Putting it all together

- Since there is likely to be an opportunity cost to holding assets that hedge against either deflation or inflation…
  - Carve out a bond allocation sufficient to provide needed protection, but not any larger than is needed.
    - Bonds will provide liquidity for funding programs and payout during deflationary period so that equities will not have to be sold at fire sale prices.
    - Degree of protection needed will vary from institution to institution
  - Carve out allocation required for inflation protection.
    - Use basket of asset classes
    - Seek value added strategies/managers to limit opportunity costs

13

CAMBRIDGE ASSOCIATES LLC

Putting it all together

- Diversify equity asset classes to add return and limit volatility
  - A rich asset mix is needed to provide opportunity for generating required return
  - Quantitative modeling can be helpful in guiding allocations.
    - Quantitative modeling most helpful in assessing the relative merits of differing portfolios
    - Asset Allocation should be informed by quantitative modeling, but never determined by it.
    - Fundamental assessment of long-term intrinsic sources of return for each asset class must be considered.

14

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The University of Texas System Board of Regents
Asset Allocation Review

REFLECTIONS ON THE PRACTICES OF PEER INSTITUTIONS

C | A
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Reflections on the Practices of Peer Institutions

- Allocation to U.S. Equity have been driven down as portfolios become more broadly diversified
  - Average (median) allocation was 24%, with outliers as high as 60% and as low as 9%
  - 24 of the 34 institutions had allocations between 15 and 35%.

- Allocations to U.S. Fixed Income reduced sharply over last ten years:
  - Of the 34 educational institutions we track with endowments greater than $1 billion:
    - Average (median) fixed income allocation was 13.4%
    - Range was from a high of 26% to a low of 5%
    - Eight institutions held less than 10% in fixed income

C | A
CAMBRIDGE ASSOCIATES LLC

Reflections on the Practices of Peer Institutions

- Allocations to Marketable Alternative strategies (a/k/a hedge funds) have grown sharply (especially since 2000).
  - Average (median) allocation about 20%, targets likely higher.
  - Range of observations: from 62% on the high side to a low of 6%
    - Reported allocations may understate presence of these strategies in some portfolios where hedge funds are being used as fixed income or equity substitutes.
    - 16 of the 34 institutions reported current allocations of 20% or more.

C | A
CAMBRIDGE ASSOCIATES LLC

Reflections on the Practices of Peer Institutions

- General belief that earning 5%+ after inflation is likely to be very difficult in a period of muted investment returns with moderately higher levels of inflation.
  - Rich asset mix and broad opportunity set critical.
  - Tilt toward asset classes where manager skill can add value (alpha), and reduction in asset classes where alpha is hard to come by.
  - Increased desire to have the flexibility to be opportunistic or tactical.

11. U. T. System: UTIMCO review and discussion of asset allocation for U. T. System endowment funds

REPORT

UTIMCO Chairman Hunt and Mr. Boldt will lead a discussion of asset allocation for U. T. System endowment funds, using a PowerPoint attached on Pages 11.1 – 11.21.

