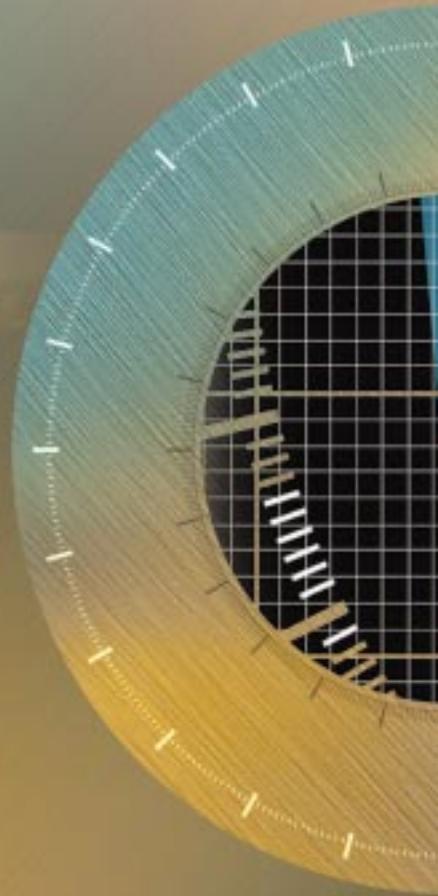


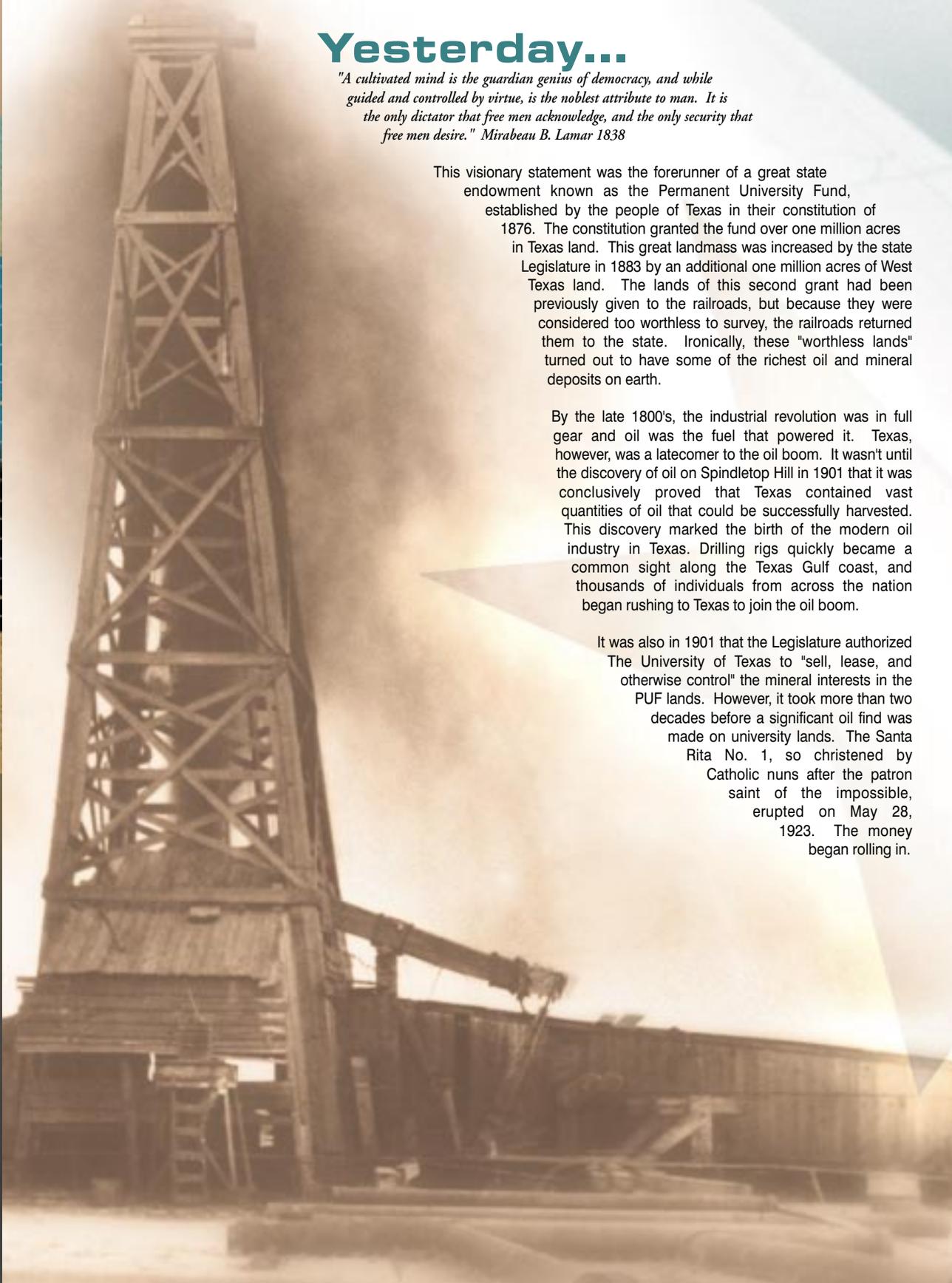
*History of the*

## **Permanent University Fund**

*1876 - present - time tells the story*



The Permanent University Fund (PUF) was established in the Texas Constitution of 1876 through appropriations of land grants previously given to The University of Texas at Austin plus an additional one million acres in 1883. The PUF is a public endowment contributing to the support of certain institutions of The University of Texas System and The Texas A&M University System. The history of the PUF spans a rather colorful and storied past, from its inception in the early days of Texas, to its relevance today as a modern investment fund for the furthering of higher education in the state.

A tall, wooden oil derrick structure, likely a Spindletop Hill derrick, stands against a bright, hazy sky. The structure is made of dark wood with a complex lattice of beams. The background is a soft, golden light, suggesting a sunrise or sunset. The overall tone is historical and industrial.

# Yesterday...

*"A cultivated mind is the guardian genius of democracy, and while guided and controlled by virtue, is the noblest attribute to man. It is the only dictator that free men acknowledge, and the only security that free men desire." Mirabeau B. Lamar 1838*

This visionary statement was the forerunner of a great state endowment known as the Permanent University Fund, established by the people of Texas in their constitution of 1876. The constitution granted the fund over one million acres in Texas land. This great landmass was increased by the state Legislature in 1883 by an additional one million acres of West Texas land. The lands of this second grant had been previously given to the railroads, but because they were considered too worthless to survey, the railroads returned them to the state. Ironically, these "worthless lands" turned out to have some of the richest oil and mineral deposits on earth.

By the late 1800's, the industrial revolution was in full gear and oil was the fuel that powered it. Texas, however, was a latecomer to the oil boom. It wasn't until the discovery of oil on Spindletop Hill in 1901 that it was conclusively proved that Texas contained vast quantities of oil that could be successfully harvested. This discovery marked the birth of the modern oil industry in Texas. Drilling rigs quickly became a common sight along the Texas Gulf coast, and thousands of individuals from across the nation began rushing to Texas to join the oil boom.

