

**THE UNIVERSITY OF TEXAS SYSTEM
PERMANENT UNIVERSITY FUND
INVESTMENT POLICY STATEMENT**

Purpose

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

PUF Organization

The PUF was established in the Texas Constitution of 1876 through the appropriation of land grants previously given to The University of Texas at Austin plus one million acres. The land grants to the PUF were completed in 1883 with the contribution of an additional one million acres of land. Today, the PUF contains 2,109,190 acres of land (the "PUF Lands") located in 19 counties primarily in West Texas.

The 2.1 million acres comprising the PUF Lands produce two streams of income: a) mineral income, primarily in the form of oil and gas royalties and b) surface income, primarily from surface leases and easements. Under the Texas Constitution, mineral income, as a non-renewable source of income, remains a non-distributable part of PUF corpus, and is invested pursuant to this Policy Statement. Surface income, as a renewable source of income, is distributed to the Available University Fund (the "AUF"), as received. The Constitution also requires that all surface income and investment distributions paid to the AUF be expended for certain authorized purposes.

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

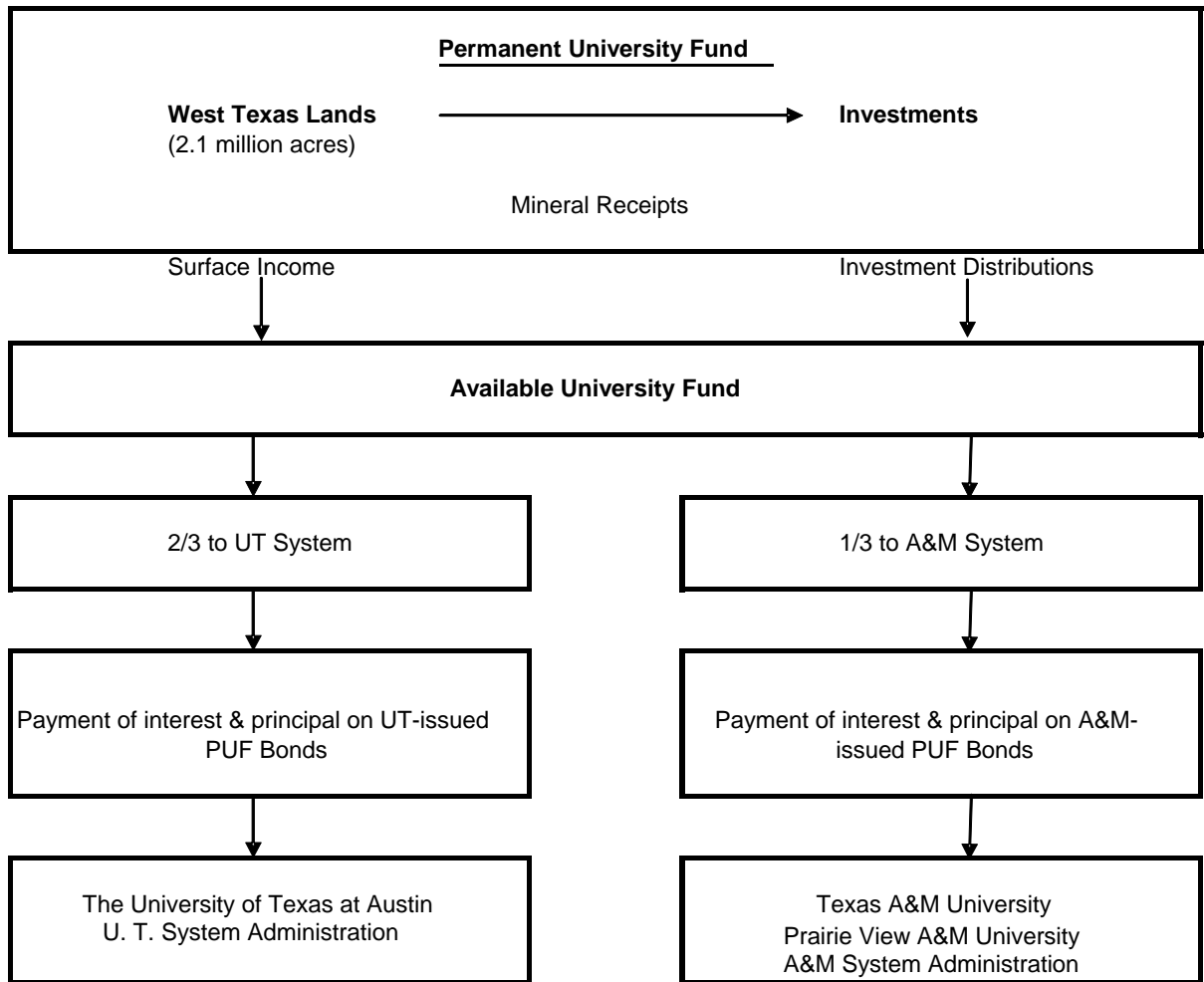
First, following a 2/3rds and 1/3rd allocation of AUF receipts to the U. T. System and the A&M System, respectively, expenditures for debt service on PUF bonds. Article VII of the Texas Constitution authorizes the Board of Regents and the Texas A&M University System Board of Regents (the "TAMUS Board")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

