

II.G. Finances

Context and Background

To successfully carry out its mission and remain accountable to all its constituents, the University of Minnesota must maintain a position of strong financial health. While a number of specific indicators illustrate this strength, a general overview of how a large enterprise such as the University of Minnesota compares with other American public research universities is helpful to understand the similarities and differences among institutions, and the unique position held by the University of Minnesota among its peers. Comparisons are described in terms of institutional characteristics, revenues, and the University's three-part mission of instruction, research, and public service. A broad historical perspective is also included, showing how different fund sources have changed to reflect overall growth in enrollments since 1945.

This section articulates specific financial goals regarding:

- sound balance sheets
- balanced revenue streams
- well-managed expenditures
- positive cash flows
- managed long-term debt
- maximized returns of portfolios
- successful fundraising and voluntary support

Numerous indicators supporting these goals show that the University of Minnesota is fiscally sound and in a strong position to continue to manage strategically its financial resources.

Funding Sources for the University of Minnesota

University funding comes from a variety of sources, as shown below.

Chart A
Funding of Mission Activities: University Total

Fund Source Type	% of Total
State General Appropriation	30.2%
State Special Appropriation	5.1%
Tuition Revenue	16.8%
Federal	16.0%
MN Grants and Contracts	2.6%
Indirect Cost Recovery	3.4%
Other Current Restricted	15.8%
Other Current Unrestricted	9.1%
Auxiliary	1.0%
Total	100.0%

Comparison with Peer Institutions

Universities are organized in many different ways. Comparison is possible only at the campus level, and even then comparison is difficult because the institutional characteristics of campuses vary significantly. This is illustrated in Chart B, which shows the five main factors that determine the level of revenue and expenditures for a public research university campus:

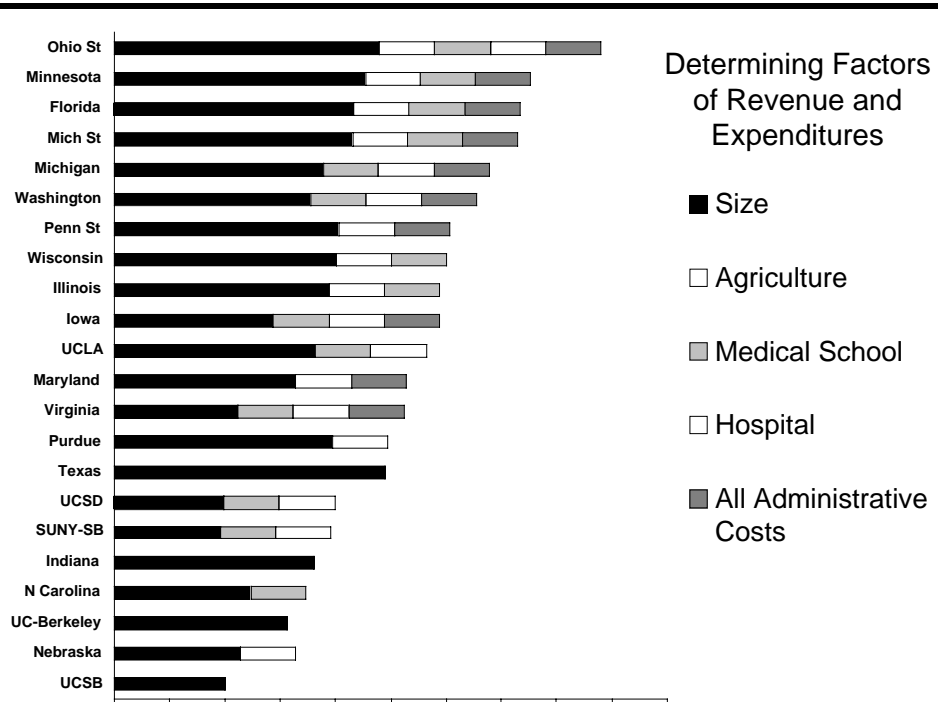
- 1) Size. The size of a campus in terms of student enrollment (and therefore number of employees) is a major factor.
- 2) Agriculture. Relatively few campuses have major agricultural programs and an extension service, but those that do will have a much higher level of revenue and expenditures than those that do not.
- 3) Medical School. Medical schools and academic health centers generate very high levels of revenue and expenditures.
- 4) Hospital. The hospital revenue and expenditures on major campuses such as Michigan and UCLA are 30 percent or more of total revenue and expenditures – and more than the total revenue and expenditures for most of the nation's higher education campuses.
- 5) All Administrative Costs. Many campuses (e.g., Wisconsin-Madison, Texas-Austin, UCLA) are part of large university systems with separate system offices that carry much of the administrative cost. Others such as Minnesota and Michigan are multi-campus universities, and for these campuses much of the cost of administering the university is reported as a cost for the main campus. The same is true of single-campus universities such as the University of Iowa.

The breadth of academic programs and administrative responsibilities on the Twin Cities campus is much greater than at many research university campuses. The Twin Cities campus has agricultural programs, an extension service, and an academic health center built around a major medical school.

Like Minnesota, Wisconsin also concentrates responsibilities in a single campus, the University of Wisconsin, Madison. A major difference, however, is that the University of Wisconsin has a separate system office with a very large budget. The University of Wisconsin Extension Service, for example, is budgeted through the system office, not the Madison campus. Nearly all administrative costs for the University of Minnesota are reported as Twin Cities campus costs, since there is no system office. The Ohio State University, Columbus and the University of Florida, Gainesville are the only other major university campuses that have both agricultural programs and academic health centers.

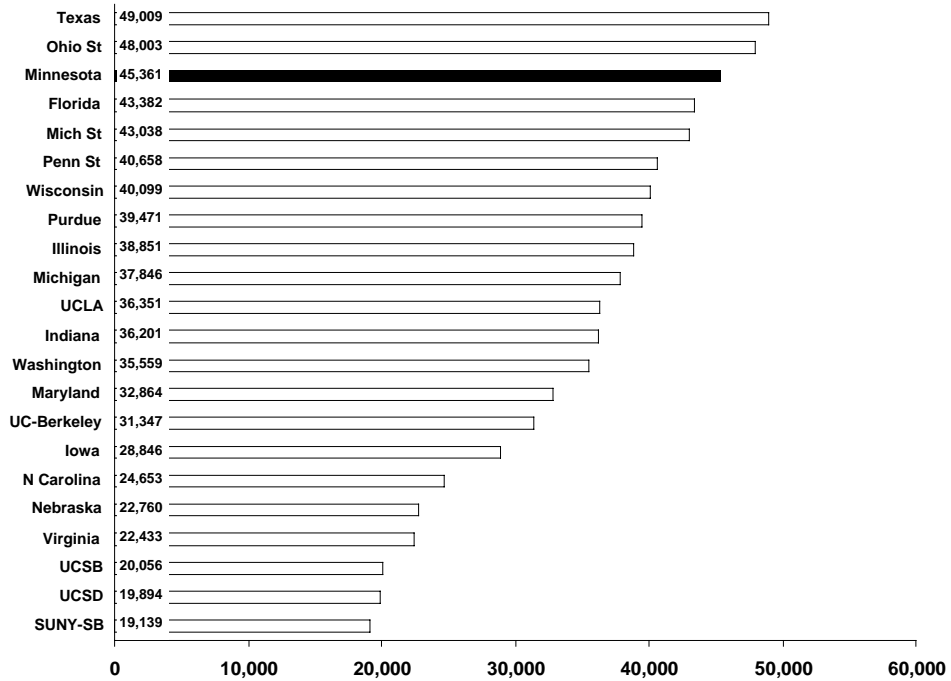
Chart B presents an attempt to graphically characterize the complexity of the 22 most highly regarded public universities based on the five characteristics above. The reader is cautioned not to read too much into the scale of Chart B but instead use it as a helpful heuristic.

Chart B
Institutional Characteristics: Campus Size, Programs, Administration



Charts C-J provide comparison information for the institutions shown above in Chart B. Chart C shows enrollment, to emphasize that the Twin Cities campus has the nation's third largest enrollment. The remaining figures provide revenue and expenditure information. Charts E-G refer to "education and general" revenue and expenditures. These are revenue and expenditures that support the mission activities of instruction, research, and public service, expenses and revenues associated with hospitals and auxiliaries excluded.