11.1

UTIMCO

1996

THE UNIVERSITY OF TEXAS
INVESTMENT MANAGEMENT COMPANY

Joint Meeting of
UT System Board of Regents
UTIMCO Board of Directors

Asset Allocation Policy Review Process

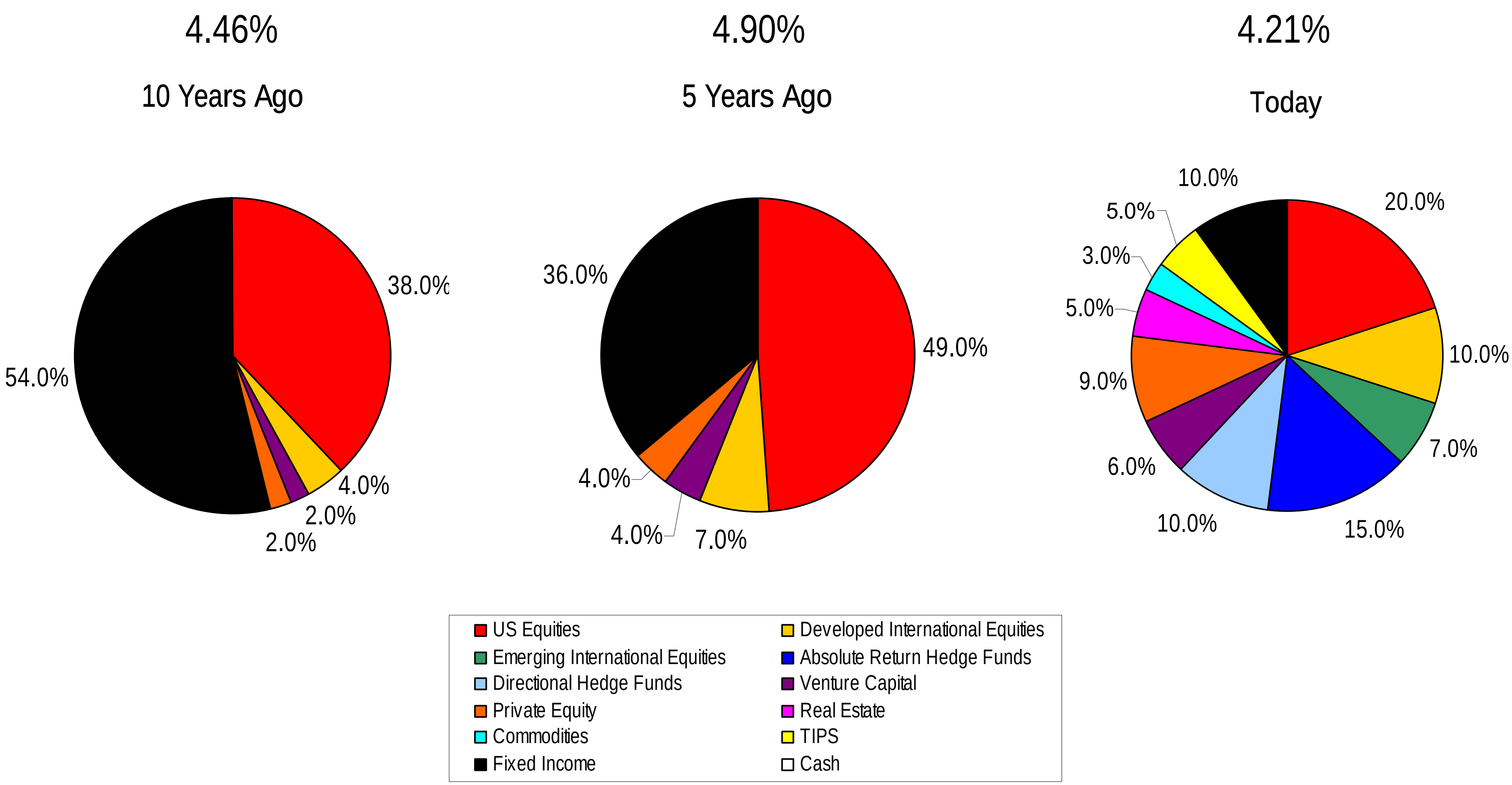
Bob L. Boldt

July, 2005

Asset Allocation Policy Has Changed Substantially Over the Past 10 Years

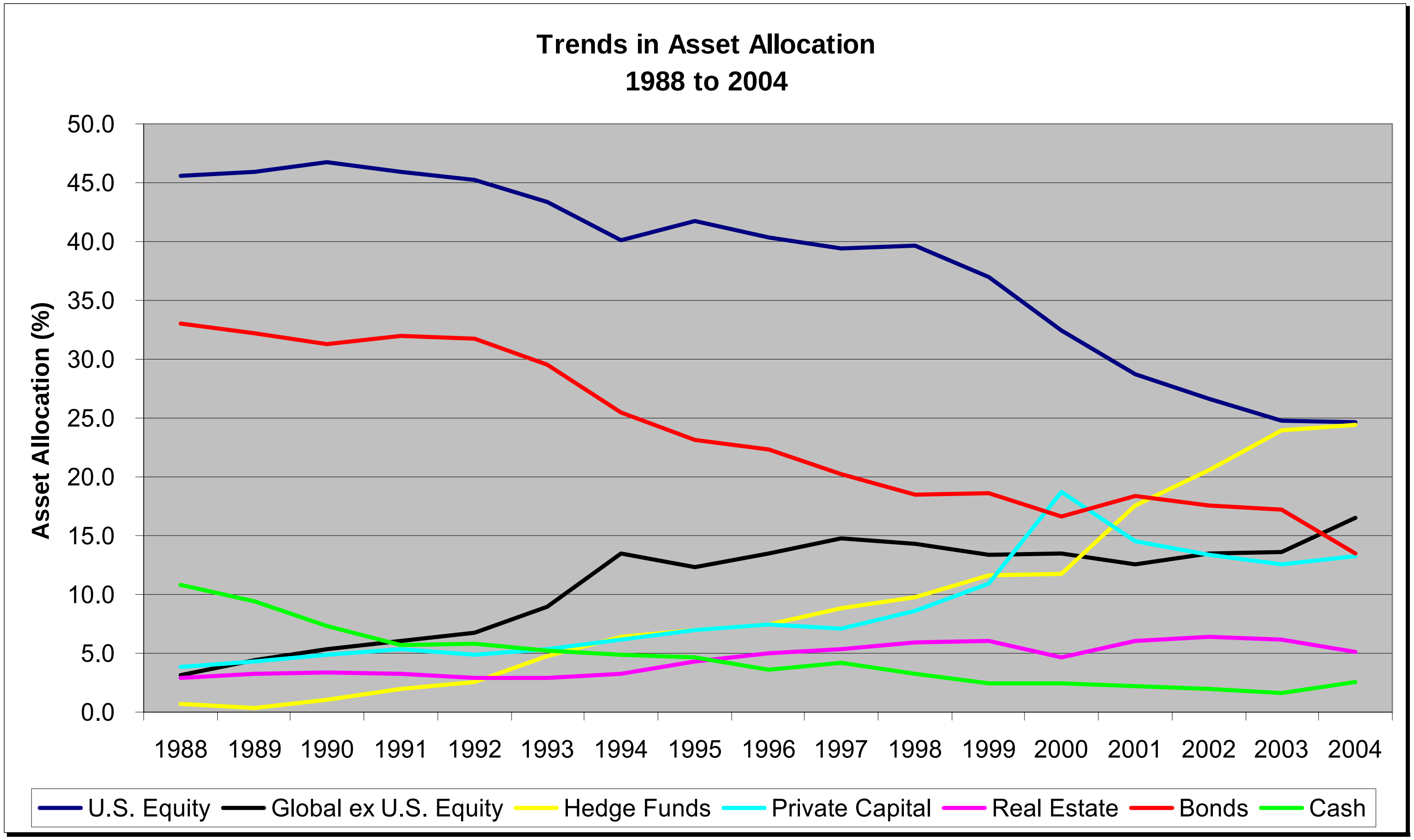
11.2

Downside Risk at 8.1% Target



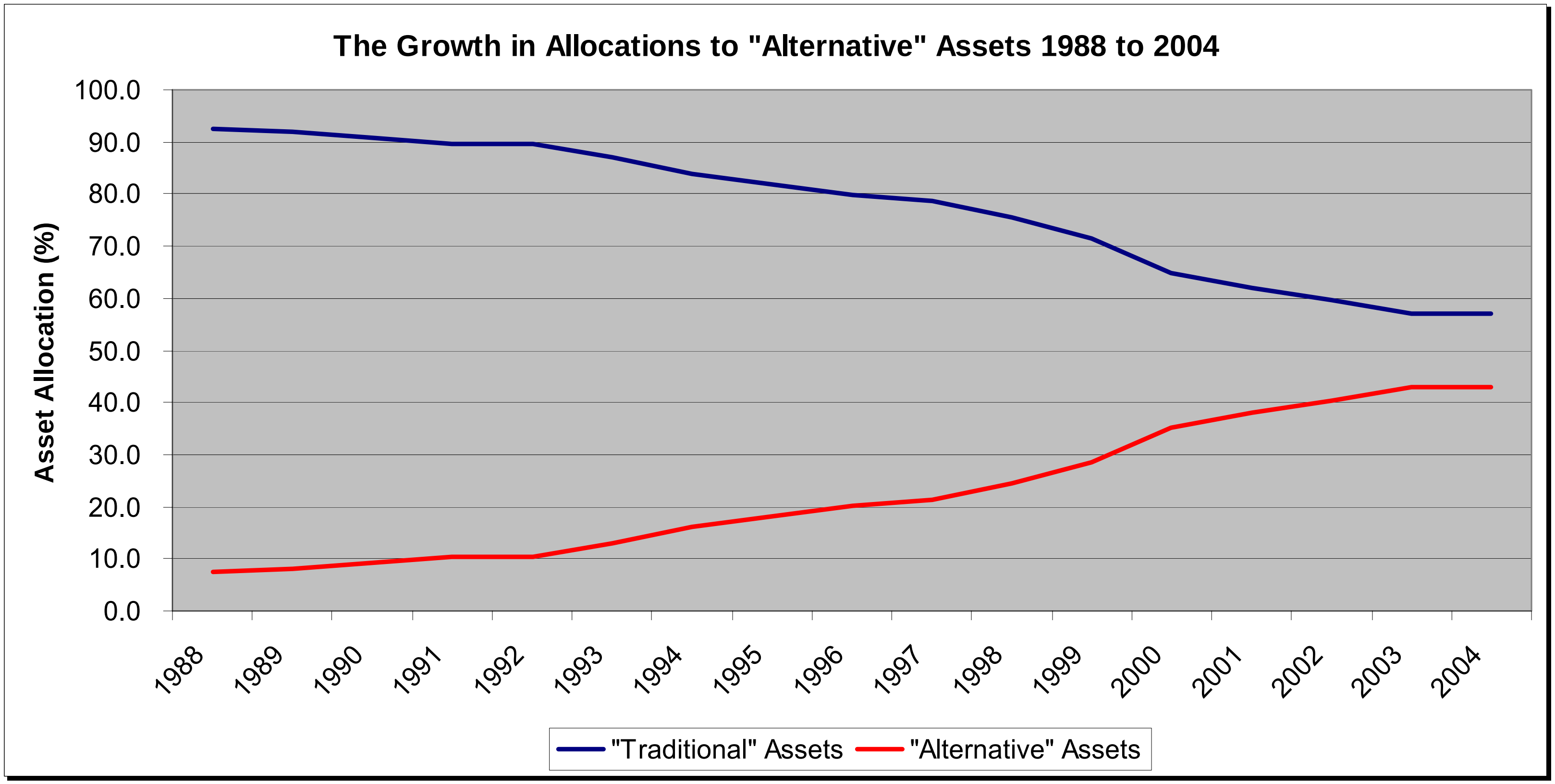
Asset Allocation Changes at Largest and Most Sophisticated Endowments

11.3



Source: Cambridge Associates

Focus is on Adding Value Through Alternative Investments



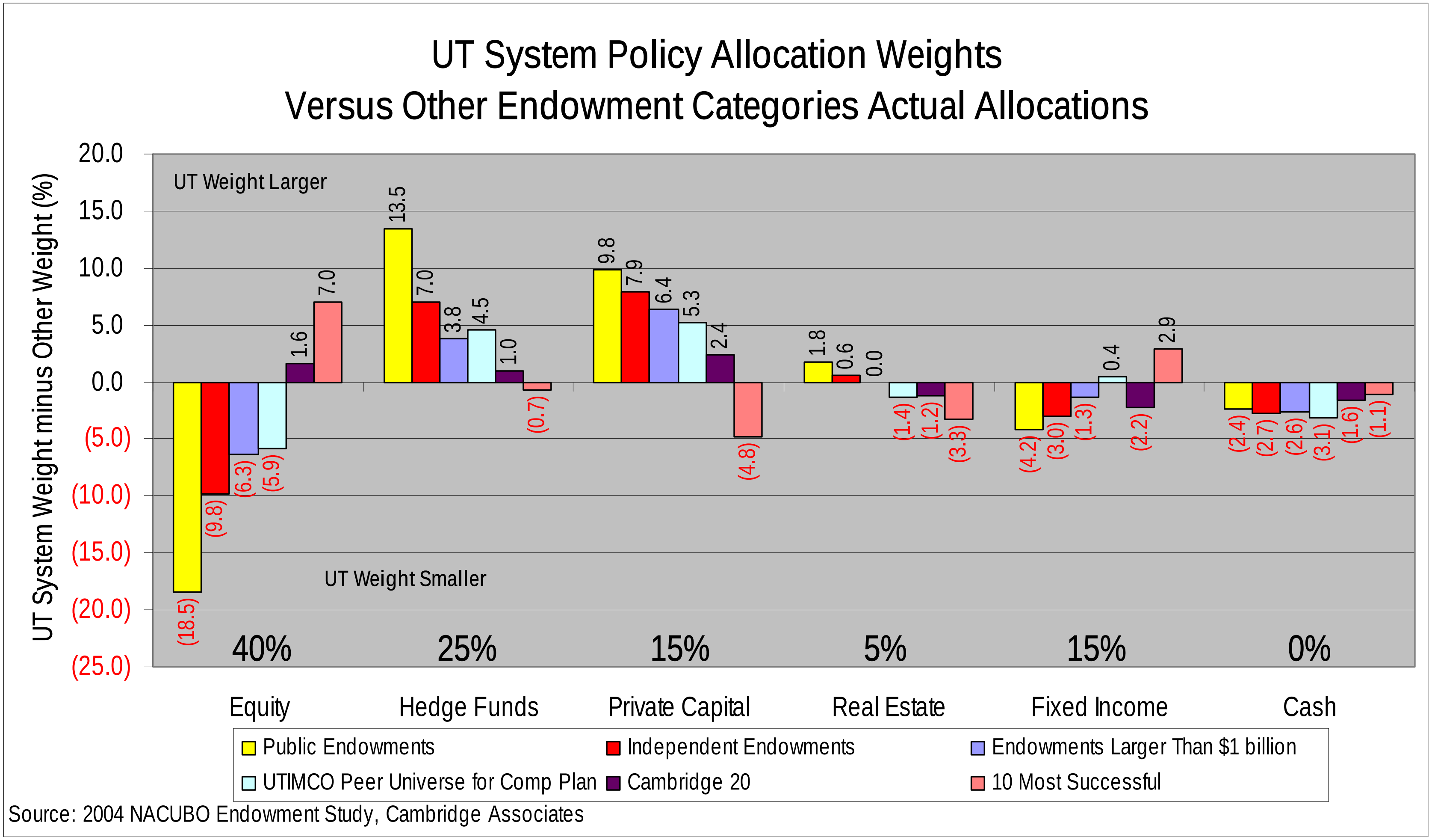
Source: Cambridge Associates

"Alternative" Assets include: venture capital, private equity, hedge funds, real estate, oil & gas, timber, and other opportunistic asset categories.