preceding fiscal year covers projected debt service on all PUF Bonds of that System by at least 1.5 times.

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

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

Exhibit 1



PUF Management

Article VII, Section 11b of the Texas Constitution assigns fiduciary responsibility for managing and investing the PUF to the Board of Regents. Article VII, Section 11b authorizes the Board of Regents, subject to procedures and restrictions it establishes, to invest the PUF in any kind of investments and in amounts it considers appropriate, provided that it adheres to the prudent investor standard. This standard provides that the Board of Regents, in making investments, may acquire, exchange, sell, supervise, manage, or retain, through procedures and subject to restrictions it establishes and in amounts it considers appropriate, any kind of investment that prudent investors, exercising reasonable care, skill, and caution, would acquire or retain in light of the purposes, terms, distribution requirements, and other circumstances of the fund then prevailing, taking into consideration the investment of all the assets of the fund rather than a single investment.

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

Pursuant to an Investment Management Services Agreement between the Board of Regents and The University of Texas Investment Management Company ("UTIMCO"), the PUF shall be managed by UTIMCO, which shall a) recommend investment policy for the PUF, b) recommend specific asset allocation targets, ranges and performance benchmarks consistent with PUF objectives, and c) monitor PUF performance against PUF objectives. UTIMCO shall invest the PUF's assets in conformity with this Policy Statement. All changes to this Policy Statement or the exhibits to this Policy Statement, including changes to asset allocation targets, ranges, and performance benchmarks, are subject to approval by the Board of Regents.

UTIMCO may select and terminate unaffiliated investment managers subject to the Delegation of Investment Approval Authority approved by the UTIMCO Board. Managers shall be monitored for performance and adherence to investment disciplines.

PUF Administration

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

PUF Investment Objectives

The PUF and the General Endowment Fund (the “GEF”) are pooled for efficient investment purposes. The primary investment objective for each fund 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 current 5.1% target was derived by adding the PUF’s current target distribution rate of 4.75% plus an annual expected expense of .35%. The target is subject to adjustment from time to time consistent with the primary investment objectives for the funds. The PUF’s success in meeting its objectives depends upon its ability to generate high returns in periods of low inflation that will offset lower returns generated in years when the capital markets underperform the rate of inflation.

The secondary fund objective is to generate a fund return in excess of the Policy Portfolio benchmark 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. The Policy Portfolio benchmark will be established by UTIMCO and will be comprised of a blend of asset class indices weighted to reflect PUF’s asset allocation policy targets.