**Chart C
FY2000 Total Enrollment**



**Chart D
FY2000 Total Revenue**

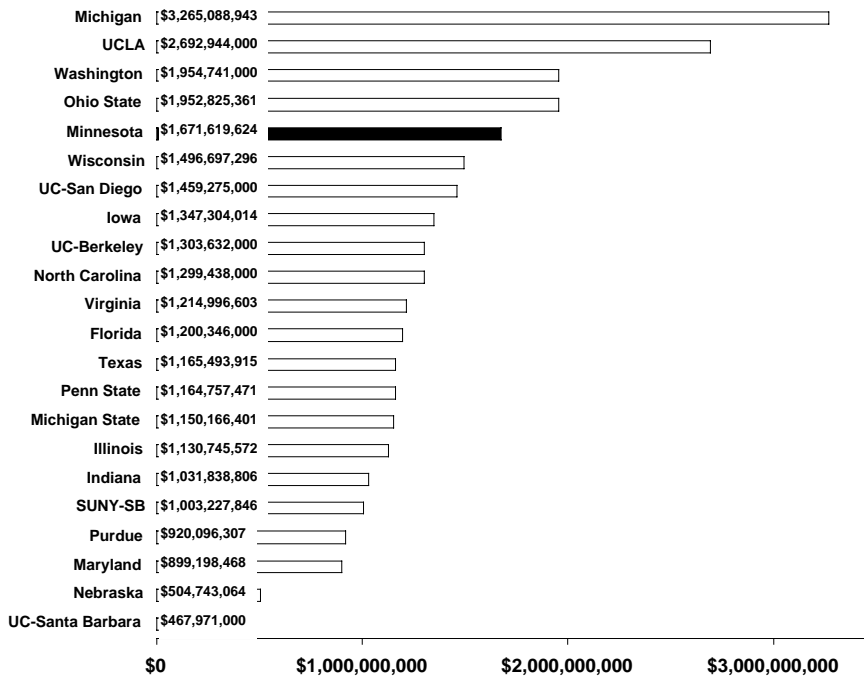


Chart E
FY 2000 Total Education and General Revenue

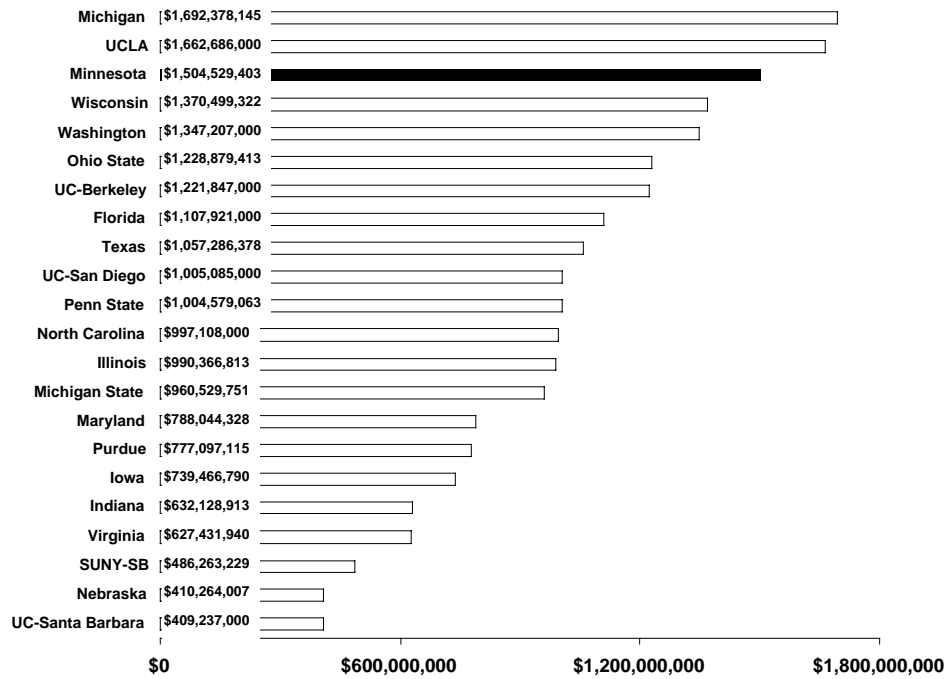


Chart F
FY2000 Education & General Revenue by Fund Source

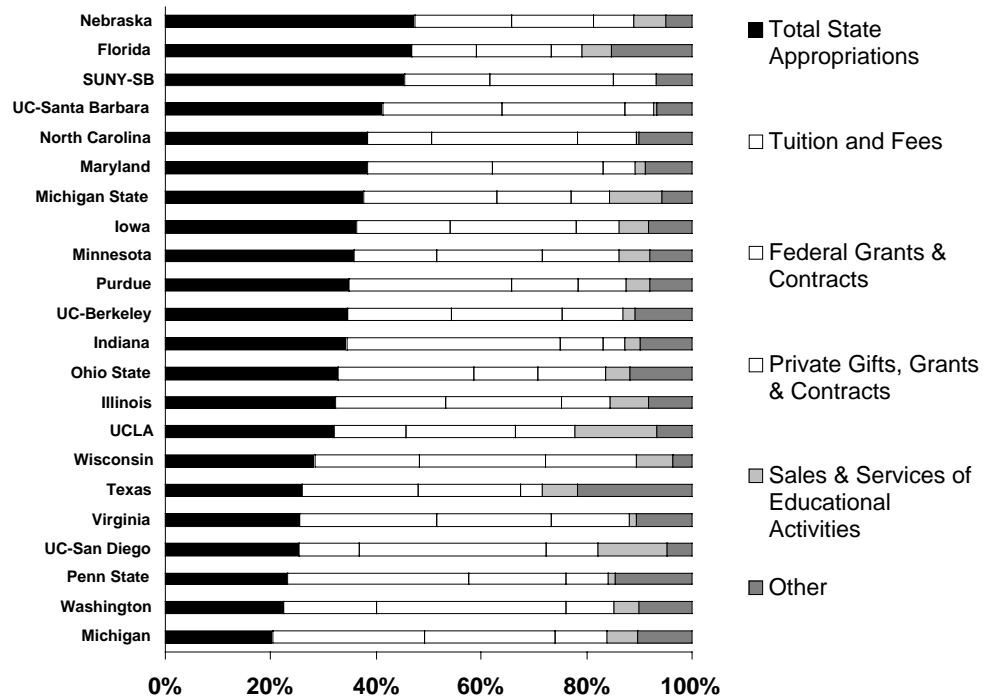


Chart G
FY2000 Total Educational and General Expenditures

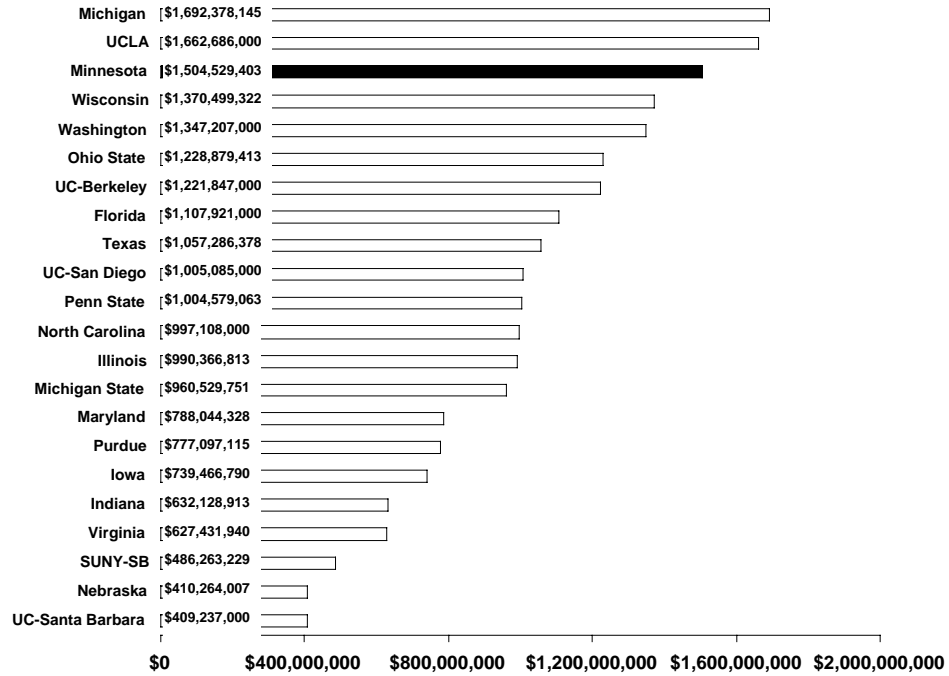


Chart H
FY2000 Direct Expenditures for Instruction

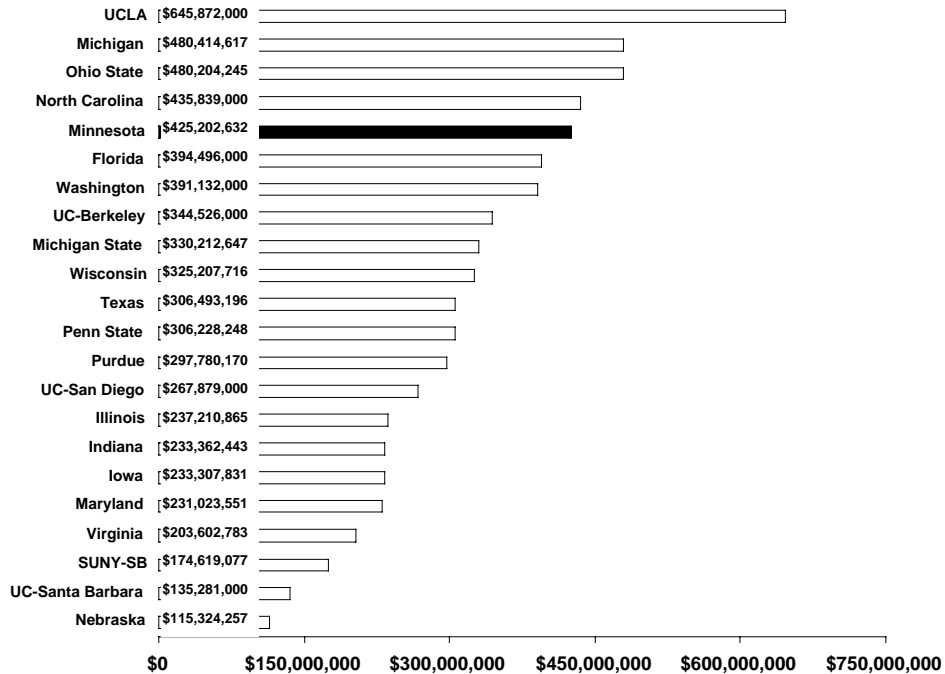


Chart I
FY2000 Direct Expenditures for Research

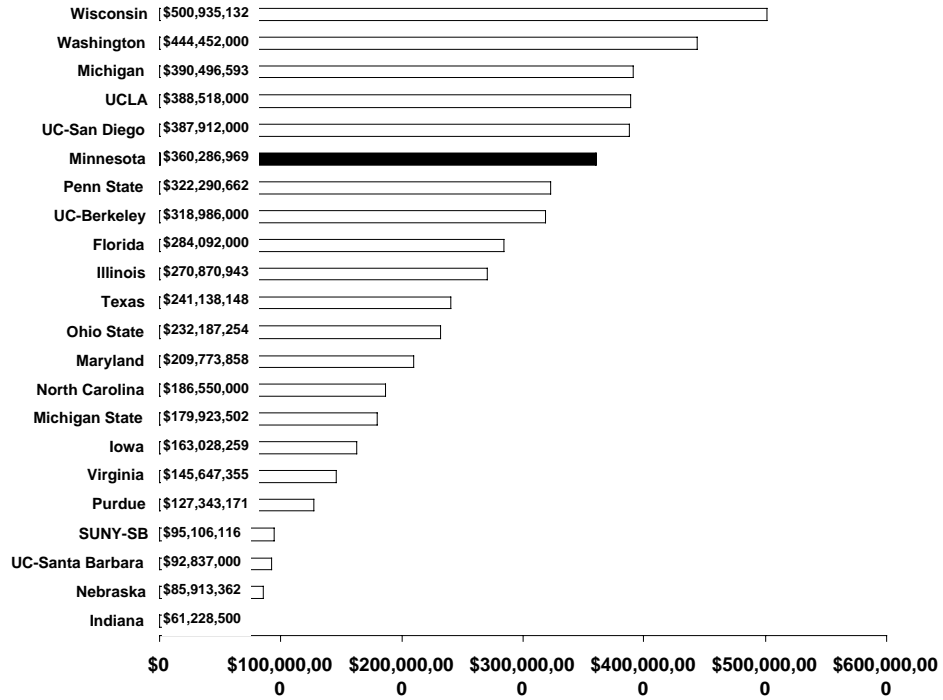
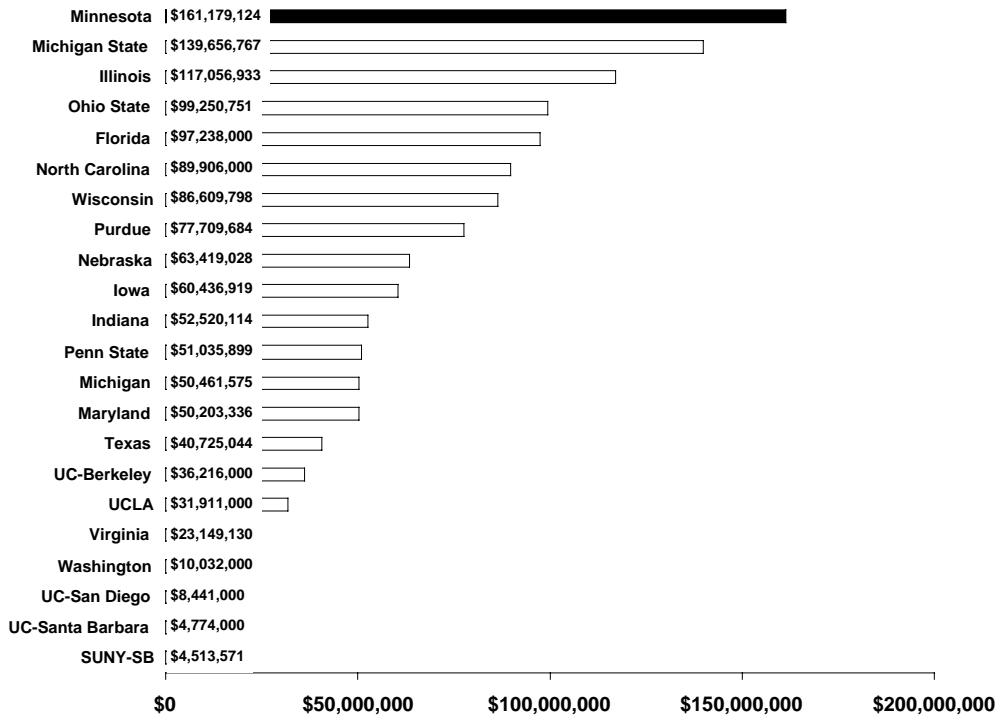


Chart J
FY2000 Direct Expenditures for Public Service



Although most people associate the University of Minnesota Extension Service with public service, it accounted for just \$50 