11.4

11.5

UT System Allocation Weights Compared to Other Endowments

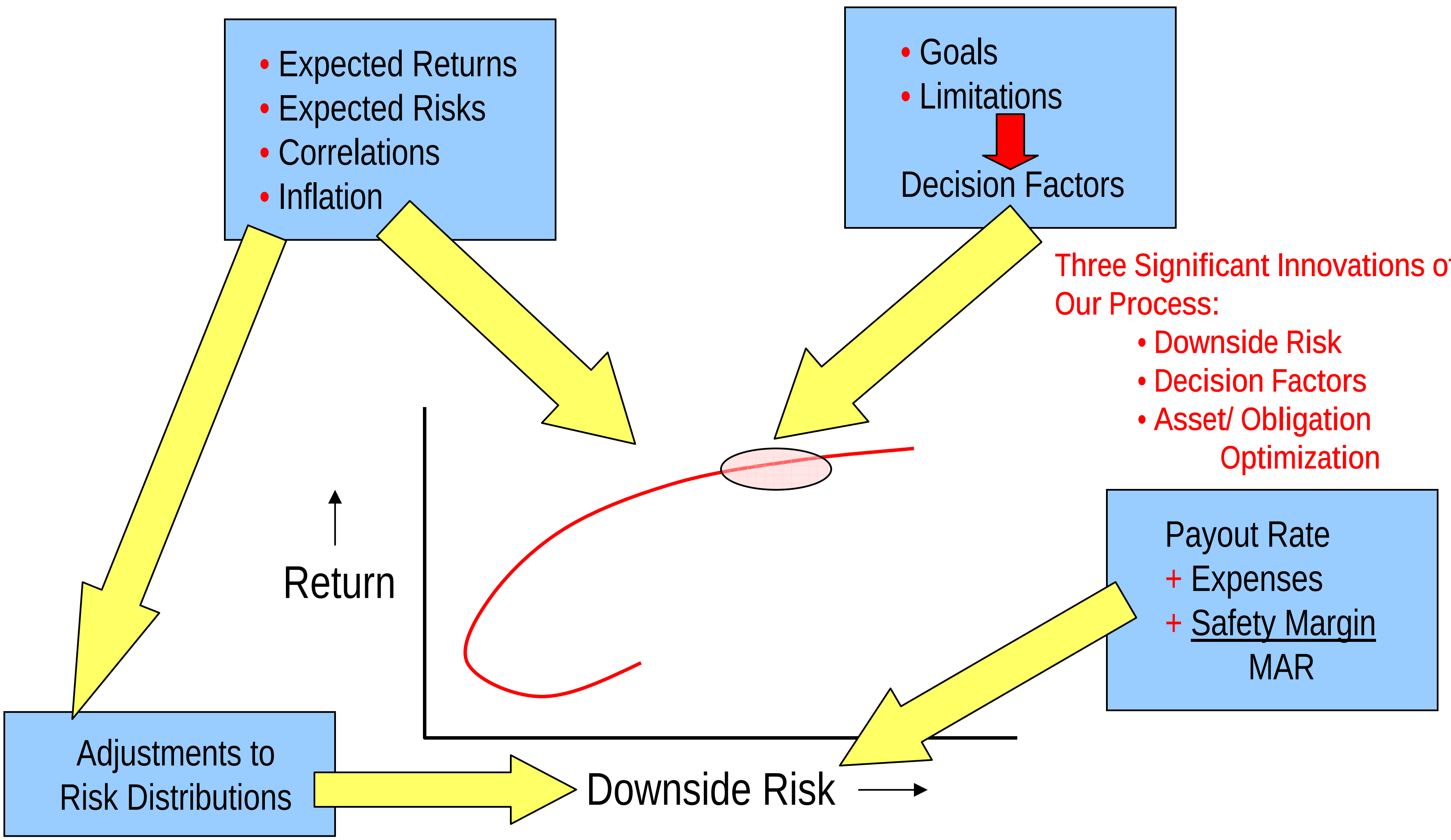


Objectives of Asset Allocation Review Process

- Select the appropriate risk level for the endowment funds
- Select the most effective strategic asset allocation targets at the selected risk level
- Establish tactical allocation ranges around the strategic allocation targets to allow staff to respond to market conditions
- Establish appropriate benchmarks to measure performance relative to expectations

11.7

Overview of Asset Allocation Process



11.8

Capital Market Assumptions and Constraints

Risk & Return Assumptions Summary: **PVA Assumptions:** **Constraints:**

Data Item	Consultant Average	Historical	UTIMCO 2003	UTIMCO 2005	▪ 75th Pct PVA ▪ 25th Pct PVA V/A Spread	Capture Ratio	▪ Exp PVA ▪ Std Dev	UTIMCO 2003 with PVA	UTIMCO 2005 with PVA	2003 Minimum %	2003 Maximum %	2005 Minimum %	2005 Maximum %
US Equity										**20%**	**100%**	**20%**	**100%**
Nominal Returns	8.85%	11.53%	8.50%	**8.50%**	2.50%	35%	0.88%	**9.13%**	**9.38%**				
Real Returns	6.37%	6.86%	5.50%	**5.50%**	-2.50%			**6.13%**	**6.38%**				
Std Deviation	16.44%	15.82%	17.00%	**17.00%**	5.00%		3.71%	**17.40%**	**17.40%**				
Non-US Developed Equity										**10%**	**100%**	**10%**	**100%**
Nominal Returns	8.85%	11.86%	8.50%	**8.50%**	3.00%	35%	1.05%	**9.25%**	**9.55%**				
Real Returns	6.38%	7.19%	5.50%	**5.50%**	-3.00%			**6.25%**	**6.55%**				
Std Deviation	17.48%	16.77%	19.00%	**19.00%**	6.00%		4.45%	**19.51%**	**19.51%**				
Emerging Markets Equity										**0%**	**10%**	**0%**	**15%**
Nominal Returns	10.34%	15.04%	11.00%	**10.50%**	10.00%	25%	2.50%	**12.50%**	**13.00%**				
Real Returns	7.86%	10.36%	8.00%	**7.00%**	-10.00%			**9.50%**	**10.00%**				
Std Deviation	24.80%	23.25%	26.00%	**26.00%**	20.00%		14.83%	**29.93%**	**29.93%**				
Absolute Return Hedge Funds										**0%**	**20%**	**0%**	**15%**
Nominal Returns	6.91%	10.79%	7.00%	**7.00%**	4.00%	25%	1.00%	**8.00%**	**8.00%**				
Real Returns	4.42%	6.12%	4.00%	**4.00%**	-4.00%			**5.00%**	**5.00%**				
Std Deviation	6.49%	6.15%	7.50%	**7.50%**	8.00%		5.93%	**9.56%**	**9.56%**				
Equity Hedge Funds										**0%**	**20%**	**0%**	**15%**
Nominal Returns	8.46%	10.48%	8.00%	**8.00%**	5.00%	25%	1.25%	**9.25%**	**9.25%**				
Real Returns	5.97%	5.81%	5.00%	**5.00%**	-5.00%			**6.25%**	**6.25%**				
Std Deviation	8.37%	8.16%	11.00%	**10.00%**	10.00%		7.41%	**13.26%**	**12.45%**				
Venture Capital										**0%**	**10%**	**0%**	**10%**
Nominal Returns	14.24%	15.16%	14.00%	**14.00%**	15.00%	15%	2.25%	**16.25%**	**16.25%**				
Real Returns	11.57%	10.49%	11.00%	**11.00%**	-15.00%			**13.25%**	**13.25%**				
Std Deviation	31.63%	18.78%	30.00%	**30.00%**	30.00%		22.24%	**37.34%**	**37.34%**				
Private Equity										**0%**	**10%**	**0%**	**15%**
Nominal Returns	11.85%	11.32%	11.50%	**11.50%**	10.00%	20%	2.00%	**13.50%**	**13.50%**				
Real Returns	9.38%	6.65%	8.50%	**8.50%**	-10.00%			**10.50%**	**10.50%**				
Std Deviation	28.25%	9.04%	20.00%	**24.00%**	20.00%		14.83%	**24.90%**	**28.21%**				