Asset Allocation and Policy

Asset allocation is the primary determinant of the volatility of investment return and, subject to the asset allocation ranges specified in Exhibit A, is the responsibility of UTIMCO. Specific asset allocation positions may be changed from time to time, within the ranges specified in Exhibit A, based on the economic and investment outlook. In the event that actual portfolio positions in asset categories move outside the ranges indicated in Exhibit A, UTIMCO staff will rebalance portfolio positions back within the policy ranges in an orderly manner as soon as practicable.

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

- A. U.S. Equities – U.S. equities represent ownership in U.S. companies that are traded in public markets:

- Traditional U.S. Equities – Traditional U.S. equities include common stocks and derivatives based on common stocks, including warrants, rights, options, exchange traded funds, and futures. In addition, derivative applications approved by the UTIMCO Board that serve as a U.S. equity substitute will be classified as traditional U.S. equity. Traditional U.S. equities provide both current income and capital gains.

- REITS – REITS are real estate investment trusts and are classified as U.S. equities for purposes of this Policy Statement. REITS own, and in most cases operate, income producing real estate.

- B. Global ex U.S. Equities – Global ex U.S. equities represent ownership in global companies that are traded in public markets. The global ex U.S. markets include established and emerging markets. Derivatives including warrants, rights, options, exchange traded funds, and futures are also included if the underlying assets are Global ex U.S. equities. In addition, derivative applications approved by the UTIMCO Board that serve as a Global ex U.S. equity substitute will be classified as Global ex U.S. equities. Global ex U.S. equities provide both current income and capital gains.
- C. Hedge Funds – Hedge funds are broadly defined to include nontraditional investment strategies whereby the majority of the underlying securities are traded on public exchanges or are otherwise readily marketable.

Equity Hedge Funds – Equity hedge fund investments include U.S. and international long/short equity strategies. These strategies attempt to exploit profits from stock selection skills by taking long and short positions in various equity securities. These strategies may also include fund of hedge fund investments. Equity hedge fund investments are made through private placement agreements.

Absolute Return Hedge Funds – Absolute return hedge fund investments include arbitrage and event driven strategies. Arbitrage strategies attempt to exploit pricing discrepancies between closely related securities, utilizing a variety of different tactics primarily within equity, fixed income and convertible securities markets. Event driven strategies attempt to exploit discreet events such as bankruptcies, mergers, and takeovers. Absolute return hedge funds may include fund of hedge fund investments. Absolute return hedge fund investments are made through private placement agreements.

- D. Private Capital - Private Capital investments include the illiquid debt and equity securities of private or publicly-traded companies. Private Capital investments consist of two sub-asset class categories: Venture Capital and Private Equity.

Venture Capital – Venture capital investments consist of investments in companies, both U.S. and non-U.S. that are in the early stages of development. Venture Capital investments are held either through limited partnerships or as direct ownership interests.

Private Equity – Private Equity investments consist of investments in the equity securities of private businesses, both U.S. and non-U.S., that are considered to be in the post-start-up phase and that are profitable and generating income. Private Equity investments are held either through limited partnerships or as direct ownership interests. The Private Equity category also includes mezzanine and opportunistic investments.

Mezzanine investments consist of investments in funds that make subordinated debt or minority equity investments in private companies. Opportunistic investments are limited to illiquid assets and may include distressed debt or secondary private equity partnerships. Mezzanine and opportunistic investments are held through limited partnerships or as direct ownership interests.

- E. Commodities – Commodities include natural resource investments including oil and gas interests and other hard assets. These investments may be held through partnerships, derivative investments or direct investments.
- F. Fixed Income – Fixed income investments include debt (whether U.S. or foreign) issued by Governments, various government enterprises and agencies, and domestic and foreign corporations.

Traditional Fixed Income - The principal securities include bonds, notes, bills and mortgage and asset-backed securities. In addition, derivative applications approved by the UTIMCO Board that serve as a fixed income substitute will be classified as traditional fixed income.

TIPS - TIPS are treasury inflation protected securities which are marketable securities with a return linked to the inflation rate. In constructing diversified TIPS portfolios, securities classified as traditional fixed income can be utilized by outside investment managers.

