William Marsh Rice University

Consolidated Financial Statements
June 30, 2013 and 2012

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Independent Auditor's Report

To the Board of Trustees of
William Marsh Rice University

We have audited the accompanying consolidated financial statements of William Marsh Rice University (the "University") and subsidiaries, which comprise the consolidated statement of financial position as of June 30, 2013 and the related consolidated statements of activities and cash flows for the year then ended.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on the consolidated financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the University's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the University's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

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Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of William Marsh Rice University and subsidiaries at June 30, 2013, and the changes in their net assets and their cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matter

We have previously audited William Marsh Rice University's 2012 consolidated financial statements, and we expressed an unmodified audit opinion on those audited financial statements in our report dated October 31, 2012. In our opinion, the summarized comparative information presented herein as of and for the year ended June 30, 2012 is consistent, in all material respects, with the audited financial statements

PricewaterhouseCoopers LLP

October 25, 2013

William Marsh Rice University
Consolidated Statements of Financial Position
June 30, 2013 and 2012

(in thousands of dollars)	**2013**	**2012**
Assets		
Cash and cash equivalents	$ 7,175	$ 9,726
Accounts receivable and other assets, net	59,279	56,293
Pledges receivable, net	172,707	166,240
Investments	5,264,631	4,801,259
Property and equipment, net	1,183,159	1,202,003
Total assets	$ 6,686,951	$ 6,235,521
Liabilities		
Accounts payable and other liabilities	$ 87,260	$ 84,710
Notes and bonds payable	821,334	839,664
Actuarial liability for annuities payable	105,255	98,098
Government refundable advances	7,268	7,175
Total liabilities	1,021,117	1,029,647
Net assets		
Unrestricted net assets	2,680,587	2,483,944
Temporarily restricted net assets	1,929,439	1,724,660
Permanently restricted net assets	1,055,808	997,270
Total net assets	5,665,834	5,205,874
Total liabilities and net assets	$ 6,686,951	$ 6,235,521

The accompanying notes are an integral part of these consolidated financial statements.

William Marsh Rice University
Consolidated Statements of Activities
For the Year Ended June 30, 2013
With Summarized Financial Information for the Year Ended June 30, 2012

	2013				2012
(in thousands of dollars)	**Unrestricted**	**Temporarily Restricted**	**Permanently Restricted**	**Total**	**Total**
Operating revenues					
Investment returns distributed for operations	$ 111,377	$ 117,675	$ -	$ 229,052	$ 220,117
Student tuition and fees, net	124,868	-	-	124,868	120,392
Grants and contracts	117,775	-	-	117,775	108,951
Gifts and pledges	25,231	8,391	-	33,622	37,900
Gifts and trusts released from restrictions	109,297	(109,297)	-	-	-
Auxiliary enterprises	42,497	-	-	42,497	40,551
Other revenues	20,453	-	-	20,453	23,090
Total operating revenues	551,498	16,769	-	568,267	551,001
Operating expenses					
Operating expenses	569,529	-	-	569,529	547,477
Total operating expenses	569,529	-	-	569,529	547,477
Net operating income (loss)	(18,031)	16,769	-	(1,262)	3,524
Nonoperating changes					
Gifts, grants, and pledges for property and endowment	-	34,880	51,926	86,806	70,446
Investment returns, reduced by operating distribution above	162,587	211,570	13,139	387,296	(83,198)
Net assets released from restrictions	43,379	(43,757)	378	-	-
Change in liabilities due under life-income agreements	-	(14,963)	(6,905)	(21,868)	(10,030)
Other nonoperating changes	8,708	280	-	8,988	(14,733)
Net nonoperating changes	214,674	188,010	58,538	461,222	(37,515)
Net increase (decrease) in net assets	196,643	204,779	58,538	459,960	(33,991)
Net assets					
Beginning of year	2,483,944	1,724,660	997,270	5,205,874	5,239,865
End of year	$ 2,680,587	$ 1,929,439	$ 1,055,808	$ 5,665,834	$ 5,205,874

The accompanying notes are an integral part of these consolidated financial statements.

William Marsh Rice University
Consolidated Statements of Cash Flows
Years Ended June 30, 2013 and 2012

(in thousands of dollars)	**2013**	**2012**
Cash flows from operating activities		
Net increase (decrease) in net assets	$ 459,960	$ (33,991)
Adjustments to reconcile increase (decrease) in net assets to net cash used in operating activities		
Depreciation of property and equipment	64,126	62,732
Loss (gain) on disposal of property and equipment	367	(1,619)
Net realized and unrealized investment gains	(544,876)	(72,338)
Contributions restricted for long term purposes and noncash contributions	(89,272)	(109,187)
Donated securities received	(24,238)	-
Proceeds from sale of donated securities	3,951	-
Actuarial change in life-income agreements	21,868	10,030
Change in fair value of swap agreements	(10,815)	13,847
Change in		
Accounts receivable and other assets	(2,833)	(4,537)
Pledges receivable for current purposes	13,513	1,977
Accounts payable and accrued liabilities	12,345	(1,675)
Net cash used in operating activities	(95,904)	(134,761)
Cash flows from investing activities		
Proceeds from sales and maturities of investments	1,118,169	773,752
Purchases of investments	(996,968)	(607,517)
Purchases of property and equipment	(43,939)	(47,606)
Net cash provided by investing activities	77,262	118,629
Cash flows from financing activities		
Contributions restricted for long term purposes		
Endowment	-	12,418
Property	-	5,334
Trusts and other	16,035	16,588
Proceeds from sale of donated securities		
Endowment	11,066	-
Property	9,221	-
Proceeds from issuance of tax-exempt bonds	247,180	-
Principal payment of tax-exempt bonds	(2,310)	(2,220)
Advance refunding of tax-exempt bonds	(347,180)	-
Return of unspent proceeds of tax-exempt bonds	(13,000)	-
Issuance cost for tax-exempt bonds	(1,080)	-
Payment of outstanding commercial paper	(17,005)	(18,025)
Proceeds from issuance of taxable bonds	113,985	-
Issuance cost for taxable bonds	(914)	-
Change in government refundable advances	93	3
Net cash provided by financing activities	16,091	14,098
Net decrease in cash and cash equivalents	(2,551)	(2,034)
Cash and cash equivalents		
Beginning of year	9,726	11,760
End of year	$ 7,175	$ 9,726

Noncash investing activities: The University had open accounts payable and accruals of $2,043,000 at June 30, 2013 and of $2,365,000 at June 30, 2012, related to property, plant and equipment purchases.

The accompanying notes are an integral part of these consolidated financial statements.

1. Basis of Presentation and Summary of Significant Accounting Policies

Basis of Presentation

William Marsh Rice University (the "University") is a Texas not-for-profit corporation that operates a private research university in Houston, Texas. The consolidated financial statements of the University as of June 30, 2013, and for the year then ended, have been prepared in accordance with accounting principles generally accepted in the United States of America. Accordingly, the accompanying consolidated financial statements have been prepared on the accrual basis of accounting and include the accounts of the University and all wholly owned subsidiaries. All material transactions between the University and its subsidiaries have been eliminated.