million of the \$161 million in Twin Cities campus public service expenditures in FY 2000. The Twin Cities campus has a broad range of public service programs, including non-credit instruction (e.g., conferences and workshops) in every college, state-wide outreach efforts to K-12 schools in the College of Education and Human Development, and extensive clinical activities in the Medical School, the School of Dentistry, and the College of Veterinary Medicine. In addition, the Minnesota Geological Survey and the Veterinary Diagnostic Laboratory are University departments that do public service work often conducted by state agencies in other parts of the country.

Chart K
University Campuses and Colleges: FY2001 Expenditures by Source

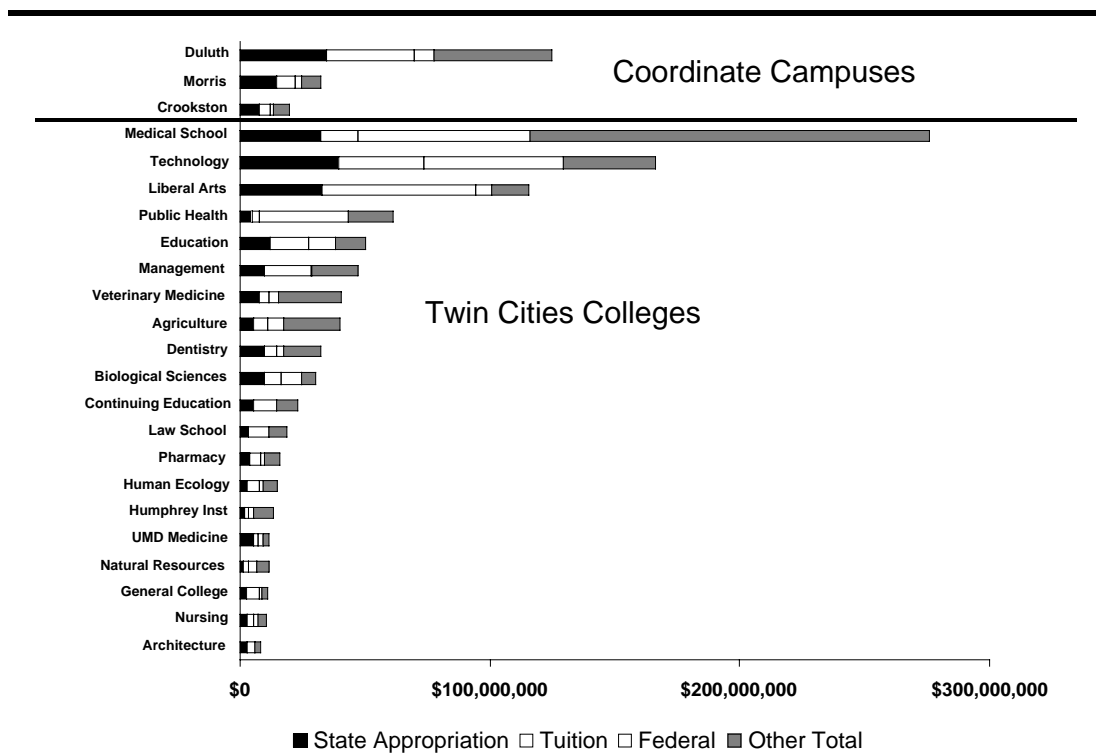
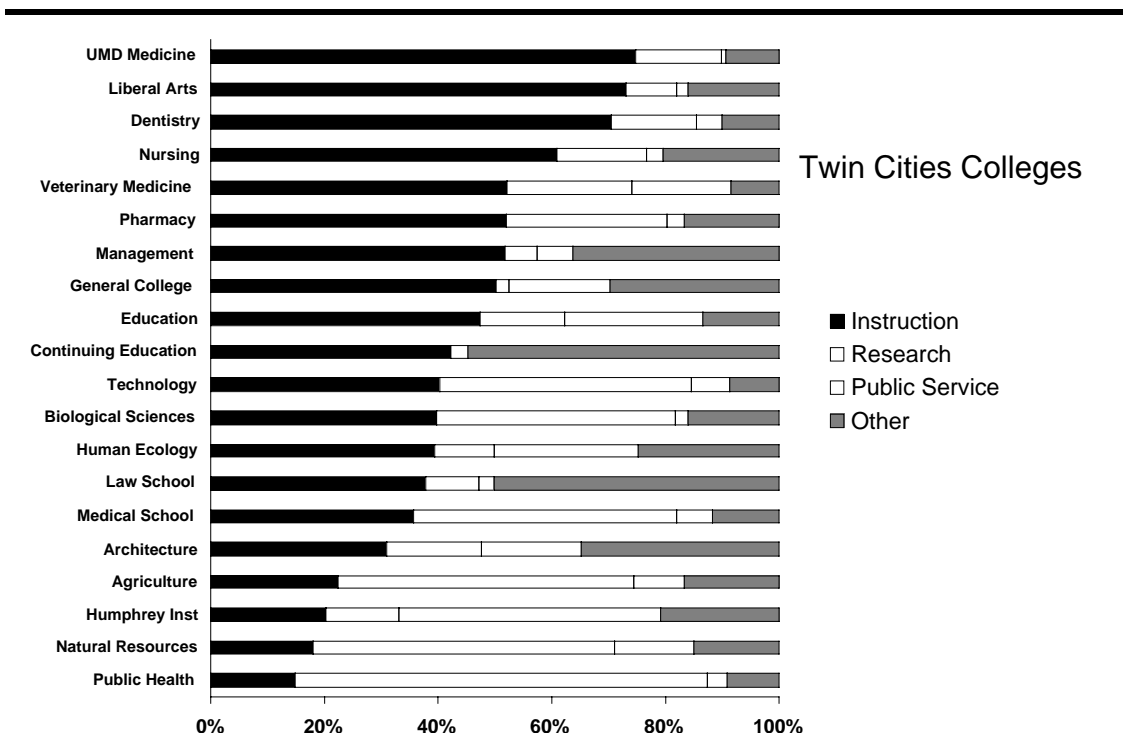