Capital Market Assumptions and Constraints

11.9

Risk & Return Assumptions Summary: **PVA Assumptions:** **Constraints:**

Data Item	Consultant Average	Historical	UTIMCO 2003	UTIMCO 2005	▪ 75th Pct PVA ▪ 25th Pct PVA V/A Spread	Capture Ratio	▪ Exp PVA ▪ Std Dev	UTIMCO 2003 with PVA	UTIMCO 2005 with PVA	2003 Minimum %	2003 Maximum %	2005 Minimum %	2005 Maximum %
REITS										**0%**	**10%**	**0%**	**10%**
Nominal Returns	7.89%	14.54%	7.50%	**7.50%**	3.00%	25%	0.75%	**8.25%**	**8.25%**				
Real Returns	5.41%	9.87%	4.50%	**4.50%**	-3.00%			**5.25%**	**5.25%**				
Std Deviation	13.64%	14.74%	15.00%	**15.00%**	6.00%		4.45%	**15.65%**	**15.65%**				
Commodities (Financial)										**0%**	**10%**	**0%**	**10%**
Nominal Returns	6.40%	13.37%	5.00%	**6.00%**	3.00%	25%	0.75%	**5.00%**	**6.75%**				
Real Returns	3.70%	8.70%	2.00%	**3.00%**	-3.00%			**2.00%**	**3.75%**				
Std Deviation	18.47%	18.43%	18.00%	**18.00%**	6.00%		4.45%	**18.00%**	**18.54%**				
TIPS										**0%**	**10%**	**0%**	**15%**
Nominal Returns	4.94%	9.07%	5.50%	**5.50%**	1.00%	25%	0.25%	**5.50%**	**5.75%**				
Real Returns	2.40%	4.39%	2.50%	**2.50%**	-1.00%			**2.50%**	**2.75%**				
Std Deviation	6.00%	3.69%	6.00%	**6.00%**	0.00%		1.48%	**6.00%**	**6.18%**				
US Fixed Income										**10%**	**100%**	**10%**	**100%**
Nominal Returns	5.18%	8.80%	5.00%	**5.75%**	1.00%	25%	0.25%	**5.25%**	**6.00%**				
Real Returns	2.70%	4.13%	2.00%	**2.75%**	-1.00%			**2.25%**	**3.00%**				
Std Deviation	5.34%	6.02%	6.00%	**7.00%**	2.00%		1.48%	**6.18%**	**7.16%**				
Cash										**0%**	**0%**	**0%**	**0%**
Nominal Returns	3.33%	6.43%	4.00%	**4.00%**	0.00%	0%	0.00%	**4.00%**	**4.00%**				
Real Returns	0.86%	1.75%	1.00%	**1.00%**	0.00%			**1.00%**	**1.00%**				
Std Deviation	0.88%	0.91%	1.00%	**1.00%**	0.00%		0.00%	**1.00%**	**1.00%**				
Inflation													
Returns	2.48%	4.67%	3.00%	**3.00%**				**3.00%**	**3.00%**				
Std Deviation	1.25%	1.17%	2.00%	**1.50%**									

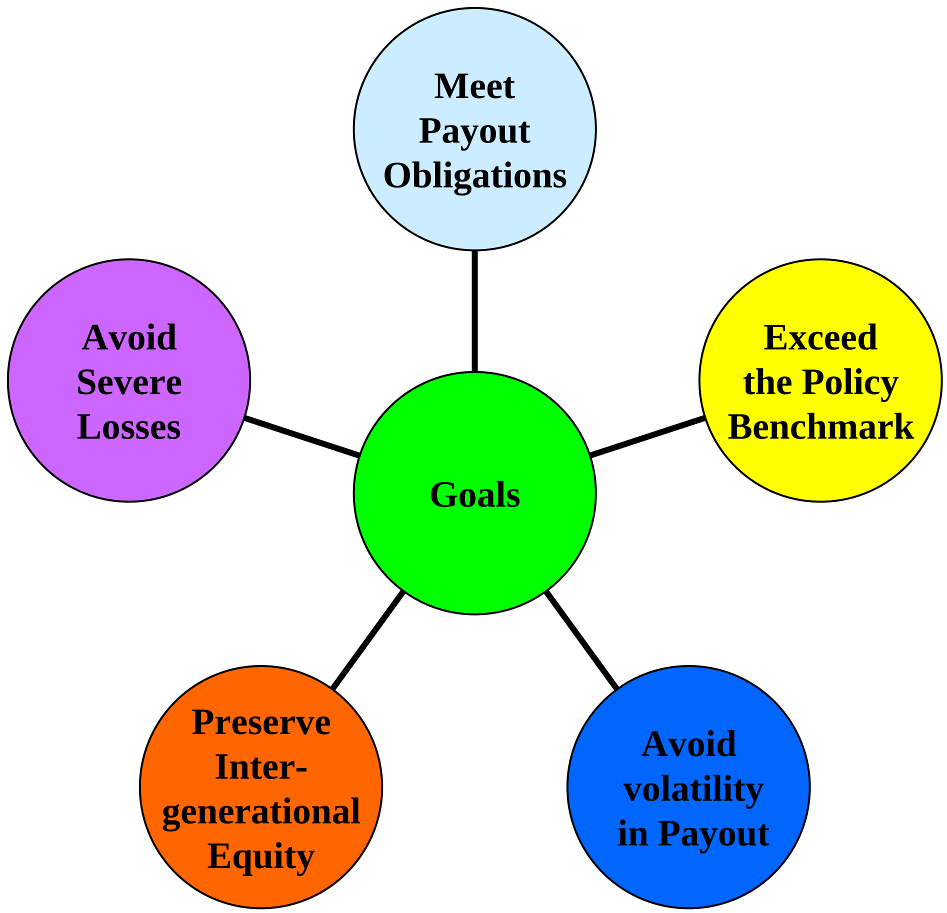
2005 Candidate Policy Portfolios

11.10

2005 Candidate Policy Portfolios

	1	3	5	7	9	11	13	14	2003 Policy
USE	20.0%	20.0%	20.0%	20.0%	20.0%	20.0%	30.0%	45.0%	20.0%
GE	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%
EM	0.0%	0.0%	0.2%	4.3%	8.3%	13.9%	15.0%	15.0%	7.0%
AR	15.0%	15.0%	15.0%	15.0%	15.0%	13.1%	0.0%	0.0%	15.0%
EHF	8.3%	10.4%	15.0%	15.0%	15.0%	15.0%	15.0%	5.0%	10.0%
VC	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	6.0%
PE	7.4%	9.7%	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%	9.0%
REITS	1.4%	2.2%	5.0%	5.0%	5.0%	3.0%	5.0%	0.0%	5.0%
COM	3.9%	3.2%	3.3%	2.4%	1.7%	0.0%	0.0%	0.0%	3.0%
O&G	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
TIPS	4.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	5.0%
BND	25.0%	24.5%	16.5%	13.3%	10.0%	10.0%	10.0%	10.0%	10.0%
CA	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Exp Ret	7.75%	7.95%	8.15%	8.35%	8.55%	8.75%	8.95%	9.05%	8.39%
Vol	8.7%	9.2%	9.8%	10.6%	11.4%	12.3%	13.7%	15.0%	10.8%
1 Yr VaR	-10.6%	-11.4%	-11.8%	-12.9%	-14.4%	-16.3%	-18.1%	-21.1%	-13.6%
1 yr DR	6.5%	6.7%	7.0%	7.4%	7.9%	8.5%	9.4%	10.3%	7.6%
3 yr DR	3.8%	3.9%	4.0%	4.2%	4.5%	4.8%	5.2%	5.7%	4.3%
Avg PO	$254.9	$257.8	$260.8	$264.3	$268.1	$272.2	$277.0	$280.0	$265.2
Illiquidity	29.1%	32.6%	35.3%	35.4%	35.4%	34.6%	27.3%	22.0%	32.4%
PVA	$42.3	$45.1	$48.4	$52.4	$56.5	$60.8	$60.8	$59.4	$53.2

Goals Are Multidimensional



- Typically, an investor wants to achieve several goals at the same time
- Decision Factors can help decision makers sort through those goals

11.11

11.12

Decision Factors

A Decision Factor is a measure or characteristic which may be used to relate specific goals to a particular decision ….

Using Decision Factors as a Link

Endowment Fund
Investment Policies and
Objectives

Decision Factors

Best Strategic
Asset Allocation Strategy
For Fund

2005 Decision Factors

Permanent University Fund

2005 Decision Factors

	Decision Factor	Relative Importance Score
P1a	Maximize the possibility that distributions made at the current policy rate of 4.75% of average assets would match or exceed the prior year's inflation adjusted distribution in any future 1 year period.	
P2	Maximize the possibility that future rolling 10 year compound annual real returns in the PUF will exceed 5.1%	
P3	Minimize the possibility that the real value of the PUF, after distributions at the current 4.75% distribution policy rate, will decline over future 10 year periods.	
P4	Maximize the possibility that actual PUF returns will exceed the PUF Policy Portfolio returns in future one year periods.	
P5a	Maximize the possibility that the PUF will have returns in the top half of the UTIMCO performance compensation peer universe over future 3 year periods.	
P6a	Maximize the possibility that future real returns over rolling 10 year time periods will exceed the 5.1% MAR by 1%, the margin necessary to maintain HEPI purchasing power by historical standards.	
P7	Minimize the possibility that the PUF will have a return of minus 20% or less over any future 3 year time period.	
P8	Minimize the exposure of PUF assets to "illiquid" investment options as defined in the PUF Liquidity Policy Statement.	