The financial statements include certain prior year summarized comparative information in total but not by net asset class. Such information does not include sufficient detail to constitute a presentation in conformity with accounting principles generally accepted in the United States of America. Accordingly, such information should be read in conjunction with the University's financial statements for the year ended June 30, 2012, from which the summarized information was derived.

The University's subsidiaries consolidated in these financial statements include Center for Collaborative Research Inc., JTVP Corporation, R.U. Corporation, Rice-Land Lumber Company, Rice Trust Inc., Village Projects Inc., Village Real Property, Village Venturers Inc., and Houston Area Translational Research Consortium, Inc. all of which are exempt from federal income tax, and Peabody Inc., R.I. Patents, and STEMscopes Inc., which are subject to taxation.

Net Asset Categories

Standards for external financial reporting by not-for-profit organizations require that resources be classified for reporting purposes into three net asset categories according to donor-imposed restrictions. A description of the University's three net asset categories follows:

a. Unrestricted net assets and related activity include the following:

All revenues traditionally classified as unrestricted resources of the University, including tuition and fees, unrestricted gifts, investment returns on unrestricted funds designated to function as endowment, recovery of facility and administrative costs from grants and contracts, and auxiliary enterprise revenues.

Revenues related to sponsored research and other sponsored program agreements, which are considered exchange transactions.

Unrestricted funds functioning as endowment.

Gifts with donor imposed restrictions, if the restriction will be met within the current fiscal year of the University.

Investments in plant assets.

All expenses of the University.

b. Temporarily restricted net assets include gifts for which donor-imposed restrictions have not been met and investment returns from unrestricted and restricted endowments. The restriction on unrestricted endowment returns (income and realized and unrealized gains and losses) is released when appropriations are distributed for use in the current fiscal year. The category also includes pledges receivable and life-income gifts for which the ultimate purpose of the proceeds is not permanently restricted.

c. Permanently restricted net assets include gifts, trusts and pledges on which donors have imposed the restriction that the corpus be maintained in perpetuity and only the investment returns be made available for program operations. In the case of trusts, gains and losses are added to the gift amount. Gifts restricted by donors to provide loans to students are also included in permanently restricted net assets.

The terms of certain gifts of real property made by the founder of the University provided that all returns realized from these properties are to be invested to generate income to be used for University purposes. Changes in the market value of these specific properties, whether gains or losses, are recorded as permanently restricted as required by the donor.

Expirations of temporary restrictions on net assets are reported as release from restrictions on the Statement of Activities. Donor required matching from University funds and donor release or clarification of restrictions are also included in this line.

The Board of Trustees interprets the Uniform Prudent Management of Institutional Funds Act (UPMIFA), as adopted in Texas, to require the preservation of the original gift as of the gift date of the donor restricted endowment funds absent explicit donor stipulation to the contrary. As a result of this interpretation, the University classifies as permanently restricted net assets, (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and (c) other additions to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the addition is added to the fund. The remaining portion of the donor restricted endowment fund that is not classified as permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the University in a manner consistent with the standard of prudence prescribed by UPMIFA (Note 5).

Contributions

Contributions, including unconditional promises to give and irrevocable trusts held by others under which the University is the beneficiary, are recognized as revenues in the period received or promised. Contributions restricted for the acquisition of land, buildings and equipment are reported as temporarily restricted revenues. These contributions are reclassified to unrestricted net assets when the assets are placed in service. Promises to give that are subject to donor-imposed stipulations that the corpus be maintained in perpetuity are recognized as increases in permanently restricted net assets. It is the University's practice to sell marketable securities received as donations upon receipt.

On July 1, 2012, the University adopted new guidance related to the Consolidated Statements of Cash Flows. This guidance requires the University to classify cash receipts from the sale of donated marketable securities consistently with cash donations received in the Consolidated Statements of Cash Flows if the donated marketable securities are converted into cash on receipt or shortly thereafter.

Conditional promises to give are not recognized until the conditions on which they depend are met. Contributions of assets other than cash are reported at their estimated fair value at the date of gift. Contributions scheduled to be received after one year are discounted using a market rate (Note 3). Amortization of the discount is recorded as contribution revenue.

Operating and Nonoperating Activities

The Consolidated Statement of Activities reports the change in net assets from the University's operating and nonoperating activities. Operating activities exclude (a) gifts, grants and pledges for property and endowment (including annuity and life-income trusts), (b) release from restrictions of contributions restricted for the acquisition of property and equipment, (c) donor release of restrictions from permanently restricted net assets, (d) endowment returns net of the University's operating needs as defined by University spending policy (Note 5), (e) actuarial adjustments of annuities payable, (f) changes in fair value of swap agreements (Note 6) and (g) net gain or loss on nonrecurring transactions.

Cash and Cash Equivalents

The University considers all highly liquid financial instruments with an original maturity of 90 days or less to be cash and cash equivalents, except those amounts assigned to its investment managers and unspent commercial paper proceeds, which are classified as investments.

Investments and Other Financial Instruments

Investments are made within guidelines authorized by the University's Board of Trustees. Investments are initially recorded at cost at date of acquisition or fair value at date of donation in the case of gifts. Ownership of marketable securities is recognized as of the trade date. Marketable securities transactions that have not settled are recognized as accounts receivable or accounts payable until the settlement date. Endowment returns are calculated net of internal and external investment management expenses.

Investments are stated at fair value. Fair value is defined as the price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date.

The hierarchy of valuation inputs is based on the extent to which inputs are observable in the marketplace. Observable inputs reflect market data obtained from sources independent of the University and unobservable inputs reflect assumptions about how market participants would value an asset or liability based on the best information available. Valuation techniques used to measure fair value maximize the use of observable inputs and minimize the use of unobservable inputs. The fair value hierarchy is based on three levels of inputs of which the first two are considered observable and the last unobservable, that may be used to measure fair value.

The following describes the hierarchy of inputs used to measure fair value and the primary valuation methodologies used by the University for financial instruments measured at fair value on a recurring basis (Note 6). The three levels of inputs are as follows:

Level 1 Quoted prices in active markets for identical assets or liabilities, such as exchange-traded equity securities.

Level 2 Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active, or other inputs that are observable or can be corroborated by observable market data for substantially the same term of the assets or liabilities, including corporate bonds and most Treasury securities.

Level 3 Unobservable inputs, such as valuation supplied by the investment managers, that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities, including investments in certain hedge strategies and all private market strategies.

A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement.

The estimated fair value of certain alternative investments, such as private equity and other limited partnership interests is based on valuations provided by the general partners or partnership valuation committees. Such valuations consider variables such as financial performance of investments, recent sale prices of similar investments and other pertinent information. The University reviews and evaluates the data used in determining fair value, including the valuation methods, assumptions, and values provided by the investment managers. Because alternative investments are not readily marketable, their estimated fair value is subject to uncertainty and therefore may differ from the value that would have been used had a ready market for such investments existed. These differences could be material.