Chart L
Twin Cities Colleges: FY2001 Distribution of Expenditures by Source



Conclusion

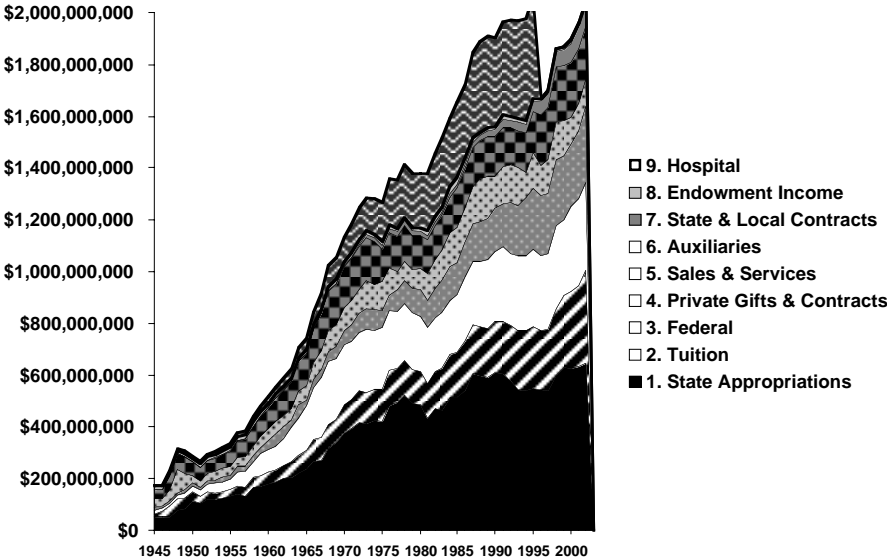
Chart M provides historical perspective on funding for the University of Minnesota over the period FY 1945 to FY 2002 by fund source, adjusted for inflation (CPI). The trend is generally upwards for most fund sources, roughly mirroring the growth in University enrollment. The level of state support has had peaks and valleys that generally follow the bad times and boom times of the economy. The sale of the University Hospital resulted in a significant decline in revenues (and expenditures). Revenue from private gifts and contracts is one of the fastest growing revenue sources. Tuition revenue is an increasingly important fund source

The figures following Chart M show the trend for each fund source. Note that the scale is different in each of these figures.

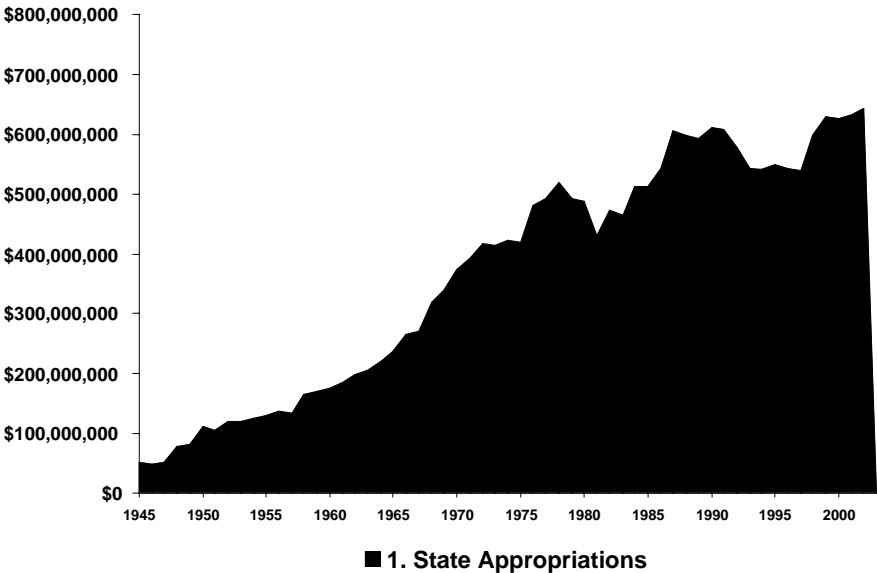
Note also the following: the unusual pattern for endowment income is because in 1987 the state agreed to transfer income from the Permanent University Fund from the University's operating budget to endowment accounts in order to endow faculty chairs and professorships as part of the University's capital campaign. The greatest increase in federal funds was during the period between Sputnik and the first Apollo lunar landing.

Chart M
University of Minnesota Revenue by Source: 1945 to 2002

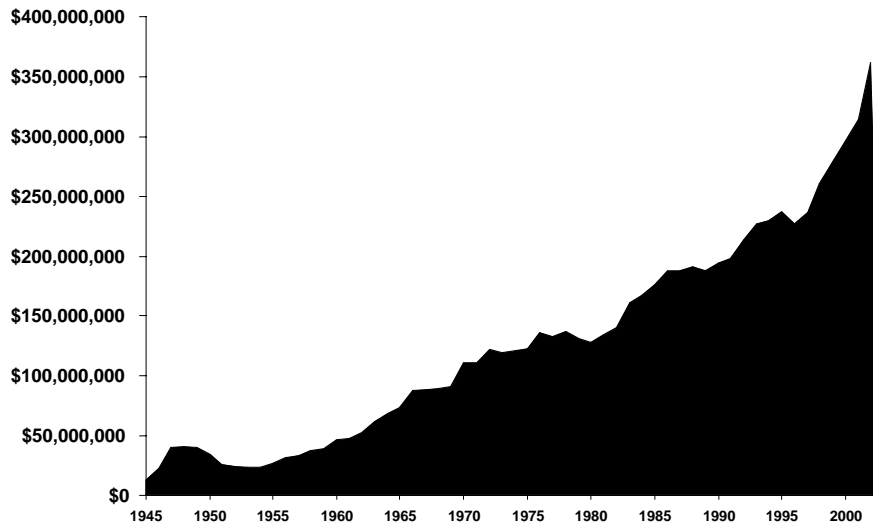
UNIVERSITY OF MINNESOTA Revenue by Source:
1945 to 2002 (adjusted for inflation)



UNIVERSITY OF MINNESOTA Revenue by Source:
1945 to 2002 (adjusted for inflation)

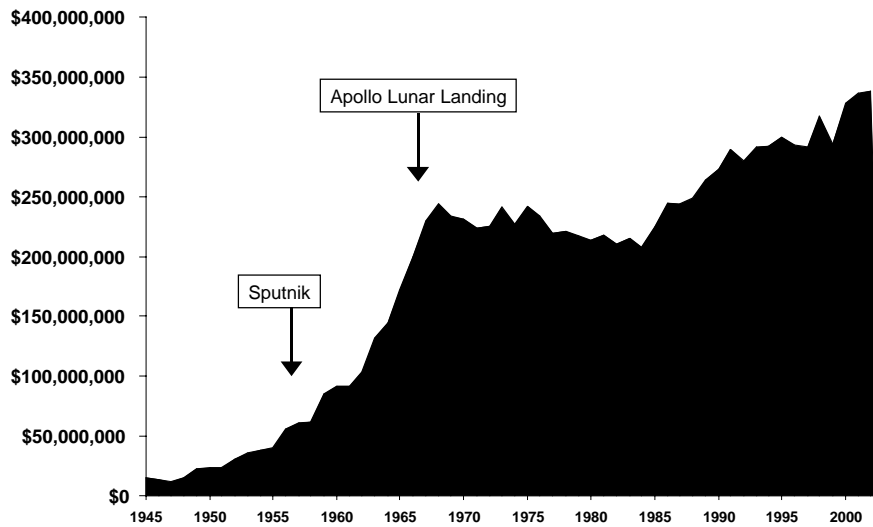


**UNIVERSITY OF MINNESOTA Revenue by Source:
1945 to 2002 (adjusted for inflation)**



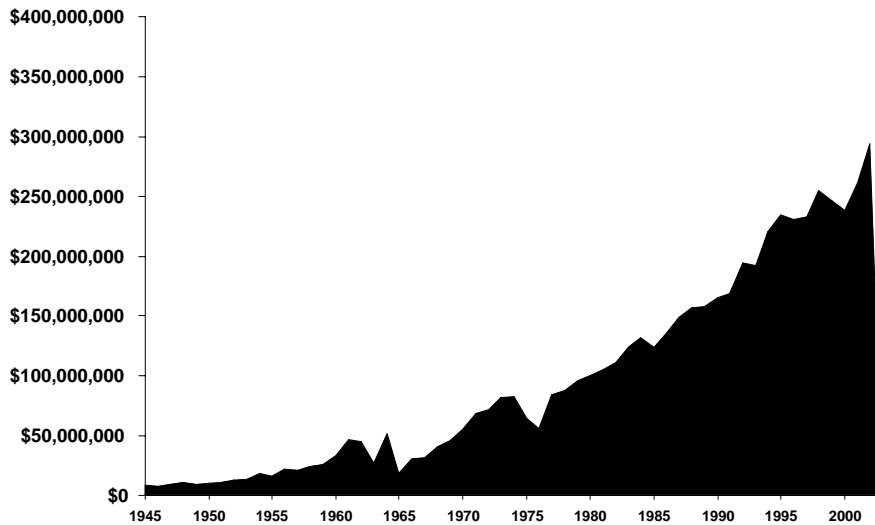
■ 2. Tuition and Fees

**UNIVERSITY OF MINNESOTA Revenue by Source:
1945 to 2002 (adjusted for inflation)**



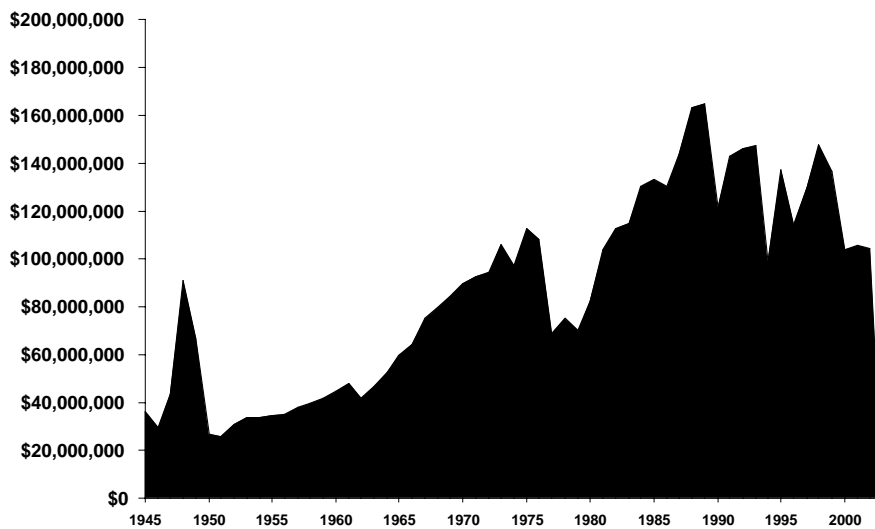
■ 3. Federal Appropriations, Grants, and Contracts