General Endowment Fund

2005 Decision Factors

	Decision Factor	Relative Importance Score
G1	Minimize the possibility that distributions made under the current distribution policy will be "frozen" at the upper bound payout rate of 5.5% in any year within the next 15 years.	
G2	Maximize the possibility of rolling 10 year compound annual GEF real returns exceeding 5.1%.	
G3	Minimize the possibility that the real value of the GEF, after distributions, will decline over future 10 year periods.	
G4	Maximize the possibility that future actual annual GEF returns will exceed the GEF Policy Portfolio return.	
G5a	Maximize the possibility that the GEF will have returns in the top half of the UTIMCO performance compensation peer universe over future 3 year periods.	
G6a	Maximize the possibility that future real returns over rolling 10 year time periods will exceed the 5.1% MAR by 1%, the margin necessary to maintain HEPI purchasing power by historical standards.	
G7	Minimize the possibility that the GEF will have a return of minus 20% or less over any future 3 year time period.	
G8	Minimize the exposure of GEF assets to "illiquid" investment options as defined in the GEF Liquidity Policy Statement.	

Actual Decision Factor Votes

11.15

	General Endowment Fund							
UTIMCO BOD	**G1**	**G2**	**G3**	**G4**	**G5**	**G6a**	**G7**	**G8**
Carlson	3%	31%	16%	8%	16%	8%	16%	3%
Caven	18%	18%	24%	12%	18%	6%	6%	0%
Ferguson	4%	9%	19%	19%	21%	11%	13%	4%
Hunt	0%	0%	0%	16%	74%	0%	11%	0%
Rowling	5%	14%	14%	14%	29%	14%	10%	0%
Tate	9%	14%	14%	18%	14%	9%	18%	5%
Yudof	10%	0%	20%	10%	10%	10%	20%	20%
Mean	**7%**	**12%**	**15%**	**14%**	**26%**	**8%**	**13%**	**5%**
Dispersion Factor	**0.8**	**0.9**	**0.5**	**0.3**	**0.9**	**0.5**	**0.4**	**1.6**

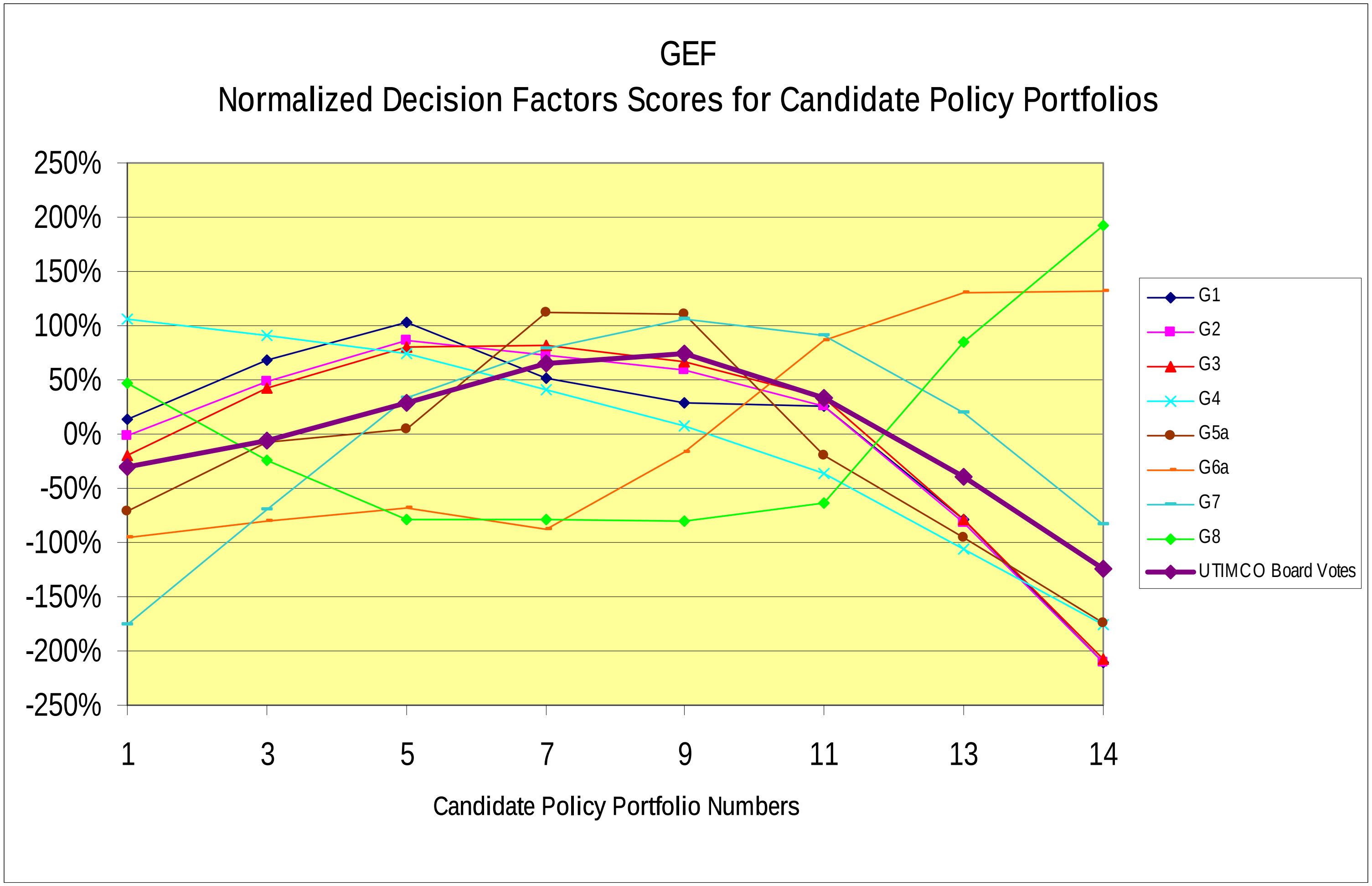
Actual Decision Factor Votes

	Permanent University Fund							
UTIMCO BOD	**P1a**	**P2**	**P3**	**P4**	**P5**	**P6a**	**P7**	**P8**
Carlson	3%	31%	16%	8%	16%	8%	16%	3%
Caven	18%	18%	24%	12%	18%	6%	6%	0%
Ferguson	4%	9%	19%	19%	21%	11%	13%	4%
Hunt	0%	0%	0%	16%	74%	0%	11%	0%
Rowling	5%	14%	14%	14%	29%	14%	10%	0%
Tate	5%	14%	14%	19%	14%	10%	19%	5%
Yudof	0%	10%	20%	10%	10%	10%	20%	20%

Mean	**5%**	**14%**	**15%**	**14%**	**26%**	**8%**	**13%**	**5%**
Dispersion Factor	**1.2**	**0.7**	**0.5**	**0.3**	**0.8**	**0.5**	**0.4**	**1.5**

11.16

Decision Factor Votes Highlight Most Appropriate Policy Portfolios



11.17

Most Appropriate Policy Portfolios

11.18

2005 Candidate Policy Portfolios

	1	3	5	7	9	11	13	14	2003 Policy
USE	20.0%	20.0%	20.0%	20.0%	20.0%	20.0%	30.0%	45.0%	20.0%
GE	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%
EM	0.0%	0.0%	0.2%	4.3%	8.3%	13.9%	15.0%	15.0%	7.0%
AR	15.0%	15.0%	15.0%	15.0%	15.0%	13.1%	0.0%	0.0%	15.0%
EHF	8.3%	10.4%	15.0%	15.0%	15.0%	15.0%	15.0%	5.0%	10.0%
VC	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	6.0%
PE	7.4%	9.7%	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%	9.0%
REITS	1.4%	2.2%	5.0%	5.0%	5.0%	3.0%	5.0%	0.0%	5.0%
COM	3.9%	3.2%	3.3%	2.4%	1.7%	0.0%	0.0%	0.0%	3.0%
O&G	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
TIPS	4.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	5.0%
BND	25.0%	24.5%	16.5%	13.3%	10.0%	10.0%	10.0%	10.0%	10.0%
CA	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Exp Ret	7.75%	7.95%	8.15%	8.35%	8.55%	8.75%	8.95%	9.05%	8.39%
Vol	8.7%	9.2%	9.8%	10.6%	11.4%	12.3%	13.7%	15.0%	10.8%
1 Yr VaR	-10.6%	-11.4%	-11.8%	-12.9%	-14.4%	-16.3%	-18.1%	-21.1%	-13.6%
1 yr DR	6.5%	6.7%	7.0%	7.4%	7.9%	8.5%	9.4%	10.3%	7.6%
3 yr DR	3.8%	3.9%	4.0%	4.2%	4.5%	4.8%	5.2%	5.7%	4.3%
Avg PO	$254.9	$257.8	$260.8	$264.3	$268.1	$272.2	$277.0	$280.0	$265.2
Illiquidity	29.1%	32.6%	35.3%	35.4%	35.4%	34.6%	27.3%	22.0%	32.4%
PVA	$42.3	$45.1	$48.4	$52.4	$56.5	$60.8	$60.8	$59.4	$53.2