The fair value of real estate, timber, oil and gas and other investments is estimated by professional appraisers or University management.

Derivative financial instruments are recorded on the Consolidated Statement of Financial Position as either an asset or liability measured at fair value as of the reporting date. Derivative financial instruments consist of interest rate swaps and energy hedge agreements. Changes in fair value of these derivatives are recognized in the Consolidated Statement of Activities.

The University's investments are exposed to a number of risks including interest rate, market, and credit risks. Due to the level of risk exposure, it is possible that changes in the valuation of these investments may occur in the near term and that such changes could be material.

Property and Equipment
Property used by the University is stated at cost for purchased assets and fair market value at the date of donation in the case of gifts. Interest expense incurred during the period of construction of an asset for University use is capitalized until that asset is substantially completed and ready for use. The University depreciates its physical assets (excluding works of art, which are not depreciated) using the straight-line method over their estimated useful lives. Repairs and maintenance of property and equipment are expensed as incurred. Property and equipment are removed from the records at the time of disposal.

Works of art, historical treasures, literary works and artifacts are preserved and protected for educational, research and public exhibition purposes. Donations and purchases of such collections are recorded for financial statement purposes as capital assets.

Asset Retirement Obligations

The University recognizes asset retirement obligations (AROs) that are conditional on a future event, such as the legal obligation to safely dispose of asbestos when a building is remodeled or demolished. The University measures conditional AROs at estimated fair value using a probability-weighted, discounted cash flow model with multiple scenarios, if applicable. The present value of weighted, discounted cash flows is calculated annually using credit-adjusted, risk-free rates applicable to the University in order to determine the estimated fair value of the conditional AROs.

Life-Income Agreements

Life-income agreements include charitable remainder trusts and gift annuities. Charitable remainder trusts hold donated assets for which the University's subsidiary acts as trustee and periodically pays specified amounts to the designated beneficiaries. Generally, beneficiary payments are a fixed amount for annuity trusts and a fixed percentage of the fair market value of the trust assets or based on income earned for other charitable remainder trusts. At a date specified in each gift instrument, usually the beneficiary's date of death, ownership of the trust assets will transfer to the University and the beneficiary payments will cease. The University also enters into gift annuity agreements, which require that the University take ownership of the assets at the date of gift with an obligation to periodically pay specified amounts to designated beneficiaries for their lifetimes. Assets held in life-income trusts and those assets associated with gift annuities are included in investments. Contribution revenues are recognized at the date the trusts or gift annuities are established at the net present value calculated based on an actuarial table. Liabilities are recorded at the same time using actuarial tables established by the IRS and discounted according to the risk-free rate at the time of the gift. Discount rates range from 1% to 6%. The liability represents the present value of the estimated future payments to be made to the beneficiaries. The liabilities are adjusted annually for changes in the value of the assets and actuarial changes, which impact the estimates of future payments.

Government Refundable Advances

The University participates in the federal Perkins loan program, which is funded principally by advances from the federal government. These advances are refundable to the federal government if the program is terminated or if the University ceases to participate in the program.

Contracts and Grants

The University receives grants and contract revenue from government and private sources. Revenue associated with the direct costs of sponsored programs is generally recognized as the related costs are incurred. The University records revenue in unrestricted net assets upon its recovery of direct and indirect costs applicable to those sponsored programs that provide for the full or partial reimbursement of such costs. The recovery of indirect costs, also referred to as facilities and administrative costs, is recognized primarily based on predetermined rates negotiated with the federal government. (Note 12).

Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, expenses and disclosure of contingent assets and liabilities. Actual results could differ from these estimates.

Credit Risk
The University evaluated the credit risk associated with financing receivables, primarily student loans, and determined that both the receivables and the related allowances are immaterial to the financial statements.

Tax Status
The University is exempt from federal income tax to the extent provided under Section 501(c)(3) of the Internal Revenue Code. The IRS issued a determination letter in January, 1938 that recognized the University as exempt from federal income tax under section 501(c) (3). The IRS confirmed in 2008 that this exemption still applies.

The University has twelve wholly owned subsidiary corporations that are included in the consolidated financial statements. Seven of these subsidiary corporations are exempt from federal income taxes under 501(c)(2), two are exempt under 501(c)(3), and three are subject to taxation. The University is classified as an organization that is not a private foundation under section 509(a) of the Internal Revenue Code because it is described in sections 509(a)(1) and 170(b)(1)(A)(ii) and, as such, gifts to the University qualify for deduction as charitable contributions to the extent provided by law. The University and its subsidiary corporations that are exempt from federal income tax are required to pay federal income tax on unrelated business income. The University and its subsidiary corporations did not have any material income tax liabilities for the years ended June 30, 2013 and 2012. The University has no financial reporting requirements for uncertain tax positions for the years ended June 30, 2013 and 2012.

Subsequent Events
For the year ended June 30, 2013, the University evaluated subsequent events from July 1, 2013 to October 25, 2013, the date these financial statements were issued. There were no subsequent events that occurred after the financial position date that have a material impact on the University's financial statements.

2. Accounts Receivable and Other Assets

Accounts receivable and other assets of the University at June 30, 2013 and 2012, were as follows:

(in thousands of dollars)	**2013**	**2012**
Unsettled investment sales	$ 3,838	$ 5,679
Investment income receivable	3,869	4,704
Student loans receivable, net of allowance of $1,099 in 2013 and $1,056 in 2012	9,244	9,303
Inventory, prepaid expenses, and other assets	13,161	13,396
Grants and contracts receivable	22,647	17,350
Other accounts receivable, net of allowance of $310 in 2013 and $353 in 2012	6,520	5,861
Total accounts receivable and other assets	$ 59,279	$ 56,293

3. Pledges Receivable

Unconditional promises to give are included in the consolidated financial statements as pledges receivable and revenue of the appropriate net asset category. Multi-year pledges are recorded after discounting to the present value of expected future cash flows. Unconditional promises to give at June 30, 2013 and 2012 are expected to be realized in the following periods:

(in thousands of dollars)	**2013**	**2012**
In one year or less	$ 41,907	$ 51,682
Between one year and five years	106,455	101,673
More than five years	62,705	45,661
Less:		
Discount to net present value	(25,696)	(20,835)
Allowance for uncollectible pledges	(12,664)	(11,941)
	$ 172,707	$ 166,240

Pledges receivable at June 30, 2013 and 2012, had the following restrictions:

(in thousands of dollars)	**2013**	**2012**
Restricted for long-term investment	$ 59,217	$ 35,039
Buildings	68,468	75,983
Support of University programs and activities	83,382	87,994
Less:		
Discount to net present value	(25,696)	(20,835)
Allowance for uncollectible pledges	(12,664)	(11,941)
	$ 172,707	$ 166,240

Rates ranging from 1% to 6% are used to discount pledges. A reserve rate of 6% was used for the allowance for uncollectible pledges as of June 30, 2013 and 2012. The reserve rate is reviewed periodically to ensure adequate provision for uncollectible amounts. The rate was reviewed in 2013.