**UNIVERSITY OF MINNESOTA Revenue by Source:
1945 to 2002 (adjusted for inflation)**



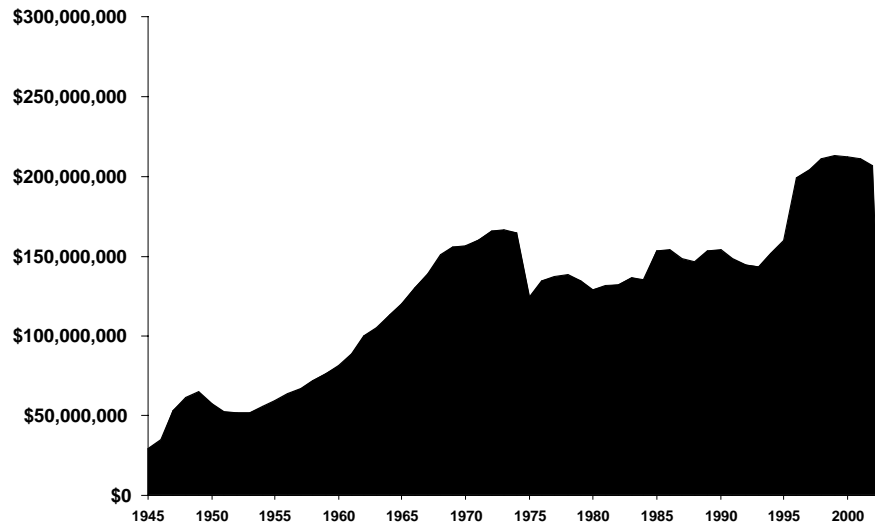
■ 4. Private Gifts & Contracts

**UNIVERSITY OF MINNESOTA Revenue by Source:
1945 to 2002 (adjusted for inflation)**



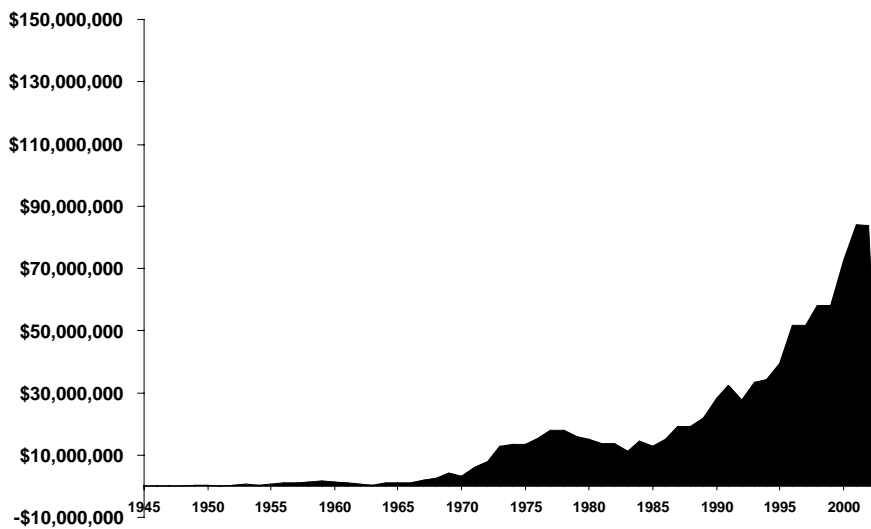
■ 5. Sales & Services

**UNIVERSITY OF MINNESOTA Revenue by Source:
1945 to 2002 (adjusted for inflation)**



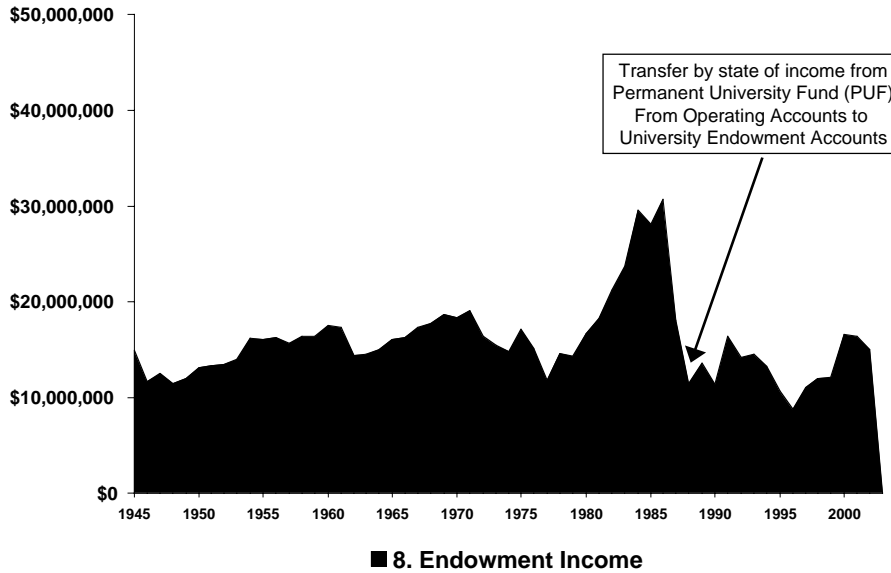
■ 6. Auxiliaries

**UNIVERSITY OF MINNESOTA Revenue by Source:
1945 to 2002 (adjusted for inflation)**

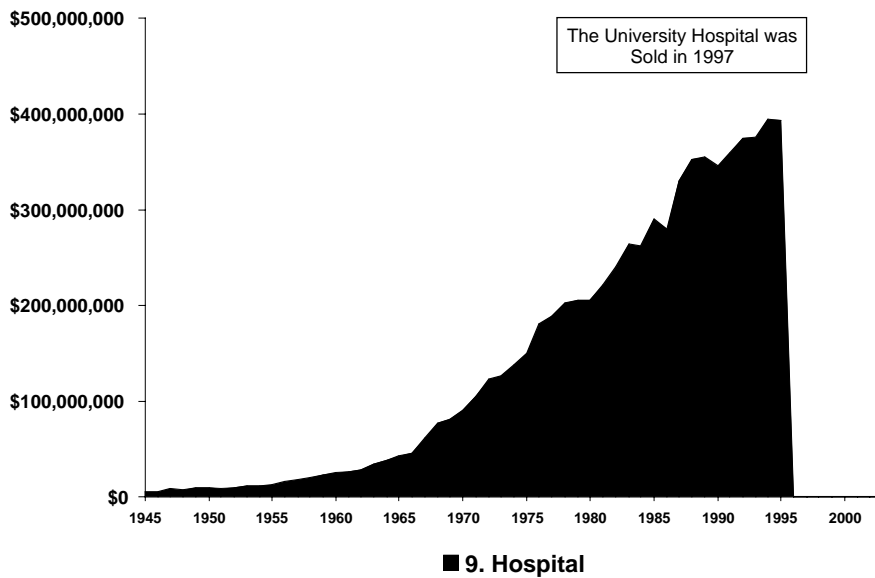


■ 7. State & Local Contracts

**UNIVERSITY OF MINNESOTA Revenue by Source:
1945 to 2002 (adjusted for inflation)**



**UNIVERSITY OF MINNESOTA Revenue by Source:
1945 to 2002 (adjusted for inflation)**



To maintain a strong balance sheet that provides liquidity and financial flexibility to support the University's mission.

Indicators: audited financial statements

Annual Financial Statements

Assets, Liabilities, and Net Assets

The University's consolidated assets, liabilities, and net assets as of June 30, 2002 are summarized below (in thousands of dollars):

	June 30, 2002
Current assets	\$ 511,457
Capital assets, net	1,789,695
Other noncurrent assets	1,063,686
Total assets	3,364,838
Current liabilities	629,255
Noncurrent liabilities	564,280
Total liabilities	1,193,535
Unrestricted	334,989
Restricted – expendable	486,067
Restricted - nonexpendable	188,742
Invested in capital assets, net of related debt	1,161,505
Net assets	\$2,171,303

Current assets at June 30, 2002 totaled \$511.5 million, consisting primarily of cash and cash equivalents of \$149.6, securities lending collateral of \$31.0, and net receivables of \$306.1. State appropriations receivable totaled \$131.0 million, while receivables from students amounted to \$46.0 million net of estimated uncollectible amounts, including student loans scheduled for collection within the next year. Sponsored program, and trade and other receivables, net of allowances, totaled approximately \$77.8 million and \$51.3 million respectively as of June 30, 2002. Although we would prefer to highlight comparative data from similar-sized institutions, this data is based on a new reporting format. As such, it represents baseline data for future reports and comparative trends.

Capital assets, net of accumulated depreciation, totaled \$1,789.7 million, and included significant investment in buildings and infrastructure assets of \$1,279.4 million, and construction-in-progress of another \$204.0 million. Other noncurrent assets totaled \$1,063.7 million, including long-term endowment and other investments of \$913.2 million, unspent bond proceeds that are earmarked for approved capital projects, and the portion of student loan receivables scheduled for collection beyond June 2003.