It was also in 1901 that the Legislature authorized The University of Texas to "sell, lease, and otherwise control" the mineral interests in the PUF lands. However, it took more than two decades before a significant oil find was made on university lands. The Santa Rita No. 1, so christened by Catholic nuns after the patron saint of the impossible, erupted on May 28, 1923. The money began rolling in.

## Tomorrow...

*"Democracy cannot succeed unless those who express their choice are prepared to choose wisely. The real safeguard of democracy, therefore, is education."*  
Franklin D. Roosevelt

Tomorrow provides no assurances other than the promise that there will be obstacles to overcome. The University of Texas and Texas A&M University Systems are likely to become increasingly dependent upon the PUF in the future as state appropriations have not kept pace with inflation. As a result of the passage of Proposition 17 in 1999, capital expenditure budgets for the two systems over the first five post-amendment years have expanded to spend \$572 million in PUF distributions. However, expected increases in student enrollment rates will stress the PUF's ability to make distributions to the AUF that will keep pace with inflation on a per student basis. Legislators, system boards, and the institutions will have to work together to solve these and other problems of the new millennium.

The essential guide for the PUF is to continue to balance the needs and interests of present beneficiaries with those of beneficiaries of the future. The Texas Constitution states: "The amount of any distributions to the available university fund shall be determined by the Board of Regents of The University of Texas System in a manner intended to provide the available university fund with a stable and predictable stream of annual distributions to maintain over time the purchasing power of permanent university fund investments and annual distributions to the available university fund."

Looking forward, when future generations study the PUF's history, time again will tell the story of the PUF's enduring support for academic excellence at the University of Texas and Texas A&M University institutions.

## Legislative History of the Permanent University Fund

Many legislative and legal events throughout the 20<sup>th</sup> century transformed the PUF to what it is today.