The University has received $51,300,000 in conditional pledges from two donors for the construction of campus buildings. These pledges will be recognized as revenue in the year in which the conditions are met.

4. Investments

Investments at June 30, 2013 and 2012, were as follows:

(in thousands of dollars)	**2013**	**2012**
Short term investments and fixed income securities	$ 758,582	$ 853,795
Equity securities and equity funds	1,618,332	1,314,961
Limited partnerships and other funds	2,568,823	2,343,650
Real assets, oil and gas, and other	318,894	288,853
	$ 5,264,631	$ 4,801,259

Investments include annuity and life income fund assets of $158,026,000 and $147,244,000 as of June 30, 2013 and 2012, respectively. Fixed income securities include unspent bond proceeds that are available to fund project expenditures in future years (Note 9). The University is obligated to advance additional funding for certain limited partnerships (Note 16).

The following table presents investment income and net gains (losses) for the year ended June 30, 2013 by net asset classification, with summarized information for the year ended June 30, 2012:

	2013				2012
(in thousands of dollars)	**Unrestricted**	**Temporarily Restricted**	**Permanently Restricted**	**Total**	**Total**
Investment earnings	$ 33,253	$ 33,801	$ 4,418	$ 71,472	$ 64,581
Net gains on investments	240,711	295,444	8,721	544,876	72,338
Total investment gains and earnings	273,964	329,245	13,139	616,348	136,919
Less: Investment returns distributed for operations	(111,377)	(117,675)	-	(229,052)	(220,117)
Investment returns, reduced by operating distribution	$ 162,587	$ 211,570	$ 13,139	$ 387,296	$ (83,198)

Return on investments is presented net of investment management fees. Certain expenses paid directly by the University for investment management and custody services, including certain internal costs, amounted to approximately $43,592,000 and $43,706,000 for the years ended June 30, 2013 and 2012, respectively. Certain investments report net returns without specific identification of management fees.

5. Endowments

The University's endowment consists of approximately 1,500 individual donor restricted endowment funds and approximately 200 funds designated by the Board of Trustees to function as endowments. The net assets associated with endowment funds, including funds designated by the Board of Trustees to function as endowments, are classified and reported based on the existence or absence of donor imposed restrictions.

The following table presents endowment net asset composition by type of fund for the year ended June 30, 2013, with summarized information for the year ended June 30, 2012:

	2013				2012
(in thousands of dollars)	**Unrestricted**	**Temporarily Restricted**	**Permanently Restricted**	**Total**	**Total**
Donor restricted	$ -	$ 1,722,244	$ 1,031,690	$ 2,753,934	$ 2,482,641
Board designated	2,140,191	1,174	-	2,141,365	1,965,428
Total endowment funds	2,140,191	1,723,418	1,031,690	4,895,299	4,448,069
Pledges restricted for long-term investment, net of discount and allowance	-	-	50,811	50,811	31,194
Endowment funds excluding pledges	$ 2,140,191	$ 1,723,418	$ 980,879	$ 4,844,488	$ 4,416,875

In accordance with UPMIFA, the University considers the following factors in making a determination to appropriate or accumulate endowment funds:

1. The duration and preservation of the fund

2. The purposes of the University and the donor restricted endowment fund

3. General economic conditions

4. The possible effect of inflation and deflation

5. The expected total return from income and the appreciation of investments

6. Other resources of the University

7. The investment policies of the University

Endowment Investment Policies
The University has adopted endowment investment policies that attempt to provide a predictable stream of funding to programs supported by its endowment while seeking to maintain, and, if possible, enhance the purchasing power of endowment assets. The University has a diversified approach to management of the endowment investment portfolio. By diversifying among asset classes and rebalancing toward policy target allocations, the University strives to manage and maintain the risk profile implied by the policy targets adopted by the board.

To achieve its long-term return objectives, the University relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized gains) and current yield (interest and dividends). The University's diversified asset allocation places greater emphasis on equity based investments to achieve its long-term objectives within prudent risk and liquidity constraints. The long term investment objectives of the endowment are to attain an average annual real total return in excess of endowment spending and to outperform various strategic policy and comparable industry universe benchmarks over the long term.

Endowment Spending Allocation and Relationship of Spending Policy to Investment Objectives
The Board of Trustees of the University approves the appropriation of endowment funds for expenditure. In establishing a distribution policy, the Board of Trustees considered a number of factors, including the expected long term investment rate of return on the endowment. Accordingly, over the long term, the University expects the current spending policy to allow its endowment to grow, consistent with its intention to maintain the purchasing power of the endowment assets while providing a relatively predictable and stable (in real terms) stream of earnings for current use. Under the University's endowment earnings distribution policy, endowment returns on donor restricted endowments, net of operating distributions, are reinvested in the investment pool as temporarily restricted net assets functioning as endowment and endowment returns on board designated endowment funds, net of operating distributions, are reinvested in the investment pool as unrestricted net assets functioning as endowment.

Endowment Funds With Deficits
From time to time, the fair value of assets associated with individual donor restricted endowment funds may fall below the value of the initial and subsequent donor gift amounts (deficit). These deficits result when unfavorable market fluctuations occur shortly after the investment of newly established endowments. Donor endowment deficits are classified as a reduction of unrestricted net assets in the year they occur and as an increase in unrestricted net assets in the year the fair value exceeds the gift amounts. There were no deficits as of June 30, 2013 and 2012.

Changes in endowment net assets for the year ended June 30, 2013, with summarized information for the year ended June 30, 2012, were as follows:

(in thousands of dollars)	2013 Unrestricted	2013 Temporarily Restricted	2013 Permanently Restricted	2013 Total	2012 Total
Endowment net assets at beginning of year	$ 1,964,304	$ 1,508,539	$ 975,226	$ 4,448,069	$ 4,498,951
Investment returns				-	
Investment income	31,252	37,020	6,457	74,729	66,882
Net realized and unrealized gains (losses)	240,739	292,116	(1,744)	531,111	75,326
Total investment returns	271,991	329,136	4,713	605,840	142,208
Contributions	-	-	50,529	50,529	18,153
Appropriation of endowment assets for expenditure	(109,064)	(117,868)	-	(226,932)	(220,151)
Other changes					
Transfers to create board designated endowment funds	12,959	-	-	12,959	16,449
Donor designation	-	-	1,222	1,222	3,141
Other transfers	1	3,611	-	3,612	(10,682)
Change in endowment net assets	175,887	214,879	56,464	447,230	(50,882)
Endowment net assets at end of year	$ 2,140,191	$ 1,723,418	$ 1,031,690	$ 4,895,299	$ 4,448,069

6. Financial Instruments

The following table presents the financial instruments carried at fair value on the Consolidated Statement of Financial Position as of June 30, 2013 and 2012, by category, in accordance with the valuation hierarchy defined in Note 1. Certain alternative investments, such as hedge funds, that do not have readily determinable fair values, but are redeemable in the near term at investee-reported net asset value per share or its equivalent, are reported as Level 2:

(in thousands of dollars)	2013 Level 1	2013 Level 2	2013 Level 3	2013 Total
Investments				
Short term investments and fixed income securities				
Cash and equivalents	$ 54	$ -	$ -	$ 54
Unspent bond proceeds	20,639	-	-	20,639
Short term investments	-	450,642	-	450,642
Investment grade US bonds	-	247,944	-	247,944
Equity securities	707,085	-	-	707,085
Equity funds	-	806,707	-	806,707
Limited partnerships and other funds				
Private equity and venture capital	-	-	841,705	841,705
Hedge	-	619,903	401,143	1,021,046
Real estate	-	-	488,283	488,283
Energy and natural resources	-	-	217,789	217,789
Real assets, oil and gas, and other	178	-	304,528	304,706
Life income agreements	156,077	1,086	868	158,031
Total investments at fair value	$ 884,033	$ 2,126,282	$ 2,254,316	$ 5,264,631
Swaps payable	$ -	$ -	$ (14,809)	$ (14,809)

	2012			
(in thousands of dollars)	**Level 1**	**Level 2**	**Level 3**	**Total**
Investments				
Short term investments and fixed income securities				
Cash and equivalents	$ 27	$ -	$ -	$ 27
Unspent bond proceeds	35,733	-	-	35,733
Short term investments	-	369,019	-	369,019
Investment grade US bonds	-	392,603	-	392,603
Equity securities	515,356	-	-	515,356
Equity funds	-	722,662	-	722,662
Limited partnerships and other funds				
Private equity and venture capital	-	-	841,048	841,048
Hedge	-	511,443	370,031	881,474
Real estate	-	-	352,209	352,209
Energy and natural resources	-	-	268,917	268,917
Real assets, oil and gas, and other	165	-	274,800	274,965
Life income agreements	145,283	1,095	868	147,246
Total investments at fair value	$ 696,564	$ 1,996,822	$ 2,107,873	$ 4,801,259
Swaps payable	$ -	$ -	$ (25,624)	$ (25,624)

The following tables present the changes in amounts included in the consolidated statement of financial position for financial instruments classified by the University within Level 3:

Assets
Investments

(in thousands of dollars)	**Limited Partnership and Other Funds**	**Real Assets, Oil and Gas, and Other**	**Life Income Agreements**	**Total**
Fair value July 1, 2012	$ 1,832,205	$ 274,800	$ 868	$ 2,107,873
Realized gains	171,959	-	-	171,959
Unrealized gains	72,598	12,106	-	84,704
Capital calls/purchases	304,370	17,942	-	322,312
Distributions	(432,212)	-	-	(432,212)
Other	-	(320)	-	(320)
Fair value June 30, 2013	$ 1,948,920	$ 304,528	$ 868	$ 2,254,316

(in thousands of dollars)	**Limited Partnership and Other Funds**	**Real Assets, Oil and Gas, and Other**	**Life Income Agreements**	**Total**
Fair value July 1, 2011	$ 1,708,955	$ 296,758	$ 786	$ 2,006,499
Realized gains	71,881	-	-	71,881
Unrealized losses	(11,835)	(21,399)	-	(33,234)
Capital calls/purchases	290,419	-	-	290,419
Distributions	(212,915)	-	-	(212,915)
Other	(17,888)	(559)	82	(18,365)
Transfers in	3,588	-	-	3,588
Fair value June 30, 2012	$ 1,832,205	$ 274,800	$ 868	$ 2,107,873

Swap Agreements

(in thousands of dollars)	**Interest Rate Swaps**	**Commodity Swaps**	**2013 Total**	**2012 Total**
Fair value July 1	$ -	$ -	$ -	$ 686
Unrealized losses	-	-	-	(686)
Fair value June 30	$ -	$ -	$ -	$ -

Liabilities
Swap Agreements

(in thousands of dollars)	**Interest Rate Swaps**	**Commodity Swaps**	**2013 Total**	**2012 Total**
Fair value July 1	$ 20,611	$ 5,013	$ 25,624	$ 12,463
Unrealized (gains) losses	(7,020)	(3,795)	(10,815)	13,161
Fair value June 30	$ 13,591	$ 1,218	$ 14,809	$ 25,624

The following table presents a summary of Level 3 valuation techniques and quantitative information utilized in determining the value of real assets, oil and gas, and other investments, where no practical expedient to using external manager's reported NAV exists:

(in thousands of dollars)	**Fair Value at June 30, 2013**	**Valuation Technique**	**Unobservable Input**	**Rates**
Asset type				
Real estate	$ 125,331	Discounted cash flow	Discount rate	6% – 8%
Timber	86,600	Income approach	Discount rate	6% – 8%
Oil and gas	91,326	Discounted cash flow	Discount rate	9% – 11%
Other	1,271	Varies	Varies	Varies
	$ 304,528			

The University recognizes transfers between levels as of the end of the reporting period. There were no transfers between Levels 1 and 2 in 2013 and 2012. There were no transfers between Level 2 or Level 3 in 2013. Transfers were made from Level 3 to Level 2 of $15,575,000 and from Level 2 to Level 3 of $19,163,000 in 2012, resulting primarily from a change in redemption status for hedge funds as of June 30, 2012.

The University utilizes a hierarchy of inputs in determining fair value (Note 1). The following is a description of the University's valuation methodologies for assets and liabilities measured at fair value. The methods described below may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, while the University believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different estimate of fair value at the reporting date.

Fair value for Level 1 is based upon quoted prices in active markets that the University has the ability to access for identical assets and liabilities. Market price data is generally obtained from exchange or dealer markets. The University does not adjust the quoted price for such assets and liabilities.

Fair value for Level 2 is based on quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market or can be corroborated by observable market data for substantially the full term of the assets. Certain alternative investments, such as hedge funds, that offer redemptions within 180 days of the measurement date at investee-reported net asset value per share or its equivalent are reported as Level 2. Hedge funds that have significant portions of the net asset value in side-pockets or special purpose vehicles and/or are only redeemable at fund manager discretion are reported as Level 3. If the redemption extends beyond 180 days, the investment is categorized as Level 3. Inputs are obtained from various sources including market participants, dealers, and brokers.

Fair value for Level 3 is based on valuation techniques that use significant inputs that are unobservable as they trade infrequently or not at all.

Investments included in Level 3 primarily consist of the University's ownership in alternative investments (including limited partnerships and interests in certain hedge and other similar funds). The fair values held by funds that do not have readily determinable fair values are determined by the respective managers and are based on appraisals or other estimates that require varying degrees of judgment. If no public market exists for the investments, the fair value is determined by the manager taking into consideration, among other things, the cost of the investments, prices of recent significant placements of investments of the same issuer, and subsequent developments concerning the companies to which the investments relate. The University has performed due diligence with respect to these investments to ensure net asset value (NAV) or partners’ capital per share is an appropriate measure of fair value as of June 30.