Current liabilities totaled \$629.3 million and consisted primarily of accounts payable, securities lending collateral, and accrued liabilities and other, including significant expected obligations under

the University's self-insured medical plan. Current liabilities also included revenue related to summer session tuition that was deferred to fiscal year 2003, funds received in advance of expenditures on sponsored accounts, and the current portion of bonds payable.

Noncurrent liabilities, totaling \$564.3 million, included primarily principal amounts due on University bonds, and vacation and other compensation-related liabilities that are payable beyond June 2003.

Revenues, Expenses and Changes in Net Assets

The University's consolidated revenues, expenses, and changes in net assets for the year ended June 30, 2002 are summarized as follows (in thousands of dollars):

	Year Ended June 30, 2002
Operating revenues:	
Student tuition and fees (net)	\$ 293,127
Grants and contracts	508,328
Auxiliary enterprises (net)	206,721
Educational activities	104,422
Federal appropriations	18,215
Other revenues	4,833
Total operating revenues	<u>1,135,646</u>
Operating expenses (see following table)	<u>2,005,138</u>
Operating loss	<u>(869,492)</u>
Nonoperating revenues (expenses):	
State appropriations	643,088
Grants and gifts	203,895
Net investment loss	(56,719)
Interest expense	(22,400)
Other nonoperating expenses (net)	(1,432)
Decrease before other items	<u>(103,060)</u>
Capital appropriations	81,711
Capital and endowment gifts and grants	23,631
Total other revenues	<u>105,342</u>
Increase in Net Assets	<u>\$2,282</u>

To maintain a balanced stream of revenues that funds the University's mission, while minimizing the University's dependence on any one source of funds.

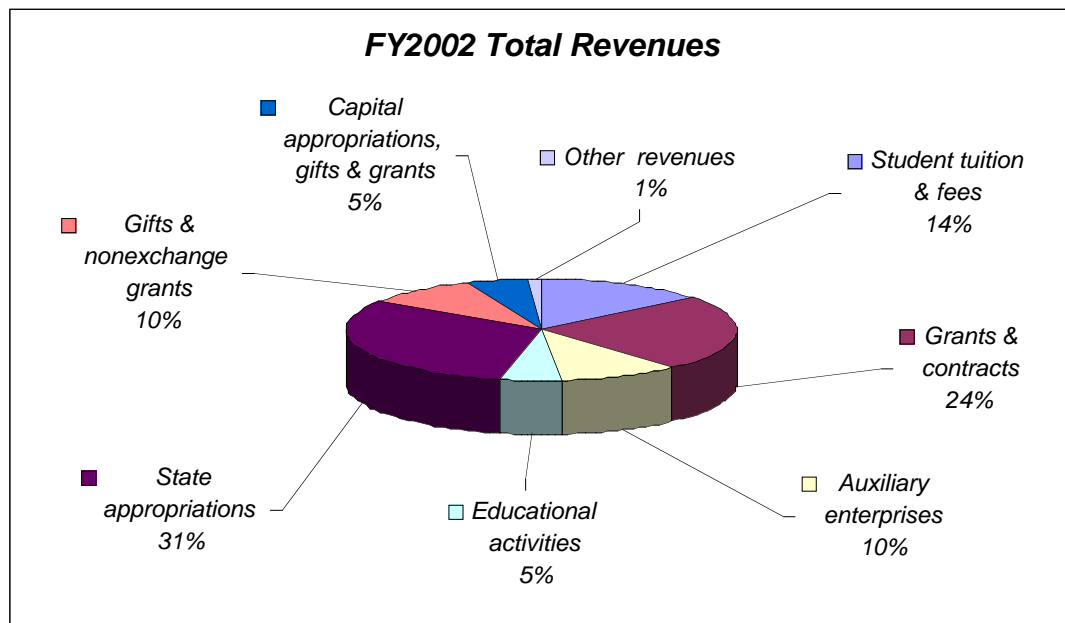
Indicators: budgeted revenues by source

Revenues

One of the University's strengths is that it is not overly dependent on any of its four main sources of revenue: student tuition and fees, grants and contracts, sales by auxiliary and educational units, and state appropriations.

The following graph illustrates the sources of the University's operating and nonoperating revenues for the year ended June 30, 2002.

Chart N



For the year ended June 30, 2002, student tuition and fees totaled \$293.1 million, net of \$68.3 million of scholarship allowances; auxiliary revenues of \$206.7 million were net of \$7.4 million of scholarship allowances.

Grants and contracts from the federal government totaled \$319.8 million in fiscal year 2002, with an additional \$188.5 million from other government and private sources, all primarily related to the funding of research, instruction, and public service programs. For the most part, we recognize sponsored revenues when the University expends the funds on projects.

State operating appropriations totaled \$643.1 million. This funding, in addition to other sources of unrestricted revenue (tuition; educational and auxiliary activities) and nonoperating grants totaling \$114.8 million, funded a number of University priorities including:

- competitive compensation plans for faculty and staff;

- various academic initiatives;
- enhancement of services to students including technology improvements, upgrades to the financial aid process, and the conduct of freshman seminars; and
- increases in facilities costs.

Other significant sources of revenue to the University in fiscal year 2002 included donations and gifts in support of operating expenses of \$89.1 million, and gifts for capital purposes that totaled \$21.5 million.

Capital appropriations occur biennially, and the amount appropriated by the State of Minnesota for fiscal year 2002 totaled \$97.9 million, including funding for preservation and replacement of campus facilities, classroom improvements, and new construction and renovation of facilities on three campuses. The University records state capital appropriation revenue only when approved capital expenditures have been incurred, however, and thus recorded revenue for the year ended June 30, 2002 of \$81.7 million.

To manage University expenditures within available resources, to support the University's mission, facilities, and infrastructure.

Indicators: audited financial statements

Expenses

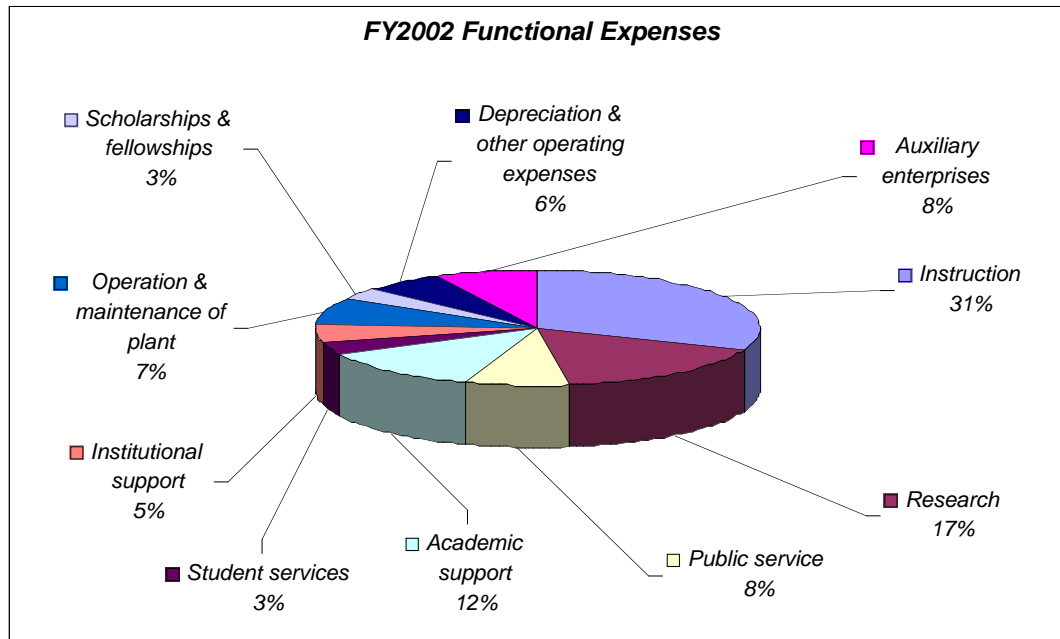
The University's expenses for the year ended June 30, 2002, broken down by functional and natural category, are as follows (in thousands of dollars). Functional category represents the programmatic nature of expenses, e.g., instructional and research expenses. Natural category represents the nature of particular expenditures, e.g., payroll.

Chart O

<i>Function</i>	<i>Natural Expenses</i>				<i>Total</i>
	<i>Compensation & Benefits</i>	<i>Supplies & Services</i>	<i>Scholarships & Fellowships</i>	<i>Depreciation</i>	
Instruction	\$ 519,180	\$ 103,039			\$ 622,219
Research	215,972	117,856			333,828
Public service	107,749	44,488			152,237
Academic support	182,216	61,819			244,035
Student services	55,707	11,288			66,995
Institutional support	99,424	9,214			108,638
Operation and maintenance of plant	79,901	68,351			148,252
Scholarships and fellowships	3,669	245	\$55,075		58,989
Auxiliary enterprises	63,370	87,048			150,418
Depreciation				\$119,041	119,041
Other expenses		486			486
Total	\$1,327,188	\$503,834	\$55,075	\$119,041	\$2,005,138

Total expenses by functional category are illustrated below:

Chart P



Across the majority of functional categories, salaries, benefits, and other compensation-related expenditures continued to represent the most significant expense to the University. Early in the fiscal year, the University initiated a self-insured health plan, moving away from the Minnesota State Employee Group Insurance Program (SEGIP) that the University had been a participant in since 1964. The change was made in the interest of gaining more control over the management of health care benefits, containing the rising cost of health care (which is projected to increase 20 percent per year through 2004), and tailoring benefits to meet the expressed needs of employees.

***To generate positive cash flows to finance the institution's operations, debt service,
and capital needs.***

Indicators: audited financial statements

Cash Flows

The University's cash flows for the year ended June 30, 2002 are summarized below (in thousands of dollars).