Slight Practical Revisions to the Candidate Portfolios Result in Recommended Policy

11.19

Asset Category	Percent of Portfolio: 2003 Policy Portfolio	Candidate Policy Portfolio 7	Candidate Policy Portfolio 9	2005 Policy Portfolio Version 1	2005 Policy Portfolio Final Version
US Equities	20.0	20.0	20.0	20.0	20.0
Global Equities ex US	10.0	10.0	10.0	12.0	10.0
Emerging Markets Equities	7.0	4.3	7.0	7.0	7.0
Absolute Return Hedge Funds	15.0	15.0	15.0	15.0	15.0
Equity Hedge Funds	10.0	15.0	10.0	10.0	10.0
Venture Capital	6.0	5.0	6.0	3.0	4.0
Private Equity	9.0	10.0	9.0	12.0	11.0
REITs	5.0	5.0	5.0	5.0	5.0
Commodities	3.0	2.4	3.0	3.0	3.0
TIPs	5.0	0.0	5.0	3.0	5.0
Fixed Income	10.0	13.3	10.0	10.0	10.0
Cash	0.0	0.0	0.0	0.0	0.0

Expected Return>	8.39%	8.35%	8.55%	8.38%	8.34%
1 Year Downside Risk>	7.6%	7.4%	7.9%	7.8%	7.6%
Standard Deviation>	10.8%	10.6%	11.4%	11.1%	10.8%
95% 1 Year VaR>	-13.6%	-12.9%	-14.4%	-14.2%	-13.8%
Illiquidity>	32.4%	35.4%	35.4%	32.5%	32.4%

11.20

Recommended 2005 Asset Allocation Policy Targets, Ranges, and Benchmarks

Recommended 2005 Asset Allocation Policy	Percent of Portfolio (%)		
Asset Category	Policy Targets	Policy Ranges	Benchmark
US Equities	20.0	10 to 30	Russell 3000 Index
Global ex US Equities	17.0	10 to 30	
Non-US Developed Equity	10.0	0 to 30	MSCI EAFE Index with net dividends
Emerging Markets Equity	7.0	0 to 10	MSCI Emerging Markets Index with net dividends
Hedge Funds	25.0	15 to 30	
Directional Hedge Funds	10.0	5 to 15	Combination index: 50% S&P Event-Driven Hedge Fund Index plus 50% S&P Directional/Tactical Hedge Fund Index
Absolute Return Hedge Funds	15.0	10 to 20	Combination index: 66.7% S&P Event-Driven Hedge Fund Index plus 33.3% S&P Arbitrage Hedge Fund Index
Private Capital	15.0	5 to 20	Venture Economics' Periodic IRR Index
Venture Capital	4.0	0 to 8	
Private Equity	11.0	5 to 15	
Inflation Linked	13.0	5 to 20	
REITS	5.0	0 to 10	Wilshire Associates Real Estate Securities Index
Commodities	3.0	0 to 6	GSCI Index minus 1%
TIPS	5.0	0 to 10	Lehman Brothers US TIPS Index
Fixed Income	10.0	5 to 15	Lehman Brothers Aggregate Index
Cash	0.0	0 to 10	91 Day T-Bills

Expected Return>	8.34%
1 Year Downside Risk>	7.6%
Standard Deviation>	10.8%
95% 1 Year VaR>	-13.8%
Illiquidity>	32.4%

Benchmarks subject to additional review by Cambridge

Comparison of 2003 Policy and Recommended 2005 Policy

11.21

2003 Asset Allocation Policy	Percent of Portfolio (%)	
Asset Category	Policy Targets	Policy Ranges
US Equities	25.0	15 to 45
Traditional US Equities	20.0	15 to 45
REITS	5.0	0 to 10
Global ex US Equities		
Non-US Developed Equity	10.0	5 to 15
Emerging Markets Equity	7.0	0 to 10
Total Equity	42.0	20 to 60
Equity Hedge Funds	10.0	5 to 15
Absolute Return Hedge Funds	15.0	10 to 20
Total Hedge Funds	25.0	15 to 25
Venture Capital	6.0	0 to 10
Private Equity	9.0	5 to 15
Total Private Capital	15.0	5 to 15
Commodities	3.0	0 to 5
Fixed Income	15.0	10 to 30
Traditional Fixed Income	10.0	10 to 30
TIPS	5.0	0 to 10
Cash	0.0	0 to 5

Recommended 2005 Asset Allocation Policy	Percent of Portfolio (%)	
Asset Category	Policy Targets	Policy Ranges
US Equities	20.0	10 to 30
Global ex US Equities	17.0	10 to 30
Non-US Developed Equity	10.0	0 to 30
Emerging Markets Equity	7.0	0 to 10
Hedge Funds	25.0	15 to 30
Directional Hedge Funds	10.0	5 to 15
Absolute Return Hedge Funds	15.0	10 to 20
Private Capital	15.0	5 to 20
Venture Capital	4.0	0 to 8
Private Equity	11.0	5 to 15
Inflation Linked	13.0	5 to 20
REITS	5.0	0 to 10
Commodities	3.0	0 to 6
TIPS	5.0	0 to 10
Fixed Income	10.0	5 to 15
Cash	0.0	0 to 10

C. ADJOURN JOINT MEETING AND CONTINUE BOARD OF REGENTS' MEETING

D. WORKING LUNCH

12. U. T. System Board of Regents: Announcement of a new Task Force

Chairman Huffines is considering the appointment of a new Task Force and may make an announcement to the Board.

13. U. T. System: Review of Fiscal Year 2006 Significant Budget Issues affecting the U. T. System institutions

REPORT

Chancellor Yudof will review the significant budget issues affecting the U. T. System institutions for Fiscal Year 2006.

14. U. T. System Board of Regents: Adoption of Regents' *Rules and Regulations*, Series 20204, related to determining and documenting compensation

RECOMMENDATION

The Chancellor concurs in the recommendation of the Executive Vice Chancellor for Academic Affairs, the Executive Vice Chancellor for Business Affairs, the Executive Vice Chancellor for Health Affairs, the Vice Chancellor for Administration, the Vice Chancellor and General Counsel, and the Director of Audits that a new rule, as set forth on Pages 14 – 15, be added to the Regents' *Rules and Regulations*, Series 20204 titled Determining and Documenting the Reasonableness of Compensation.

BACKGROUND INFORMATION

At the request of the Chancellor, The University of Texas System Audit Office reviewed the compensation setting process for highly compensated individuals within the U. T. System. As a result of that review, the Audit Office recommended the development of a System-wide policy for establishing the compensation of highly compensated personnel, defined as individuals whose total annual compensation is $500,000 or more.

The Internal Revenue Service's *Internal Revenue Manual*, Section 4233.27 lists the factors an IRS agent is to consider in determining the reasonableness of compensation in *Internal Revenue Code* (IRC) Section 162 regarding reasonable compensation cases. While IRC Section 162 and the *Internal Revenue Manual* Section 4233.27 are not applicable to the U. T. System as an agency of the State of Texas, the Chancellor recommends voluntary compliance with the spirit of Section 4233.27.

Under current policy, compensation for the presidents and others defined as "key employees" of U. T. System is determined in accordance with procedures outlined in Regents' *Rules and Regulations*, Series 20203 (Compensation for Key Executives). The U. T. System Audit Office has determined Series 20203 complies with the spirit of the *Internal Revenue Manual* for determining the reasonableness of compensation. Because Series 20203 is not applicable to all highly compensated employees such as highly recruited healthcare faculty researchers and some coaches, the proposed new rule will cover them. Under the proposed rule, the Chancellor is charged with developing a System-wide policy for ensuring institutions have processes in compliance with the spirit of Section 4233.27 for setting the compensation of highly compensated personnel. In addition, employees whose total annual compensation is $500,000 or more but less than $1,000,000 must be approved by the appropriate Executive Vice Chancellor. Under the proposed new rule, total annual compensation of $1,000,000 or more would be approved by the U. T. System Board of Regents.

1. Title

Determining and Documenting the Reasonableness of Compensation **(DRAFT)**

2. Rule and Regulation

Sec. 1 Setting of Compensation. Institutions of The University of Texas System are charged with setting compensation levels for Highly Compensated Personnel in such a way that compensation is reasonable and adequate documentation is maintained for supporting the reasonableness of compensation paid. *Internal Revenue Code* (IRC) Section 162 imposes a reasonableness requirement for the deductibility of compensation as a business expense and its applicability has been extended to tax-exempt organizations. IRC Section 4958 imposes excise taxes on excess benefit transactions between a tax-exempt organization and certain influential persons within the organizations. Although the U. T. System is not subject to the IRC sections, the process used to determine compensation by U. T. System shall be pursuant to a process in conformance with the spirit of the Internal Revenue Service (IRS) guidelines in *Internal Revenue Manual*, Section 4233.27, which lists the factors used to determine the reasonableness of compensation in IRC Section 162 reasonable compensation cases.