Hedge funds held by the University may be subject to restrictions that limit (i) the University's ability to redeem/withdraw capital from such funds during a specified period of time subsequent to the University's investment of capital (lockups) and/or (ii) the amount of capital that investors may redeem/withdraw as of given redemption/withdrawal dates (side pockets). Capital available for redemption/withdrawal may also be subject to redemption/withdrawal charges and may or may not include capital attributable to the University's participation in illiquid investments. These funds generally limit redemptions to monthly, quarterly, semi-annually, annually or longer, at NAV, and require between 30 and 90 days prior written notice, limiting the University's ability to respond quickly to changes in market conditions. The value of hedge funds classified as Level 3 included investment lockups that will expire over the next 6 to 30 months of $237,605,000 and $169,195,000 at June 30, 2013 and 2012, respectively, and side pockets of $42,194,000 and $44,116,000 at June 30, 2013 and 2012, respectively, that had indeterminate redemption periods. The University's nonhedge fund investments restrict the ability to withdraw, which limits the University's ability to respond quickly to changes in market conditions. These investments are therefore illiquid.

The University entered into agreements in March 2011 to hedge the cost of natural gas with a final expiration of June 30, 2013. The estimated fair value of the current arrangements was zero as of June 30, 2013 and a liability of $2,714,000 as of June 30, 2012. The University entered into an agreement in February 2012 to hedge the cost of natural gas that took effect on July 1, 2012. The estimated fair value of this arrangement was a liability of $79,000 as of June 30, 2013 and a liability of $75,000 as of June 30, 2012. The University entered into an agreement in June 2012 to hedge a portion of the cost of electricity that took effect on July 1, 2013. The estimated fair value of the arrangement was a liability of $1,138,000 as of June 30, 2013 and a liability of $2,224,000 as of June 30, 2012. The change in value is reported as other nonoperating change on the Consolidated Statement of Activities. The fair value of the agreements is the estimated amount that the University would pay or receive to terminate these contracts as of June 30.

Life income agreement assets consist primarily of mutual funds, with some directly held assets in real estate, oil and gas, and bonds. Life income investments included in Level 1 are cash and cash equivalents and mutual funds investing in equities, real estate funds and fixed income securities. Life income investments included in Level 2 are directly held bonds and US Treasury securities. Life income investments included in Level 3 are directly held interests in real estate, oil and gas, and other investments. The life income agreement investments are managed by an external manager.

7. Property and Equipment

Property and equipment of educational plant at June 30, 2013 and 2012, were as follows:

(in thousands of dollars)	**Estimated Useful Lives (Years)**	**2013**	**2012**
Land	-	$ 23,785	$ 23,785
Buildings and improvements	20 – 50	1,395,205	1,382,296
Equipment, furniture and library books	2 – 20	366,989	360,910
Art	-	10,086	8,110
Construction in progress	-	18,358	4,277
Less: Accumulated depreciation	-	(631,264)	(577,375)
		$ 1,183,159	$ 1,202,003

8. Accounts Payable and Other Liabilities

Accounts payable and other liabilities at June 30, 2013 and 2012, were as follows:

(in thousands of dollars)	2013	2012
Unsettled investment purchases and advances	$ 2,799	$ 1,485
Vendor accounts payable	15,517	9,724
Accrued payroll and employee benefits	11,064	10,836
Grants and contracts and other unearned income	33,326	24,041
Conditional asset retirement obligations	5,231	5,686
Swap agreements	14,809	25,624
Other liabilities	4,514	7,314
Total accounts payable and other liabilities	$ 87,260	$ 84,710

9. Notes and Bonds Payable

Notes and bonds payable at June 30, 2013 and 2012, were as follows:

(in thousands of dollars)	2013	2012
Taxable revenue refunding bonds, Series 2013, maturing 2061 through 2063, with an average coupon of 4.63% per annum payable semiannually	$ 113,985	$ -
City of Houston Higher Education Finance Corporation (CHHEFC)		
Tax-exempt revenue refunding bonds, Series 2013A & 2013B, maturing 2023 through 2048, with an average coupon of 0.40% for Series 2013A and an average coupon of 0.53% for Series 2013B per annum payable semiannually	247,180	-
Tax-exempt revenue bonds, Series 2010A & 2010B, maturing 2031 through 2048, with an average coupon of 5% per annum payable semiannually for Series 2010A and an average rate of interest at June 30, 2013 of 0.05% (0.15% at June 30, 2012) per annum payable monthly for Series 2010B	126,887	139,887
Tax-exempt revenue bonds, Series 2008A & 2008B, maturing 2039 through 2048, with an average rate of interest at June 30, 2012, of 0.15% payable daily	-	200,000
Tax-exempt revenue bonds, Series 2007A & 2007B, maturing 2010 through 2047, with an average coupon of 4.75% per annum payable semiannually	305,912	308,222
Tax-exempt revenue refunding bonds, Series 2006A & 2006B maturing 2023 through 2029, with an average rate of interest at June 30, 2012 of 0.24% per annum payable monthly	-	147,180
Tax-exempt commercial paper notes, Series A, with interest ranging from 0.12% to 0.17% at June 30, 2013 (0.17% to 0.21% at June 30, 2012) per annum payable upon maturity	27,370	44,375
	$ 821,334	$ 839,664

The University incurred interest expense, net of interest earned, of approximately $28,002,000 and $28,307,000 in 2013 and 2012, respectively. Of these amounts, interest expense of $28,011,000 and $28,291,000 was charged to operations in 2013 and 2012, respectively. An interest expense reduction resulted in a credit balance of $9,000 in capitalized interest in 2013. Interest expense of $16,000 was capitalized in 2012. The University made interest payments of approximately $28,092,000 and $28,456,000 in 2013 and 2012, respectively.

Taxable Revenue Bonds

Series 2013

On June 26, 2013, the University issued taxable revenue refunding bonds. Interest payments on the bonds are payable semiannually beginning November 15, 2013. Principal payments begin May 15, 2061 and continue annually until their maturity on May 15, 2063.

The proceeds of the bonds were used to refund all of the Series 2008A revenue bonds of $100,000,000, refund a portion of the outstanding commercial paper notes of $13,000,000, and pay the estimated costs of issuance of the bonds of $985,000.

The estimated fair value of the Series 2013 taxable bonds was $108,582,000 at June 30, 2013. These valuations are considered to be Level 2 values.

Tax-Exempt Revenue Bonds

Series 2013A and 2013B

On June 26, 2013 the University issued Series 2013A and 2013B revenue refunding bonds through the CHHEFC. The Series 2013A revenue bonds have a face value of $147,180,000 and the Series 2013B revenue bonds have a face value of $100,000,000. Both were issued as Securities Industry and Financial Markets Association (SIFMA) Index floating rate notes.

The Series 2013A and 2013B bonds were issued without an original issue premium or discount and with issuance costs of $1,080,000. The issuance costs were paid by the University and are amortized over the term of the bond issue.

Proceeds from these bonds were used to advance refund the Series 2006A, Series 2006B, and Series 2008B debt service obligation by irrevocably placing assets with a trustee to pay principal, interest and call premium on the obligations. These obligations have been paid in full.