	Year Ended June 30, 2002
Cash provided (used) by:	
Operating activities	\$(760,429)
Noncapital financing activities	878,968
Capital and related financing activities	(62,292)
Investing activities	28,338
Net change in cash	<u>84,585</u>
Cash, beginning of the year	154,037
Cash, end of the year	<u><u>\$ 238,622</u></u>

The University generated positive cash flows for the year as of June 30, 2002. Cash and cash equivalents increased \$84.6 million due to the inflow of funds provided by noncapital financing and investing activities, offset by the use of funds for capital acquisitions and related financing activities. The most significant sources of cash provided by noncapital financing activities included state appropriations totaling \$684.7 million, grants of \$99.6 million, and gifts of \$88.2 million in fiscal year 2002. Cash inflows for capital acquisitions from state appropriations, gifts and grants, and bonds issued during the year funded the University's equipment needs and ongoing renovation and construction initiatives.

Describing cash flows is part of the new accounting changes for the University and for all higher educational institutions, which explains why there is no benchmark data to help us evaluate the amount of end of the year cash. University auditors, however, recently stated that our end of the year cash was a very positive indicator of the University's financial health.

To ensure that each long-term debt financing of the University of Minnesota is completed in the most cost efficient way and in accordance with the highest standards of the industry, law, and governmental practices.

Indicators: audited financial statements, debt capacity/credit profiles

Debt Management

The goal of debt management is to ensure that each long-term debt financing of the University of Minnesota is completed in the most cost efficient and professional manner and in accordance with the highest standards of the industry, law, and governmental practices.

Debt financing allows the University to pay for an asset over a period of time, up to its useful life, rather than pay for it at the time of purchase. This is a financially responsible practice for certain types of capital investments within appropriate limitations and at market interest rates. Debt financing may be financially beneficial if borrowing rates are below investment returns or if the University invests in capital assets that provide investment returns or cost savings which are larger than the costs of borrowing. Since debt financing capital is limited and our demand for debt may exceed the supply at some point in time, it is imperative that borrowings are structured to effectively utilize this resource.

Current Board of Regents' policy focuses on these objectives:

- Maintain the University's long-term (AA/AA) and short-term (P-1/A-1+) credit ratings
- Minimize borrowing costs
- Limit issuance of revenue bonds due to uncertain internal revenue streams and higher costs of debt service
- Align maturity of debt with life expectancy of projects to be financed
- Issue debt for qualified capital projects only and not for operating and maintenance costs

Long-term debt will be issued primarily to finance capital expenditures. Short-term debt and a line of credit may be employed to finance short-term liquidity needs. The University's approach and strategy to debt management includes:

- 1) Focusing administrative management of debt on the overall portfolio of debt rather than individual debt transactions. Broad guidelines are set for identifying and managing debt capacity, fixed and floating rate mix, and use of various financing instruments.
- 2) Linking the debt structure and external debt service requirements with the capital budget process. This allows multiple project needs to be accommodated in a single borrowing, reducing the use of debt capacity for issuance costs. In addition, the amount and timing of borrowings will take into account arbitrage restrictions and opportunities.
- 3) Maintaining the highest acceptable credit rating that permits issuing debt and financing capital projects at favorable interest rates. This supports seeking the lowest-cost source of financing available.

Two committees exist for the purpose of accomplishing the above objectives. The Debt Management Advisory Committee (DMAC), chaired by a member of the Board of Regents, is made up of committee members from the external finance community. DMAC advises the Finance and Operations Committee of the Board of Regents on debt management issues. In doing so, the

group formulates, evaluates, and monitors coherent debt management policies designed to serve the financial objectives of the University of Minnesota. The Debt Oversight Group (DOG) consists of members in executive leadership positions across University functional areas. DOG provides oversight and review of day-to-day decisions made by the Debt Process Team (DPT) and individuals responsible for debt compliance. The DPT, consisting of individuals with financial responsibilities relating to debt in various University central units, meets regularly for purposes of discussion and documentation of the University processes relating to external debt, including identifying unit responsibilities for the various functions/components of the debt process.

Current Outstanding Debt

The outstanding debt as of June 30, 2002 is shown in the table below.

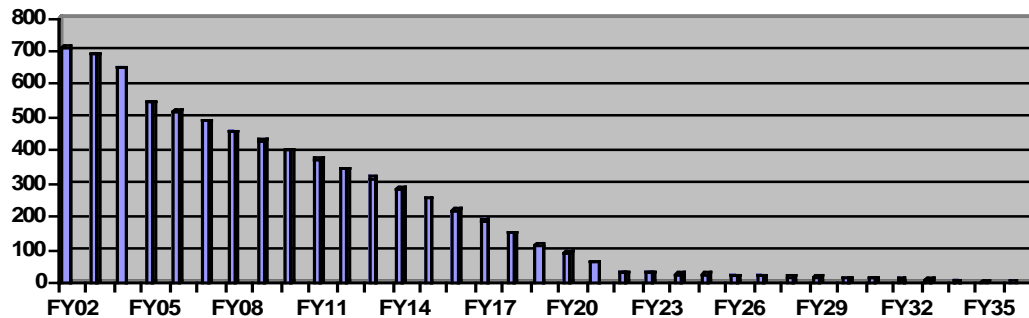
Chart Q
Current Outstanding Debt

	<i>Interest Rate</i>	<i>Swap Rate (%)</i>	<i>Due at Various Dates Thru</i>	<i>Ending Balance June 30, 2002</i>
General Obligation Bonds				
▪ Series 2001C	Weekly floating rates	4.4%	2036	\$ 159,950,000
▪ Series 2001B	Weekly floating rates	4.33%	2011	3,500,000
▪ Series 2001A	Weekly floating rates	3.08%	2008	16,500,000
▪ Series 1999A	Weekly floating rates	4.16%	2034	192,600,000
▪ Series 1996A	4.5% to 5.75%		2021	184,748,000
▪ Series 1993A	4.8%		2003	84,000,000
Obligations to the state of Minnesota pursuant to infrastructure development bonds	4.0% to 6.9%		2021	60,003,000
Auxiliary revenue bonds	3%		2013	10,815,000
Total bonds payable				\$ 712,116,000
Capital leases and other	2.2% to 8.00%		2011	7,158,000
Total				\$ 719,274,000

Debt Reduction

The following chart reflects the anticipated reduction in the University's outstanding bonds payable, assuming principal payments under existing amortization schedules and a refinancing of \$71 million of the Series 1993A bonds in FY2004:

Chart R
Anticipated Reduction in Bonds Payable



This reflects reduction of 44 percent of outstanding bonds payable by 2010 and 88 percent reduction by 2020.

Debt Capacity/Credit Profile

The University enjoys high credit ratings for its general obligation bonds from Moody's Investors Service (Moody's) - Aa2 - and Standard & Poor's Corporation (S&P) - AA. These credit ratings permit the University to borrow at a low interest cost and are a reflection of the University's excellent management, financial controls, economic conditions, and moderate debt levels.

The University provides information to credit rating services, upon request, as they review their ratings on outstanding debt issues. The Treasurer informs the credit rating service(s) regarding material changes in financial condition and developing events that may influence outstanding or future ratings.

Moody's maintains key financial ratios for institutions in their database. The following charts reflect key Moody's ratios, comparing the University's ratios for FY01, FY00 and FY99 to the 2001 medians for Aa2- and Aa3-rated institutions.

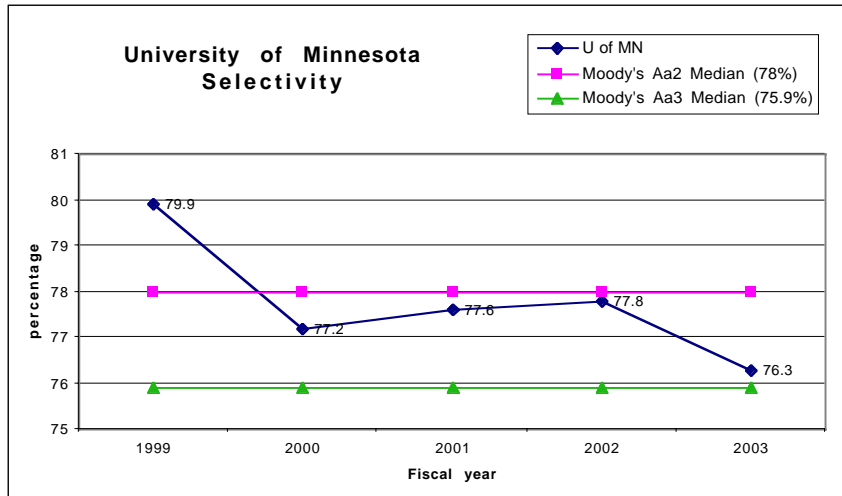
**Chart S
Moody's Financial Ratios**

Selected Public University Ratios	Public Institutions Medians By Rating Category				
	University of Minnesota			2001 Medians	
	6/30/01	6/30/00	6/30/99	Moody's "Aa2"	Moody's "Aa3"
Market Position:					
Selectivity Ratio	77.6%	77.2%	79.9%	78.0%	75.9%
Matriculation Ratio	46.6%	48.0%	48.3%	46.0%	48.5%
Net tuition per student (\$)	\$4,077	\$3,770	\$3,618	\$5,272	\$3,644
State appropriation per student (\$)	\$12,475	\$12,143	\$11,404	\$9,604	\$9,510
Education expenses per student (\$)	\$32,905	\$31,895	\$28,790	\$26,143	\$22,648
Unrestricted tuition discount (%)	14.9%	16.7%	14.6%	13.6%	1636%
Total tuition discount (%)	34.1%	34.3%	32.8%	27.7%	26.8%

The selectivity ratio is a reflection of how "selective" the University is in accepting students. It is calculated by taking the number of acceptances divided by the number of applicants. The desired trend for this ratio is downward, i.e., the lower the ratio, the more selective the institution is in accepting students for admittance.