- G. Cash and Cash Equivalents – Cash and cash equivalents consist of money market funds, deposit of the Texas State Treasury, cash in foreign currencies, and other overnight funds that have not been allocated to a specific asset class.

Performance Measurement

The investment performance of the PUF will be measured by the PUF's custodian, an unaffiliated organization, with recognized expertise in this field and reporting responsibility to the UTIMCO Board, and compared against the stated investment benchmarks of the PUF, as indicated in Exhibit A.

Investment Guidelines

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

Investment guidelines include the following:

General

- Investment guidelines for index, commingled funds, and limited partnerships managed externally shall be governed by the terms and conditions of the respective investment management contracts or partnership agreements.
- All investments will be U.S. dollar denominated assets unless held by an internal or external portfolio manager with the authority to invest in foreign currency denominated securities.
- Investment policies of any unaffiliated liquid investment fund must be reviewed and approved by UTIMCO's chief investment officer prior to investment of PUF assets in such liquid investment fund.
- No securities may be purchased or held which would jeopardize the PUF's tax-exempt status.
- No investment strategy or program may purchase securities on margin or use leverage unless specifically authorized by the UTIMCO Board.
- No investment strategy or program employing short sales may be made unless specifically authorized by the UTIMCO Board.
- The PUF's investments in warrants shall not exceed more than 5% of the PUF's net assets or 2% with respect to warrants not listed on the New York or American Stock Exchanges.
- The PUF may utilize derivative securities to: a) simulate the purchase or sale of an underlying market index while retaining a cash balance for fund management purposes; b) facilitate trading; c) reduce transaction costs; d) seek higher investment returns when a derivative security is priced more attractively than the underlying security; e) index or to hedge risks associated with PUF investments; or f) adjust the market exposure of the asset allocation, including long and short strategies and other strategies provided that the PUF's use of derivatives complies with the Derivative Investment Policy approved by the UTIMCO Board. The Derivative Investment Policy shall serve the purpose of defining the permitted applications under which derivative securities can be used, which applications are prohibited, and the requirements for the reporting and oversight of their use. Derivative applications implemented in compliance with the Derivative Investment Policy shall be deemed to be specifically authorized by the UTIMCO Board for purposes of this Policy Statement. The objective of the Derivative Investment Policy is to facilitate risk management and provide efficiency in the implementation of the investment strategies using derivatives.

Cash and Cash Equivalents

Holdings of cash and cash equivalents may include the following:

- Internal short-term pooled investment funds managed by UTIMCO.
- Unaffiliated liquid investment funds as approved by UTIMCO's chief investment officer.
- Deposits of the Texas State Treasury.
- The PUF's custodian late deposit interest bearing liquid investment fund.
- Commercial paper rated in the two highest quality classes by Moody's Investors Service, Inc. (P1 or P2) or Standard & Poor's Corporation (A1 or A2).
- Negotiable certificates of deposit with a bank that is associated with a holding company meeting the commercial paper rating criteria specified above or that has a certificate of deposit rating of 1 or better by Duff & Phelps.
- Bankers' acceptances guaranteed by an accepting bank with a minimum certificate of deposit rating of 1 by Duff & Phelps.
- Repurchase agreements and reverse repurchase agreements transacted with a dealer that is approved by UTIMCO and selected by the Federal Reserve Bank as a Primary Dealer in U.S. Treasury securities and rated A-1 or P-1 or the equivalent.
 - Each approved counterparty shall execute the Standard Public Securities Association (PSA) Master Repurchase Agreement with UTIMCO.
 - Eligible collateral securities for repurchase agreements are limited to U.S. Treasury securities and U.S. Government Agency securities with a maturity of not more than 10 years.
 - The maturity for a repurchase agreement may be from one day to two weeks.
 - The value of all collateral shall be maintained at 102% of the notional value of the repurchase agreement, valued daily.
 - All collateral shall be delivered to the PUF custodian bank. Tri-party collateral arrangements are not permitted.
- The aggregate amount of repurchase agreements with maturities greater than seven calendar days may not exceed 10% of the PUF's fixed income assets.