Interest payments on the 2013 bonds are payable monthly, commencing on August 1, 2013. Principal payments for Series 2013A commence on November 15, 2023 and will be required annually until November 15, 2029. Principal payments for Series 2013B begin May 15, 2039 and continue annually until May 15, 2048. The scheduled maturity dates for Series 2013A and Series 2013B are November 15, 2029 and May 15, 2048, respectively.

The estimated fair value of the CHHEFC Series 2013A and Series 2013B bonds approximates the face value at June 30, 2013, as these are floating rate notes. These valuations are considered to be Level 2 values.

Series 2010A and 2010B

On June 2, 2010 the University issued Series 2010A and 2010B revenue bonds through the CHHEFC. The Series 2010A revenue bonds, with a face value of $94,485,000, were issued as fixed rate debt with an average coupon of 5%. The Series 2010B revenue bonds, with a face value of $39,765,000, were issued as variable rate demand bonds (VRDBs), which are subject to optional and mandatory tender. The University is not required to obtain or maintain a liquidity facility for the Series 2010B bonds.

The Series 2010A bonds were issued with a $5,637,000 original issue premium and issuance costs of $606,000. The Series 2010B bonds were issued without an original issue premium or discount and issuance costs of $158,000. The original issue premium and costs were capitalized by the University and are being amortized over the term of the bond issue. Interest payments on the Series 2010A bonds are payable semiannually and interest payments on the Series 2010B bonds are payable monthly. Principal payments for Series 2010A commence on May 15, 2031 and will be required annually until the scheduled maturity date of May 15, 2040. Principal payments for Series 2010B begin May 15, 2041 and continue annually until their maturity on May 15, 2048. On June 20, 2013, the University returned $13,000,000 of unspent Series 2010B bond proceeds.

Unspent bond proceeds of $20,640,000 at June 30, 2013 and $35,733,000 at June 30, 2012 were invested in a mutual fund holding U.S. government securities.

The estimated fair value of the CHHEFC series 2010A bonds was $101,714,000 at June 30, 2013 and $107,829,000 at June 30, 2012. The estimated fair value of the CHHEFC Series 2010B bonds approximates the face value at June 30, 2013, as these are VRDBs. These valuations are considered to be Level 2 values.

Series 2008A and 2008B
On June 4, 2008 the University issued Series 2008A and 2008B revenue bonds through the CHHEFC. The Series 2008A and 2008B revenue bonds, each with a face value of $100,000,000, were issued as VRDBs, which were subject to optional and mandatory tender. The bonds were refunded in 2013. The University was not required to obtain or maintain a liquidity facility for the bonds. The University obtained a credit facility from a group of banks that could only be used by the University to provide liquidity in the event the bonds were tendered but not successfully remarketed. The University did not need to draw against the liquidity facility as a result of an inability to remarket these bonds.

Issuance costs of $627,000 were capitalized by the University and were amortized over the term of the bond issue. Remaining un-amortized issuance costs of $544,000 were recognized as a loss at the time of refunding.

A portion of the proceeds of the Series 2008A and 2008B bonds was used to refund $28,800,000 of commercial paper.

The estimated fair value of the Series 2008A and 2008B bonds approximated the face value at June 30, 2012, as these are VRDBs. These valuations are considered to be Level 2 values.

Series 2007A and 2007B
On June 12, 2007, the University issued Series 2007A and 2007B revenue bonds through the CHHEFC. The Series 2007A bonds were issued with a $5,832,000 original issue premium and the Series 2007B bonds were issued net of a $365,000 original issue discount. The original issue premium and discount and issuance costs of $2,494,000 were capitalized by the University and are being amortized over the term of the bond issue. Interest payments on the bonds are payable semiannually. Principal payments for Series 2007A commenced on May 15, 2010 and are required annually until the scheduled maturity date of May 15, 2047. Principal payments for Series 2007B begin November 15, 2030 and continue annually until their maturity in November 2037.

Series 2007A bonds were issued with a face value of $209,165,000 and have a current face value of $200,445,000 after principal payments. Series 2007B bonds were issued with a face value of $100,000,000.

The estimated fair value of the CHHEFC Series 2007A bonds was $211,158,000 at June 30, 2013 and $220,768,000 at June 30, 2012. The estimated fair value of the CHHEFC Series 2007B bonds was $103,462,000 at June 30, 2013 and $107,132,000 at June 30, 2012. These valuations are considered to be Level 2 values.

Series 2006A and 2006B

In March 2006, the University issued Series 2006A and 2006B revenue refunding bonds in the amount of $147,180,000. The face value of Series 2006A is $98,155,000 and the face value of Series 2006B is $49,025,000. The bonds were refunded in 2013. The Series 2006A and 2006B revenue refunding bonds were issued as VRDBs, which are subject to optional and mandatory tender. The University was required to maintain a liquidity facility for the bonds to provide liquidity in the event the bonds were tendered but not successfully remarketed. This liquidity facility expired on March 28, 2013 and called for balances outstanding at maturity to be repaid over six equal semi-annual payments. The University did not need to draw against the liquidity facility as a result of an inability to remarket these bonds.

Proceeds from these bonds were used to refund $20,000,000 of the commercial paper program and to advance refund the Series 1999A debt service obligation by irrevocably placing assets with a trustee to pay principal, interest and call premium on the obligations. These obligations have now been paid in full.

Issuance costs of $479,000 were capitalized by the University and were amortized over the term of the bond issue. Remaining un-amortized issuance costs of $332,000 were recognized as a loss at the time of refunding.

The estimated fair value of the CHHEFC Series 2006A and 2006B bonds approximated the face value at June 30, 2012, as these are VRDBs. These valuations are considered to be Level 2 values.

In June 2012 the University received from the IRS a Notice of Proposed Issue with respect to the Series 2006A and Series 2006B bonds that asserted a Violation of Qualified Hedge under Treasury Regulation 1.148-4(h). In November 2012 the IRS issued a Notification of No-Change Determination in this matter. The IRS notification states that the IRS has completed its examination of the bonds and has made a determination to close the examination with no change to the position that interest received by the beneficial owners of the bonds is excludable from gross income under section 103 of the Internal Revenue Code.

Principal maturities for notes and bonds payable as of June 30, 2013, excluding commercial paper and unamortized discounts and premiums, are as follows:

(in thousands of dollars)

2014	$	2,405
2015		2,500
2016		2,635
2017		2,770
Thereafter		772,550
	$	782,860

Commercial Paper Notes
The University has a tax-exempt commercial paper credit facility that provides for borrowings in the form of individual notes up to an aggregate of $100,000,000. The notes bear a fixed rate of interest, established on the borrowing date, over their individual terms, not to exceed 270 days. The outstanding balance under the facility was $27,370,000 and $44,375,000 with an average interest rate of 0.17% and 0.19% and an average maturity of 77 days and 78 days as of June 30, 2013 and 2012, respectively.

The estimated fair value of the commercial paper notes approximates the face value.

Line of Credit
The University established a $100,000,000 variable rate line of credit with a commercial bank on January 30, 2009. The line of credit expired on January 30, 2013, and was not renewed. No funds were borrowed under this agreement during 2013 or 2012.