- 1926 - The Texas Supreme Court ruled that proceeds from the sale of oil from the PUF lands should be considered sale of part of the "corpus of the estate" and could not be regarded as income.
- 1928 - The Texas Attorney General issued an opinion stating that the UT Board could issue bonds against the annual income from the PUF.
- 1931 - Legislation was passed which provided that the income from the PUF be divided two-thirds to The University of Texas and one-third to Texas A&M University.
- 1947 - Due to rapidly increasing enrollments, a constitutional amendment was passed authorizing a significant-sized bond issue. The proceeds would be used to fund not only The University of Texas and Texas A&M University, but also The University of Texas Medical Branch at Galveston.
- 1956 - Constitutional amendment allowed the PUF to invest in corporate stocks and bonds and the UT Board was allowed to issue PUF bonds in an amount not to exceed 20% of the PUF cost value (exclusive of real estate).
- 1978 - The Texas Attorney General issued an opinion that interest accruing from the PUF must be used to retire outstanding debt obligations and to finance permanent improvements.

During the mid-1970's to mid-1980's mineral royalties surged and were the source of growth to the PUF's investment income, much of which was obtained through fixed income investments earning double-digit interest rates during periods of high inflation.

- 1984 - Constitutional amendment enlarged the overall bonding capacity of the University of Texas and Texas A&M University Systems to 30% of the PUF's cost (book) value. Existing University of Texas and Texas A&M University System institutions were eligible to benefit from PUF bond proceeds. This nearly doubled the number of beneficiaries receiving PUF support.

Following the mid-1980's, a decline in interest rates and mineral royalties indicated that future growth in annual PUF distributions to the Available University Fund (AUF) needed to be generated through total return (interest, dividends, and capital gains) on investments.

- 1988 - Constitutional amendment authorized the UT Board to invest according to the "prudent person" investment standard thereby creating greater flexibility in the choice of investments.
- 1996 - Legislation was passed allowing the UT Board to enter into a contract with a newly formed entity, The University of Texas Investment Management Company (UTIMCO). UTIMCO, the first external investment management corporation formed by a public university system, with its own dedicated Board appointed by the UT Board, assumed investment management responsibilities for the PUF.

PUF distributions to the AUF essentially remained flat during the 1990's and it became apparent that maintaining the purchasing power of PUF distributions could only occur by tying the distributions to the market value of PUF investments.

- 1999 - Constitutional amendments provided that distributions from the PUF would be based on the total return of all investment assets, including net gains on investments. This amendment directed the Board of Regents to establish a distribution policy that provided stable, inflation adjusted annual distributions to the AUF and preserved the real value of the PUF Investments over the long term.

With the amendment of the Texas Constitution through Proposition 17 in 1999, distributions from PUF investments to the AUF increased by 12.8%, 6.6%, and 6.7% for the fiscal years ending August 31, 2000, 2001, and 2002, respectively.

The PUF's mission has been clarified and re-affirmed by legislative action throughout the last 125 years. The PUF has changed from a mineral-based fund to an investment-based fund and today serves more than 160,000 students at 18 institutions and six agencies of The University of Texas System and The Texas A&M University System.



## The Texas A&M University System

<b>Component Institution</b>	<b>Fall 2000 FTE's</b>
Prairie View A&M University	5,742
Tarleton State University	5,779
Texas A&M University	37,104
Texas A&M at Galveston	1,280
The Texas A&M University Health Science Center	1,014
Texas Agriculture Experiment Station	*
Texas Agricultural Extension Service	*
Texas Engineering Experiment Station	*
Texas Engineering Extension Service	*
Texas Forest Service	*
Texas Transportation Institute	*

FTE's - Full-time equivalent students

\* dedicated to research

# The Permanent University Fund Today

## PUF Lands

PUF Lands consist of 2.1 million acres in 24 counties primarily in West Texas and are managed by the UT System under the direction of the Board of Regents. The lands produce two streams of income: one from oil, gas, and mineral interests, and the other from surface interests such as grazing.

## PUF Investments

The PUF Investments consist of a diversified portfolio of broadly defined equity, fixed income and absolute return investments and are managed by The University of Texas Investment Management Company (UTIMCO).

## PUF Beneficiaries

The PUF has grown over the last 125 years to support 18 component institutions and six agencies of The University of Texas System and The Texas A&M University System.

## PUF Distributions to the AUF

- PUF distributions to the Available University Fund (AUF) are from the total return on PUF Investments, including income return as well as capital gains (realized and unrealized) and the net income attributable to the surface of the PUF lands (refer to flow chart on back cover).
- The Texas Constitution directed the UT Board to establish a distribution policy that provides stable, inflation-adjusted distributions to the AUF and preserves the real value of the PUF investments over the long term. To achieve this, the annual distribution was established at 4.5% of the prior 12 quarters' average net asset value of the PUF Investments, as determined each February 28 for the following fiscal year. (The annual distribution percentage has been increased to 4.75% effective for the fiscal year beginning September 1, 2002.) PUF distributions to the AUF are subject to the following overriding conditions:

- (1) A minimum amount equal to the amount needed to pay debt service on PUF bonds;
- (2) No increase from the preceding year (except as necessary to pay debt service on PUF bonds) unless the purchasing power of PUF Investments for any rolling 10-year period has been preserved;
- (3) A maximum amount equal to seven percent of the average net fair market value of PUF Investments in any fiscal year, except as necessary to pay debt service on PUF bonds.

