PUF Distribution Discussion

THE UNIVERSITY of TEXAS SYSTEM
Nine Universities. Six Health Institutions. Unlimited Possibilities.

Presented to:
Meeting of the Board
By: Dr. Scott Kelley
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Current PUF Distribution Policy

- **The current PUF distribution policy is 4.75% of the average net asset value of the PUF for the trailing 12 fiscal quarters, calculated as of the fiscal quarter ending on the last day of February of each year.**
- **At its meeting on May 10, 2007, the Board approved a PUF distribution of $448,942,761 for Fiscal Year 2008.**
- **Based on the current distribution policy, the amount of the distribution for Fiscal Year 2009 is forecasted to be approximately $506 million.**

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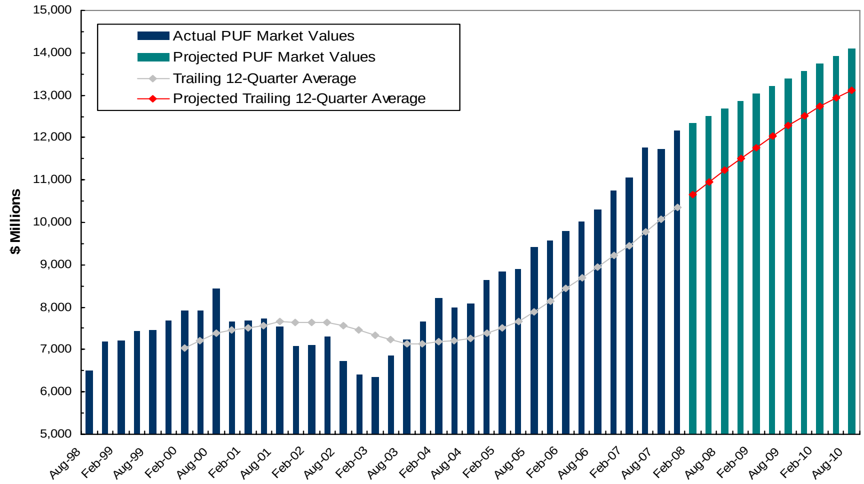
Projected Trailing 12-Quarter PUF Market Value Average



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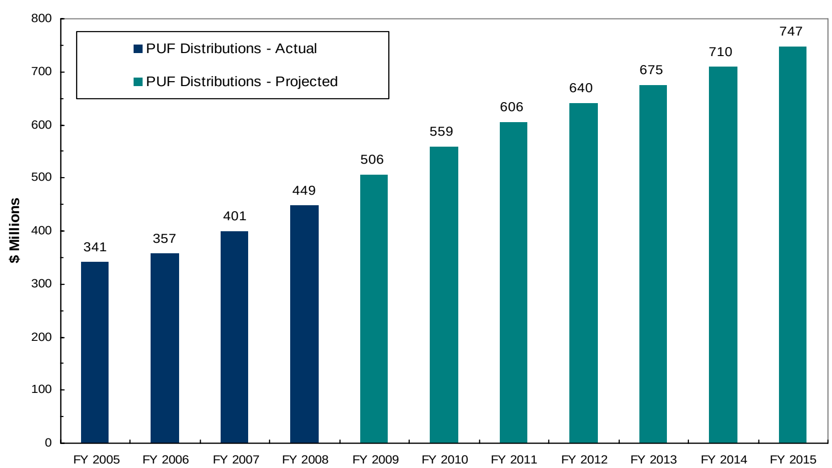
PUF Distributions to the AUF



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Constitutional Restrictions on PUF Distributions

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- **The amount of any distribution to the AUF must be determined by the Board in a manner intended to provide the AUF with a stable and predictable stream of annual distributions and to maintain over time the purchasing power of PUF investment assets and annual distributions to the AUF.**
- **The amount distributed to the AUF in a fiscal year must be not less than the amount needed to pay PUF debt service.**
- **If the purchasing power of PUF investments for any rolling ten-year period is not preserved, the Board may not increase annual distributions to the AUF until the purchasing power of PUF investment assets is restored, except as necessary to pay PUF debt service.**
- **An annual distribution made by the Board to the AUF during any fiscal year may not exceed an amount equal to 7% of the average net fair market value of PUF investment assets as determined by the Board, except as necessary to pay PUF debt service.**

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Distribution and Return Scenarios

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Distribution Scenario	PUF Expected Return March 2008 – August 2008	PUF Expected Return September 2008 – August 2009	PUF Expected Return September 2009 – August 2010	PUF Expected Return September 2010 and Beyond
1. 4.75% Distribution (Base Case)	**8.34%**	**8.47%**	**8.62%**	**8.75%**
2. 5.00% Distribution	**8.34%**	**8.47%**	**8.62%**	**8.75%**
3. 4.75% or 5.0% Distribution (Base Case less 200 bps) *	**6.34%**	**6.47%**	**6.62%**	**6.75%**
4. 4.75% or 5.0% Distribution (Base Case plus 200 bps) *	**10.34%**	**10.47%**	**10.62%**	**10.75%**

* In scenarios 3 and 4, the payout would increase to 5.00% if the average annual return over the prior 12Q exceeded the expected return plus 25 bps. If the actual return did not exceed this threshold, the payout would remain at 4.75%.