Interest Rate Swaps
Effective June 29, 2011, the University entered into an interest rate swap agreement with a notional amount of $100,000,000. The University receives amounts based on SIFMA swap index and makes payments based on a fixed rate of 1.46%. The swap matures on June 29, 2016.

The fair value of the interest rate swap agreement is the estimated amount that the University would pay or receive to terminate these contracts as of June 30, 2013. The estimated fair value of this swap arrangement was a liability of $2,831,000 as of June 30, 2013, and a liability of $3,529,000 as of June 30, 2012. The change in value is reported in other nonoperating changes in the Consolidated Statement of Activities.

Effective March 29, 2006, the University entered into interest rate swap agreements with a notional amount of $147,180,000. The University receives amounts based on 67% of the three-month London Interbank Offered Rate (LIBOR) and makes payments based on a fixed rate of 3.868%. While the Series 2006A and 2006B and the Series 2008A and 2008B bonds were repaid, the swap agreements remain outstanding. The University has the option to terminate the swaps starting in calendar year 2016.

The fair value of the interest rate swap agreements is the estimated amount that the University would pay or receive to terminate these contracts as of June 30, 2013 and 2012. The estimated fair value of these swap arrangements was a liability of $10,761,000 as of June 30, 2013, and a liability of $17,082,000 as of June 30, 2012. The change in value is reported in other nonoperating changes for 2013 and 2012 in the Consolidated Statement of Activities.

10. Net Assets

The University's unrestricted, temporarily restricted and permanently restricted net assets as of June 30, 2013 are categorized by purpose as follows, with summarized information as of June 30, 2012:

	2013				2012
(in thousands of dollars)	**Unrestricted**	**Temporarily Restricted**	**Permanently Restricted**	**Total**	**Total**
Internally designated for specific programs or ongoing activities	$ 130,038	$ -	$ -	$ 130,038	$ 120,336
Designated or restricted by donor				-	
including pledges	97,327	121,163	-	218,490	224,146
Net investment in plant	312,295	39,364	-	351,659	347,069
Endowment and designated for long-term investment including pledges	2,140,191	1,723,418	1,031,690	4,895,299	4,448,069
Life-income trusts	-	45,494	21,280	66,774	63,427
Loans	736	-	2,838	3,574	2,827
	$ 2,680,587	$ 1,929,439	$ 1,055,808	$ 5,665,834	$ 5,205,874

The Board of Trustees has designated certain unrestricted and temporarily restricted net assets for long-term investment (Note 5). Most net assets designated for long-term investment and endowment assets participate in one common investment pool.

11. Student Financial Aid

Gross student tuition and fees of $227,668,000 and $206,738,000 in 2013 and 2012, respectively, are presented in the consolidated financial statements net of scholarship and fellowship awards of $102,800,000 and $86,346,000, respectively. Auxiliary enterprises revenue was reduced by scholarship awards applied to room and board charges of $4,283,000 and $5,499,000 in 2013 and 2012, respectively. Scholarship and fellowship awards in excess of the above amounts are reported as expense.

12. Grants and Contracts

The major components of grants and contracts revenue for the years ended June 30, 2013 and 2012 are as follows:

(in thousands of dollars)	2013	2012
Government		
Direct	$ 70,883	$ 68,467
Indirect	19,666	19,831
Total government	90,549	88,298
Foundation, industrial, and other		
Direct	24,399	18,746
Indirect	2,827	1,907
Total foundation, industrial, and other	27,226	20,653
Total grants and contracts	$ 117,775	$ 108,951

The University receives funding from federal government agencies for research and other programs conducted under government grants and contracts. The grants and contracts provide for reimbursement of direct and indirect costs. Indirect (facilities and administrative) costs are reimbursed under a negotiated rate agreement with the federal government; the rate is predetermined through fiscal year 2015. The costs recovered by the University in support of sponsored programs are subject to audit and adjustment.

13. Functional Expenses

Expenses of the University by major functional category for the years ended June 30, 2013 and 2012, were as follows:

(in thousands of dollars)	2013	2012
Instruction and department research	$ 260,699	$ 245,862
Sponsored research and other sponsored programs	102,387	97,600
Library	32,126	31,411
Scholarships and fellowships	7,289	12,726
Auxiliary enterprises	55,567	56,381
Student services	50,138	48,268
General administration	33,088	30,837
Institutional development and other activities	28,235	24,392
Total operating expenses	$ 569,529	$ 547,477

The above table includes depreciation expense of $54,448,000 and $53,246,000, and operations and maintenance expense of $41,719,000 and $48,644,000 in 2013 and 2012, respectively, which were allocated to the major functional categories based on space usage. Depreciation of library books of $9,638,000 and $9,403,000 was recognized as library expense in 2013 and 2012, respectively. Interest of $28,011,000 and $28,291,000 in 2013 and 2012, respectively, was recorded by functional category based on identification of related construction projects.

14. Related Party Transactions

Members of the University's Board of Trustees and senior management may, from time to time, be associated, either directly or through interlocking board memberships, with entities doing business with the University. The University employs a conflict of interest policy that requires any such associations to be disclosed in writing on an annual basis and updated as appropriate during the year. When such associations exist, measures are taken to mitigate any actual or perceived conflict, including recusal of the board member from any decisions involving the entity doing business with the University. The transactions with entities associated with trustees or senior management are not considered to be significant and may include investment management, common membership in investment partnerships or other investment vehicles, or the purchase of goods or services.

15. Retirement Plans

Substantially all employees are eligible to participate in a defined contribution retirement plan, which is administered by an outside agency. The plan operates in accordance with Section 401(a) of the Internal Revenue Code. University contributions are made to this plan. In addition, employees may elect to participate in plans created under Section 403(b) of the Internal Revenue Code. The contributions of the University and its employees can be applied to annuity contracts. The University's contributions to the plan of $20,374,000 and $19,216,000, were recorded as expense in the appropriate functional categories in 2013 and 2012, respectively.

16. Commitments and Contingencies

A number of suits and claims are pending against the University. While final outcomes cannot be determined at this time, management believes, after consultation with its legal counsel, that the uninsured liability, if any, resulting from these suits and claims will not have a material adverse effect on the University's financial position, operations, or cash flows.

In connection with its private equity investment program (Note 4), the University is obligated under certain limited partnership agreements to advance additional funding up to levels specified in each agreement upon the request of the general partner. At June 30, 2013 and 2012, the University had unfunded commitments of approximately $516 million and $413 million, respectively, which are expected to be called primarily over the next five to seven years.

Additionally, the University was committed under contracts at June 30, 2013 and 2012, for capital construction and improvements and major maintenance of approximately $31 million and $17 million, respectively, to be financed primarily from gifts and net assets designated for long-term investments, and from debt to the extent other resources are not available. Other purchasing commitments of approximately $7 million and $4 million were also outstanding at June 30, 2013 and 2012, respectively.

The University is committed under research subcontracts at June 30, 2013 and 2012, for sponsored activity conducted at other universities of approximately $18 million and $14 million, respectively, to be paid from contract and grant revenue as expenses are incurred.