The average annual distribution rate for the 493 College and University Endowments as reported by the National Association of College and University Business Offices (NACUBO) study for June 30, 2000, was 4.9%. According to the study, institutions with smaller endowments tend to report a slightly higher distribution rate on average than larger endowments. Endowments with greater than \$1.0 billion in assets reported an average rate of 4.1%.

## Available University Fund (AUF)

The Available University Fund (AUF) is the recipient of PUF distributions and is allocated for the benefit of eligible institutions of The University of Texas and The Texas A&M University Systems, two-thirds and one-third, respectively.

Each System's portion of the AUF is expended to fund two major programs as follows:

- **Debt service on PUF bonds issued to fund capital.**  
The constitution authorizes the UT Board and the Texas A&M University Board to issue bonds (PUF bonds) payable from their respective interests in the AUF. PUF bonds are issued to finance construction and renovation projects, major library acquisitions, and educational and research equipment at the 18 eligible campuses and six agencies of the two university systems. The UT and Texas A&M University System boards may issue bonds secured by each system's interest in the AUF in amounts not to exceed 20% and 10%, respectively, of the book value of PUF assets at the time of issuance.
- **After the payment of debt service on PUF bonds, each system may spend their residual portion of the AUF on academic excellence programs. These programs may include expenditures for scholarships and fellowships, student services, organized research, institutional support, library books, and many other items.**  
In combination, these activities enhance the universities' competitive posture as they seek to attract the best scholars in fulfilling their roles as world-class academic and research universities. Distributions for academic excellence programs take second priority to debt service on PUF bonds and are limited to support of UT Austin, Texas A&M University, and Prairie View A&M University.



## The University of Texas System

<b>Component Institution</b>	<b>Fall 2000 FTE's</b>
UT Arlington	14,386
UT Austin	42,772
UT Dallas	7,404
UT El Paso	11,270
UT Permian Basin	1,554
UT San Antonio	13,274
UT Tyler	2,316
UT Southwestern Medical Center at Dallas	1,650
UT Medical Branch at Galveston	2,013
UT Health Science Center at Houston	2,864
UT Health Science Center at San Antonio	2,493
UT M. D. Anderson Cancer Center	42
UT Health Center at Tyler	*

FTE's - Full-time equivalent students

\* dedicated to research

# Permanent University Fund (PUF)

**PUF Lands**  
(2,109,190 acres)

Mineral Receipts

**PUF Investments**  
\$7.8 billion book value  
as of August 31, 2001.

**Prior to November 29, 1999**, amount of distribution to the Available University Fund (AUF) consisted of all dividends, interest and other income of the PUF, including the net income attributable to the surface of the PUF Lands. Expenses attributable to the administration of the PUF were paid from the AUF prior to the UT and TAMU system division.

**Subsequent to November 28, 1999**, the amount of the distribution to the AUF is determined by the UT Board from the "total return" on all investments of the PUF, including the net income attributable to the surface of the PUF Lands. The Constitution directs the UT Board to establish a distribution rate that preserves the PUF's purchasing power.

## Available University Fund (AUF)

### 2/3 to The University of Texas System (UT System)

#### Security for UT System PUF bonds and notes:

1. Can only issue bonds and notes of the UT System up to 20% of cost value of the PUF (excluding real estate).
2. PUF bonds payable from the first lien on the UT System's interest in the AUF.
3. Subordinate Lien Notes of the UT System payable after obligations listed in 2. above.
4. The UT Board reserves the right to issue obligations on parity with PUF bonds and Subordinate Lien Notes of the UT System subject to 1. above, or with a junior lien and pledge thereto.

#### Residual AUF

Residual AUF income constitutionally appropriated to UT Austin and the UT System for specified purposes.

### 1/3 to The Texas A&M University System (TAMU System)

#### Security for TAMU System PUF bonds and notes:

1. Can only issue bonds and notes of the TAMU System up to 10% of cost value of the PUF (excluding real estate).
2. PUF bonds payable from the first lien on the TAMU System's interest in the AUF.
3. Subordinate Lien Notes of the TAMU System payable after obligations listed in 2. above.
4. The TAMU Board reserves the right to issue obligations on parity with PUF bonds and Subordinate Lien Notes of the TAMU System subject to 1. above, or with a junior lien and pledge thereto.

#### Residual AUF

Residual AUF income constitutionally appropriated to the TAMU System for specified purposes.