Sec. 2 Compliance with IRS Guidelines. The Chancellor shall develop a System-wide policy for establishing the compensation for Highly Compensated Personnel, not covered in Regents' *Rules and Regulations*, Series 20203 (which outlines the procedures for establishing the compensation of the presidents and executive officers at System Administration), that is in conformance with the spirit of the Internal Revenue Service's *Internal Revenue Manual*, Section 4233.27.

Sec. 3 Board Approval. Compensation for employees of the U. T. System whose total annual compensation is $1 million or more and who are not covered in Regents' *Rules and Regulations*, Series 20203 must be approved by the Board of Regents. The employing institution is responsible for providing documentation that the compensation was established in accordance with the System-wide policy for establishing the compensation for Highly Compensated Personnel.

Sec. 4 Executive Vice Chancellor Approval. Compensation for employees of the U. T. System whose total annual compensation is $500,000 or more but less than $1,000,000 and who are not covered in Regents' *Rules and Regulations*, Series 20203 must be approved by the appropriate Executive Vice Chancellor. The employing institution is responsible for providing documentation to the Executive Vice Chancellor that the compensation was established in accordance with the System-wide policy for establishing the compensation for Highly Compensated Personnel.

3. Definitions

Highly Compensated Personnel – employees of the U. T. System whose total annual compensation is $500,000 or more and are not covered in Regents' *Rules and Regulations*, Series 20203 (Compensation for Key Executives).

Total Annual Compensation – includes salaries or wages, employer contributions to Teacher Retirement System of Texas and Optional Retirement Program, practice plan supplements, incentive plan payments, unpaid deferred compensation, and excluding employer-provided insurance, expense allowances, and other fringe benefits.

4. Relevant Federal and State Statutes

Internal Revenue Code Section 162 – Trade or Business Expense

Internal Revenue Code of 1986 Section 4958 – Taxes on Excess Benefit Transactions

Internal Revenue Manual, Section 4233.27

5. Relevant System Policies, Procedures, and Forms

Regents' *Rules and Regulations*, Series 20202 – Presidential Cash Compensation

Regents' *Rules and Regulations*, Series 20203 – Compensation for Key Executives

6. Who Should Know

Chancellor
Executive Vice Chancellors
Vice Chancellor for Administration
Presidents

7. System Administration Office(s) Responsible for Rule

Chancellor

15. U. T. System Board of Regents: Proposed Appointment of Regental Representatives to U. T. Austin Intercollegiate Athletics Council for Men and Intercollegiate Athletics Council for Women Effective September 1, 2005

RECOMMENDATION

Chairman Huffines, with the concurrence of Chancellor Yudof and President Faulkner, recommends the following appointments as Regental representatives to the U. T. Austin Intercollegiate Athletics Council for Men and the Intercollegiate Athletics Council for Women each for a four-year term beginning September 1, 2005:

a. Appoint Mr. R. Steven Hicks to replace Mr. Robert K. Moses, Jr., on the Intercollegiate Athletics Council for Men

b. Reappoint George Willeford III, M.D., to the Intercollegiate Athletics Council for Women.

BACKGROUND INFORMATION

The U. T. Austin Intercollegiate Athletics Council for Men is a nine-member advisory group composed of a student, an ex-student, two Regental appointees and five members of the University General Faculty. The Regental appointments are for four-year staggered terms. Mr. Robert K. Moses, Jr., was appointed to the Council on September 1, 2000, to serve through August 31, 2005.

The Intercollegiate Athletics Council for Women is composed of nine voting members and one nonvoting member as follows: two students (one nonvoting), an ex-student, two Regental appointees, and five members of the University General Faculty. The Regental appointments are for four-year staggered terms. George Willeford III, M.D., has served on the Council since September 1, 1996.

Mr. Hicks is Chairman of Capstar Partners, LLC, a private investment company based in Austin, Texas. Prior to forming this new venture in June 2000, Mr. Hicks was Vice Chairman of AMFM Inc., the nation's largest owner and operator of radio stations.

Dr. Willeford, a gastroenterologist in private practice in Austin, is a graduate of U. T. Austin and The University of Texas Southwestern Medical School at Dallas. He is an active supporter of many aspects of the women's athletic program.

16. U. T. Austin: Request for approval of the reorganization of the John A. and Katherine G. Jackson School of Geosciences

RECOMMENDATION

The Chancellor concurs in the recommendation of the Executive Vice Chancellor for Academic Affairs and President Faulkner that the U. T. System Board of Regents

a. approve the reorganization of the John A. and Katherine G. Jackson School of Geosciences as a separate academic college-level entity under the leadership of a dean, by transfer of the Department of Geological Sciences and the Institute for Geophysics from the College of Natural Sciences and by transfer of the Bureau of Economic Geology from the portfolio of the Vice President for Research; and

b. authorize the Executive Vice Chancellor for Academic Affairs to submit this administrative change to the Texas Higher Education Coordinating Board for final approval.

BACKGROUND INFORMATION

The Jackson School of Geosciences was created in July 2001 to enable effective joint use of the proceeds of an endowment created through gifts of Mr. John A. Jackson prior to his death. It was named for Mr. Jackson and his late wife, Katherine G. Jackson. The Jackson School exists as a coordinating structure (rather than a governing structure) and includes one academic unit, the Department of Geological Sciences, and two research units, the Bureau of Economic Geology and the Institute for Geophysics. The Jackson School is headed by a Director who reports to the Dean of the College of Natural Sciences. The Chair of the Department of Geological Sciences and the Director of the Institute for Geophysics also report to the Dean of the College of Natural Sciences. The Director of the Bureau of Economic Geology reports to the Vice President for Research.

Upon the death of Mr. Jackson, U. T. Austin received from his estate more than $250 million for an endowment to build a premier program in geosciences. Mr. Jackson instructed that geosciences include "...geology; geophysics; energy, mineral and water resources; as well as the broad areas of the earth sciences, including Earth's environment." Given the scale and transformative potential of this gift, President Faulkner concluded in 2003 that U. T. Austin should not establish patterns of use of the proceeds without careful thought about the most effective strategy for developing the geosciences at U. T. Austin. Toward that end, he appointed a Jackson School Vision Committee under the leadership of President Emeritus Peter T. Flawn. The Vision

Committee reported in December 2003 with a number of recommendations, principal among them that the Jackson School be reorganized to bring the units into closer interaction and common governance.

On April 1, 2004, President Faulkner issued to all members of the Jackson School a detailed response to the Vision Committee's report. He laid out three possible organizational paths that U. T. Austin might follow and invited further comment. On the basis of the responses and his own further analysis, President Faulkner concluded in late April that it would be best to pursue the concept of a "federated school" governing structure. This would provide an effective combination of the resources of the three units to optimize the teaching and research programs in the School.

President Faulkner then asked a Jackson School Implementation Committee to design a specific plan for reorganizing the Jackson School. That plan ultimately was approved by vote of the members of the Jackson School and by Executive Vice President and Provost Sheldon Ekland-Olson. President Faulkner subsequently consulted with the leadership and membership of the Faculty Council. Based upon that consultation, some proposals recommended by the Implementation Committee that are subject to institutional control and that are specific to the composition of appointments, tenure, and graduate studies committees are being modified.

The reorganized Jackson School will be headed by a dean who will report to the Executive Vice President and Provost, as do other academic college-level units. The Chair of the Department of Geological Sciences and the Directors of the Bureau of Economic Geology and the Institute for Geophysics will report to the new dean.

Upon approval of this recommendation, the Counsel and Secretary to the Board will amend the Regents' *Rules and Regulations*, Series 40601, which lists institutions and entities comprising the U. T. System, to add the John A. and Katherine G. Jackson School of Geosciences.

17. **U. T. Dallas: Creation of an Advisory Council for the new Cecil H. and Ida Green Center for Systems Biology Science (Regents' *Rules and Regulations*, Series 60302, regarding advisory councils)**

RECOMMENDATION

The Chancellor concurs in the recommendation of the Executive Vice Chancellor for Academic Affairs, the Vice Chancellor for External Relations, and President Daniel that the U. T. System Board of Regents approve the creation of an Advisory Council at U. T. Dallas to be known as the Cecil H. and Ida Green Center for Systems Biology Science Advisory Council.

BACKGROUND INFORMATION

The Cecil H. and Ida Green Center for Systems Biology Science was created by refocusing funds from the various gifts made to U. T. Dallas over the years by Mr. and Mrs. Green into a program designed to enhance a key U. T. Dallas research priority, biomedical science, and to strengthen the spirit and reality of closer collaborations with U. T. Southwestern Medical Center - Dallas. Both of these priorities were at the top of the list of the recommendations for U. T. Dallas formulated by the Washington Advisory Group and presented to the U. T. System Board of Regents in May 2004.