- Overnight repurchase agreements may not exceed 25% of the PUF's fixed income assets.
- Mortgage Backed Securities (MBS) Dollar Rolls shall be executed as matched book transactions in the same manner as reverse repurchase agreements above. As above, the rules for trading MBS Dollar Rolls shall follow the Public Securities Association standard industry terms.

Fixed Income

Domestic Fixed Income

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

- Permissible securities for investment include the components of the Lehman Brothers Aggregate Bond Index (LBAGG): investment grade government and corporate securities, agency mortgage pass-through securities, and asset-backed securities. These sectors are divided into more specific subsectors: 1) Government securities: Treasury and Agency; 2) Corporate securities: Industrial, Finance, Utility, and Yankee; 3) Mortgage-backed securities: GNMA, FHLMC, and FNMA; 4) Asset-backed securities; 5) Taxable Municipal securities; and 6) Commercial Mortgage-backed securities. In addition to the permissible securities listed above, the following securities shall be permissible: a) floating rate securities with periodic coupon changes in market rates issued by the same entities that are included in the LBAGG as issuers of fixed rate securities; b) medium term notes issued by investment grade corporations; c) zero coupon bonds and stripped Treasury and Agency securities created from coupon securities; and d) structured notes issued by LBAGG qualified entities.
- U.S. Domestic Bonds must be rated investment grade, Baa3 or better by Moody's Investors Services, BBB- or better by Standard & Poor's Corporation, or an equivalent rating by a nationally recognized rating agency at the time of acquisition. This provision does not apply to an investment manager that is authorized by the terms of an investment advisory agreement to invest in below investment grade bonds.
- Not more than 5% of the market value of domestic fixed income securities may be invested in corporate and municipal bonds of a single issuer provided that such bonds, at the time of purchase, are rated, not less than Baa3 or BBB-, or the equivalent, by any two nationally-recognized rating services, such as Moody's Investors Service, Standard & Poor's Corporation, or Fitch

Investors Service.

Non-U.S. Fixed Income

- Not more than 50% of the PUF's fixed income portfolio may be invested in non-U.S. dollar denominated bonds.
- Non-dollar denominated bond investments shall be restricted to bonds rated equivalent to the same credit standard as the U.S. Fixed Income Portfolio unless an investment manager has been authorized by the terms of an investment advisory agreement to invest in below investment grade bonds.
- Not more than 15% of the PUF's fixed income portfolio may be invested in emerging market debt.
- International currency exposure may be hedged or unhedged at UTIMCO's discretion or delegated by UTIMCO to an external investment manager.

Equities

The PUF shall:

- A. hold no more than 25% of its equity securities in any one industry or industries (as defined by the standard industry classification code and supplemented by other reliable data sources) at market
- B. hold no more than 5% of its equity securities in the securities of one corporation at cost unless authorized by UTIMCO's chief investment officer.

PUF Distributions

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

- A. provide a predictable, stable stream of distributions over time;
- B. ensure that the inflation adjusted value of distributions is maintained over the long term; and
- C. ensure that the inflation adjusted value of PUF assets after distributions is maintained over rolling 10-year periods.

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

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

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

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

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

PUF Accounting

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

Valuation of Assets

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

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

Securities Lending

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

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

Investor Responsibility

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

Amendment of Policy Statement

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

Effective Date

The effective date of this policy shall be August 12, 2004, except for Exhibit A which was effective January 1, 2004.

EXHIBIT A

POLICY TARGETS, RANGES AND PERFORMANCE OBJECTIVES

Asset Category	Percent of Portfolio (%)		Benchmarks
	Policy Targets	Policy Ranges	
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 (%)	4.22
Standard Deviation (%)	10.30