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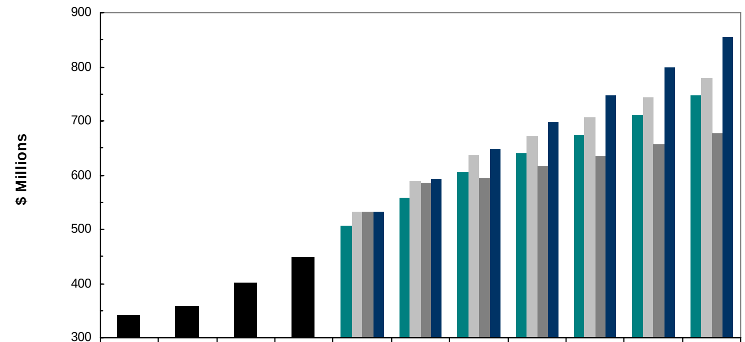
PUF Distributions Under Various Scenarios



	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015
Actual	341	357	401	449							
Projected - Scenario 1					506	559	606	640	675	710	747
Projected - Scenario 2					533	588	637	672	707	742	779
Projected - Scenario 3					532	585	594	616	636	656	677
Projected - Scenario 4					533	592	648	697	747	799	855

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Impact of Increasing the Distribution Rate to 5.0%

- Compared to a 4.75% distribution rate, increasing the distribution rate to 5.0% would increase annual distributions by approximately $30 million annually for an initial 15 years. Thereafter, the benefit would decline rapidly due to a lower rate of growth of the endowment. By year 24, distributions would be equal. Thereafter, distributions at 4.75% would be significantly higher through perpetuity.

- Increased distributions could provide funding for increased investments in capital assets in the near term, which could generate real returns directly to the institutions.

- Increasing the distribution rate slows the dollar growth of the endowment, thereby decreasing the amount of PUF debt permitted to be issued under the Texas Constitution (20% of the PUF cost value).

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Pros and Cons of Increasing the Distribution Rate

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- **Pros**
  - **Increased distributions could permit additional investments in excellence to further meet societal demands and produce real returns through increased research and philanthropy.**
  - **Increases financial debt capacity in the intermediate term (not the operative constraint).**
  - **Increases the projected AUF balance, which can be used for operational and capital purposes at U. T. Austin and at U. T. System Administration.**
  - **Provides additional resources to accelerate capital investments at a time of rising construction costs and low cost of capital.**

- **Cons**
  - **Converts investments earning 8.34%+ per annum into cash.**
  - **Reduces Constitutional debt capacity – cost of PUF debt is about 4.0%.**
  - **Reduces financial debt capacity in the out years.**
  - **Greater risk of triggering Constitutional purchasing power limitations.**

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Effect of Payout Ratio on PUF Value

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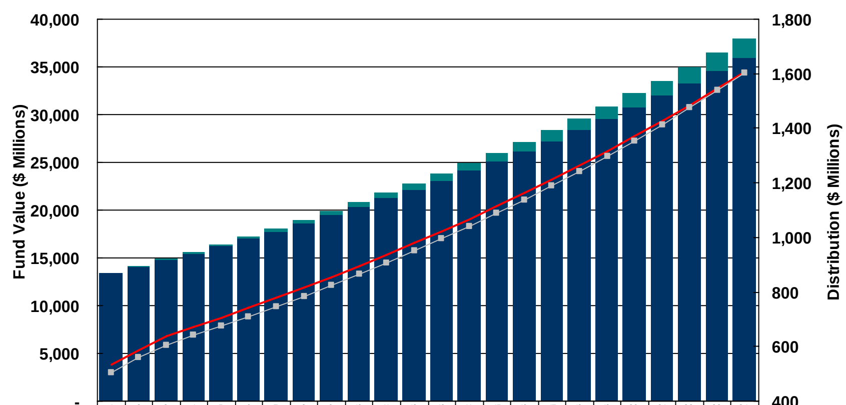

	1	2	3	4	5	6	7	8	9	10	11	12
Incremental Value (4.75%Distribution)	28	61	99	141	187	236	289	347	409	475	546	623
PUF Value (5%Distribution)	13,359	14,044	14,752	15,478	16,226	16,998	17,793	18,612	19,458	20,330	21,229	22,157
4.75%Distribution	506	559	606	640	675	710	747	785	824	864	906	950
5.0%Distribution	533	588	637	672	707	742	779	816	855	895	936	979

	13	14	15	16	17	18	19	20	21	22	23	24
Incremental Value (4.75%Distribution)	704	792	885	984	1,090	1,203	1,323	1,451	1,586	1,730	1,883	2,045
PUF Value (5%Distribution)	23,115	24,103	25,123	26,175	27,262	28,384	29,543	30,739	31,975	33,251	34,569	35,930
4.75%Distribution	994	1,041	1,089	1,138	1,189	1,243	1,298	1,355	1,413	1,474	1,538	1,603
5.0%Distribution	1,022	1,068	1,114	1,162	1,212	1,263	1,316	1,370	1,427	1,485	1,545	1,607

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