The proposed Advisory Council will have responsibility for sustaining the focus of the Green Center on forefront research in the field of Systems Biology Science; on fostering close and mutually beneficial collaborations between U. T. Dallas and U. T. Southwestern Medical Center - Dallas, in particular between the U. T. Dallas Green Center for Systems Biology Science and the U. T. Southwestern Cecil H. and Ida Green Comprehensive Center for Molecular, Computational and Systems Biology; and on ensuring that scientific discoveries that hold promise for improving human health are developed into practical therapies. The Council will review the credentials of candidates for appointment to endowed faculty positions in the Green Center for Systems Biology Science.

Proposed approval of this Advisory Council is pursuant to the Regents' *Rules and Regulations*, Series 60302, which requires Board approval for the establishment of new advisory councils.

18. U. T. System: Approval to authorize requirement of criminal background checks of applicants and students of clinical programs and charge necessary fees

RECOMMENDATION

The Chancellor concurs in the recommendation of the Executive Vice Chancellor for Academic Affairs, the Executive Vice Chancellor for Health Affairs, and the Vice Chancellor and General Counsel that authority be granted to all institutions offering clinical programs to

a. require criminal background checks of applicants and students as a condition of admission and continued participation in clinical programs; and

b. charge fees as necessary to cover the cost of the criminal background check and related services.

If approved by the Board, the next appropriate institutional catalogs will be amended to reflect this action.

BACKGROUND INFORMATION

Increasingly, facilities in which students enrolled in clinical programs receive education and training require a criminal background check. Licensing boards and clinical facilities in Texas require criminal background checks before issuing a license to practice or allowing the student in their facility. All U. T. institutions with clinical programs subject to this authorization will amend catalogs to inform prospective applicants of this requirement. Individuals who are unable to pass the criminal background check may be denied admission or continued enrollment in the program.

The detailed policies for conduct of such criminal background checks including issues of confidentiality must be approved by the Office of General Counsel and the Executive Vice Chancellor for Academic Affairs or the Executive Vice Chancellor for Health Affairs.

19. U. T. M. D. Anderson Cancer Center: Authorization to extend the term of the leaseback to the U.S. Government Department of Defense of approximately 18 acres of land and improvements located at 1850 and 1902 Old Spanish Trail, Houston, Harris County, Texas (DOD Site); and finding of public purpose

RECOMMENDATION

The Chancellor concurs in the recommendation of the Executive Vice Chancellor for Business Affairs, the Executive Vice Chancellor for Health Affairs, the Vice Chancellor and General Counsel, and President Mendelsohn that authorization be granted by the U. T. System Board of Regents, on behalf of U. T. M. D. Anderson Cancer Center, to

a. extend the leaseback to the U.S. Government Department of Defense from a term not to exceed four years to a term not to exceed 10 years from the date of acquisition of approximately 18 acres of land and improvements located at 1850 and 1902 Old Spanish Trail, Houston, Harris County, Texas (DOD Site) during construction by the Department of Defense of the Ellington Site joint Reserve facilities;

b. determine that the lease of the DOD Site and improvements thereon to the U.S. Government for an extended term to include periods of no rent or below market rent serves a public purpose appropriate to the function of U. T. M. D. Anderson Cancer Center, and that the consideration to the U. T. System and U. T. M. D. Anderson Cancer Center for lease of the DOD Site is adequate; and

c. authorize the Executive Vice Chancellor for Business Affairs or the Executive Director of Real Estate to execute all documents, instruments, and other agreements, subject to approval of all such documents as to legal form by the Office of General Counsel, and to take all further actions deemed necessary or advisable to carry out the purpose and intent of the foregoing actions.

BACKGROUND INFORMATION

On May 12, 2005, in furtherance of the long-term strategic plan for U. T. M. D. Anderson Cancer Center for development of The University of Texas Research Park on land located south of Old Spanish Trail, authorization was granted by the U. T. System Board of Regents, on behalf of U. T. M. D. Anderson Cancer Center, to: (1) acquire the Ellington Site and then convey the Ellington Site to the U.S. Government Department of Defense, together with a cash equalization payment in the amount of approximately $18.2 million from institutional funds for the construction of new joint Reserve facilities at the Ellington Site, in exchange for the conveyance by the U.S. Government Department of Defense to the U. T. System of the DOD Site; and (2) enter into a leaseback to the U.S. Government Department of Defense for a period not to exceed four years from the date of closing to occupy the DOD Site during construction by the Department of Defense of the Ellington Site joint Reserve facilities. This Agenda Item seeks additional approvals with respect to the proposed exchange transaction between the U. T. System and the U.S. Government Department of Defense.

Since the approval in May 2005, U. T. M. D. Anderson Cancer Center and the U.S. Government Department of Defense have continued their negotiations of the exchange transaction and the leaseback. Those negotiations include new lease terms to address certain concerns of the U.S. Government Department of Defense. Due to uncertainties regarding the timing of future appropriations to complete the construction of the Ellington Site new joint Reserve facilities, and because the reserve units stationed at the DOD Site have no alternative facilities in the Houston area, the U.S. Government Department of Defense has insisted on a leaseback term well in excess of four years, and the parties have negotiated a maximum leaseback term of 10 years from the date of closing.

Additionally, because there is a substantial lead time inherent in the U.S. Government Department of Defense's budget appropriation process, it is concerned about events beyond its reasonable ability to anticipate or control (Force Majeure Events) that may delay completion of the new joint Reserve facilities beyond the initial four-year rent-free period. To address these concerns, the parties have negotiated to extend the no-rent period beyond the four years previously approved by the number of days lost to Force Majeure Events that occur during the initial four-year period of the lease.

Finally, if construction of the new joint Reserve facilities at the Ellington Site takes longer than four years, the Department of Defense is concerned about obtaining additional funding from Congress to cover its rental obligations. U. T. M. D. Anderson Cancer Center, while recognizing the Department of Defense's funding and appropriation issues, also wants to motivate the U.S. Government Department of Defense to diligently pursue completion of the new joint Reserve facilities and promptly vacate the DOD Site. As a means of addressing both parties' concerns, the parties are negotiating a graduated rental rate for the fifth year through the tenth year of the lease term. The average graduated rental rate will be based on the fair market rental rate for that six-year period, as determined by appraisal prior to the fifth year of the lease. Although the specific rental rate graduations are still subject to negotiation, the parties contemplate rental rates substantially lower than fair market value in years five, six, and seven, and rising to rental rates substantially above fair market value in years 9 and 10 of the lease.

These additional lease terms are critical and necessary elements in effecting the property exchange at this time. The lease serves a public purpose appropriate to the function of U. T. M. D. Anderson Cancer Center, and provides adequate consideration for the U. T. System because it enables a transaction that

1. establishes a fixed price at the current appraised value in an escalating market, thus allowing U. T. M. D. Anderson Cancer Center to avoid market risk, future development risk, and the financial responsibility for any changes in scope to the new joint Reserve facility;

2. enhances the overall value of the contiguous U. T. Research Park land;

3. permits the activities of the Reserves on the DOD Site to continue while a new joint use facility is built; and

4. represents U. T. M. D. Anderson Cancer Center's best chance of acquiring the DOD Site, inasmuch as the DOD Site cannot be acquired by condemnation.

The terms and conditions of the leaseback of the DOD Site are reflected in the summary of the transaction set forth on Page 24. A map of the subject property is attached on Page 25.

Transaction Summary

Institution:	U. T. M. D. Anderson Cancer Center
Type of Transaction:	Lease
Total Area:	Army: 8.26 acres Navy and Marine Corps: 9.98 acres
Improvements:	Army, Navy and Marine Corps Reserves facilities; special use buildings incorporating office, classroom, and open drill hall and storage facilities; small outbuildings for storage, vehicle maintenance, and similar uses Army: 90,160 gross square feet in one main building and in two outbuildings; approximately 400-425 parking spaces Navy and Marine Corps: 97,953 gross square feet in three main buildings and in several outbuildings; 511 parking spaces
Location:	1850 and 1902 Old Spanish Trail, Houston, Texas; see attached map
Tenant:	U. S. Government
Consideration:	No rent years 1-4; additional rent-free period equal to the number of Force Majeure Event days experienced in years 1-4 Graduated rental stream years 5-10, based on fair market rental to be determined by appraisal prior to year 5 Rent substantially below market years 5-7 Rent approximately at market year 8 Rent substantially above market years 9-10 In lieu of fair market rent throughout the lease term, consideration for lease is enhanced value and usefulness of adjoining Cancer Center property and recognition that 2004 federal legislation removes risk to Cancer Center that was inherent in obligation under prior federal law to provide complete replacement facility to the Department of Defense
Lease Term:	Until Reserve elements relocate to Ellington Site joint Reserve facilities to be built, but not to exceed 10 years from the date of property exchange
Appraised Value:	Fee simple: $21,455,000 (Gerald A. Teel Company, January 13, 2005, amended February 16, 2005, clarified June 2005)
Intended Use:	Army, Navy, and Marine Corps Reserves training facilities


TEXAS MEDICAL
CENTER
MID-CAMPUS
1850 and 1902
OLD SPANISH TRAIL
U.T. RESEARCH
PARK