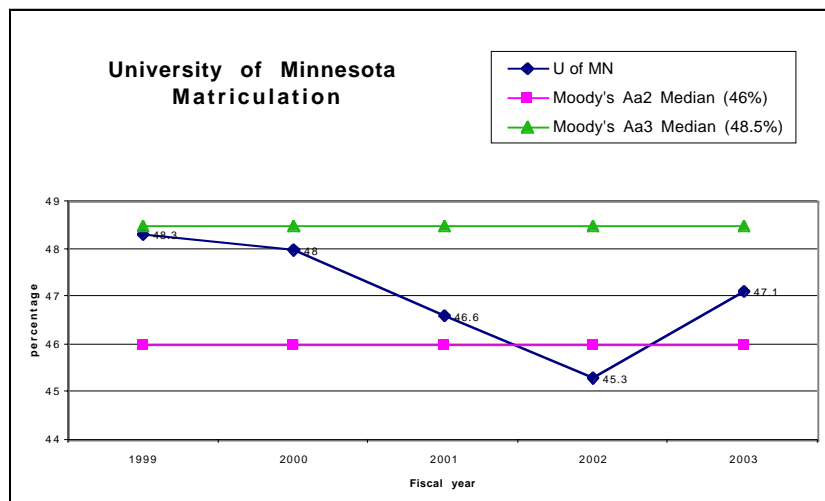
Moody's "Aa3" median is 75.9 percent; the "Aa2" median is 78.0 percent. As shown on the following chart, the University is on a downward trend since 1999, and is solidly within the two medians.

Chart T



Matriculation is the percentage of students who actually enroll to the number of acceptances. The desired trend of this ratio is upward. As shown in the graph below, though the University trend had been downward for the last couple of years, the trend has shifted for the fall of 2002 (47.1 percent compared to the 45.3 percent for fall of 2001). The current 47.1 percent is solidly in the middle of the “Aa2” and “Aa3” medians of 46.0 percent and 48.5 percent respectively.

Chart U



Capital ratios measure financial resources, in varying degrees of liquidity, relative to debt.

**Chart V
Capital Ratios**

Selected Public University Ratios	Public Institutions Medians By Rating Category				
	University of Minnesota			2001 Medians	
	6/30/01	6/30/00	6/30/99	Moody's "Aa2"	Moody's "Aa3"
Capital Ratios:					
Unrestricted operating resources to debt (%)	41.1%	64.1%	64.5%	76.9%	61.3%
Expendable resources to debt (%)	184.4%	192.3%	268.8%	209.1%	140.3%
Total resources to debt (%)	297.8%	448.9%	385.9%	296.4%	266.2%
Gross debt service to operations (%)	2.1% *	1.8%	1.3%	2.0%	2.3%

*Includes approximately \$180 million in General Obligation Bonds that were issued in FY02.

The “Aa” minimum guideline for Total Resources to Debt is 200 percent. As shown in the chart above, the University is well above the minimum guideline in this area. The “Aa” maximum guideline for Debt Service to Operations is 5 percent. Again, the University is well below the maximum and solidly in the “Aa” category of institutions.

Moody's does not expect the new GASB reporting requirements to impact the credit quality for public universities or cause significant adjustments to their methodology used to measure the financial strength and market position of public colleges and universities. There will be some minor adjustments in Moody's current methodology to reflect the new titles or reporting standards in the public universities' financial statements.

Debt capacity and credit ratings are not a function of financial ratios alone, but are highly dependent on an institution's evolving overall financial strength, market position and strategy, future fundraising, revenue producing capability, and debt structure, which are in turn consistent with its fundamental credit position. Management's risk tolerance will often be the final arbiter of debt capacity for a particular institution. Analysis of student demand, market position, and financial indicators places the University solidly in the strong "Aa" category. These indicators suggest a high level of debt capacity for the University.

Debt capacity is not a static concept but rather changes over time as an organization's fundamental credit factors evolve. As a result, an institution's debt capacity could increase for a variety of reasons independent of leverage measures. For example, if enrollment grows, state funding strengthens, external gifts increase, or endowment levels improve, an institution's debt capacity is expanded to some degree. Conversely, debt capacity could decline if student demand or operating performance were to weaken, or if other fundamental credit factors worsened.

To maximize returns of the University's various portfolios.

Indicators: returns on invested assets

Invested Assets

The University of Minnesota has invested assets residing in four distinct investment pools: Consolidated Endowment Fund (CEF), Temporary Investment Pool (TIP), Group Income Pool (GIP), and RUMINCO reserves.

The level of assets in each pool as of June 30, 2002 was:

Consolidated Endowment Fund	\$ 554.8 million
Temporary Investment Pool	\$ 455.0 million
Group Income Pool	\$ 43.8 million
RUMINCO, Ltd.	<u>\$ 24.2 million</u>
<i>TOTAL</i>	<i>\$1,077.8 million</i>

Consolidated Endowment Fund (CEF)

The CEF contains a broadly diversified group of asset classes. The overall objectives for the CEF are:

- 1) to preserve the inflation adjusted value of the fund; and
- 2) to maximize total return (income plus capital appreciation) with a goal of at least 500 basis points annually above inflation (as measured by the Consumer Price Index) over three- to five-year trailing periods.

Regents policy for the CEF includes spending guidelines which provide fund distributions to University departments for expenditures for current operations. These distributions amount to approximately 5-6 percent of average market value on a three-year trailing basis. CEF total return for the fiscal year ended June 30, 2002 was -11.5 percent compared to its benchmark return of -11.3 percent. During the most recent year, the fund distributed \$37.9 million.

Chart W

CEF Returns

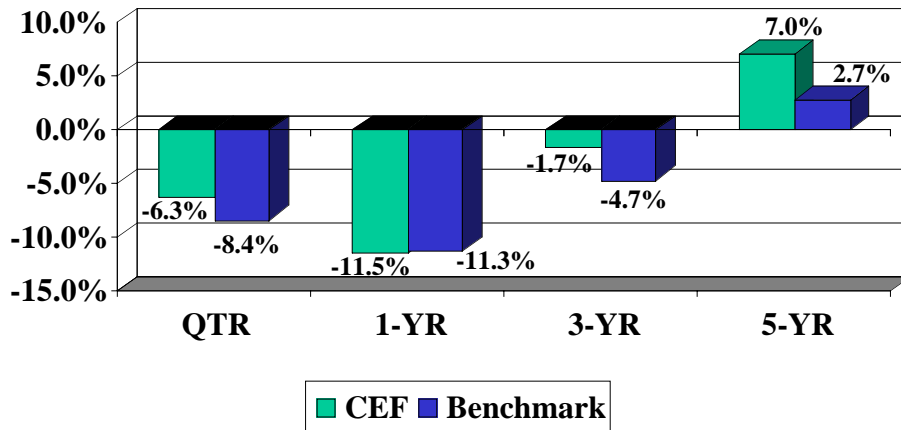
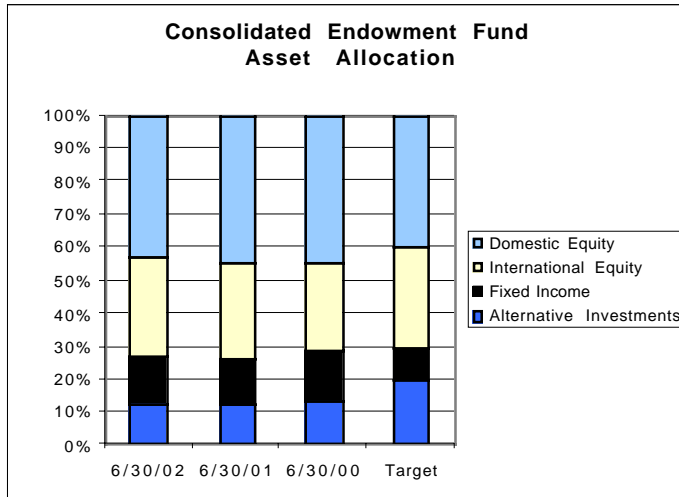


Chart X

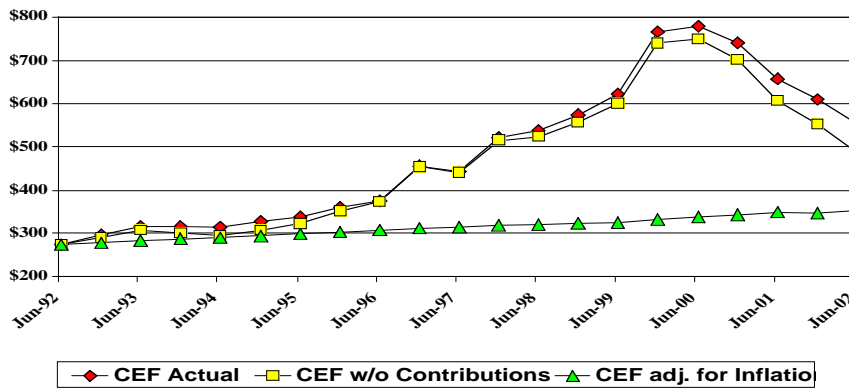


	<u>6/30/02</u>	<u>6/30/01</u>	<u>6/30/00</u>	<u>Target</u>	<u>Range</u>
Alternative Investments	12.7%	12.8%	13.0%	20.0%	15-25%
Fixed Income	14.2%	13.4%	15.9%	10.0%	5-15%
International Equity	30.2%	28.8%	26.6%	30.0%	20-40%
Domestic Equity	42.9%	45.0%	44.5%	40.0%	30-50%
	100.0%	100.0%	100.0%	100.0%	

During the fiscal year ending June 30, 2002, alternative investments included investments in venture capital funds, hedge funds, real estate, and private equity. Alternative investments along with domestic equity, international equity, and fixed income are compared to representative benchmarks. Their performance is tracked over one-, three-, five-, and ten-year periods.

Chart Y

**Consolidated Endowment Fund
10-Year Balance Growth through June 30, 2002**

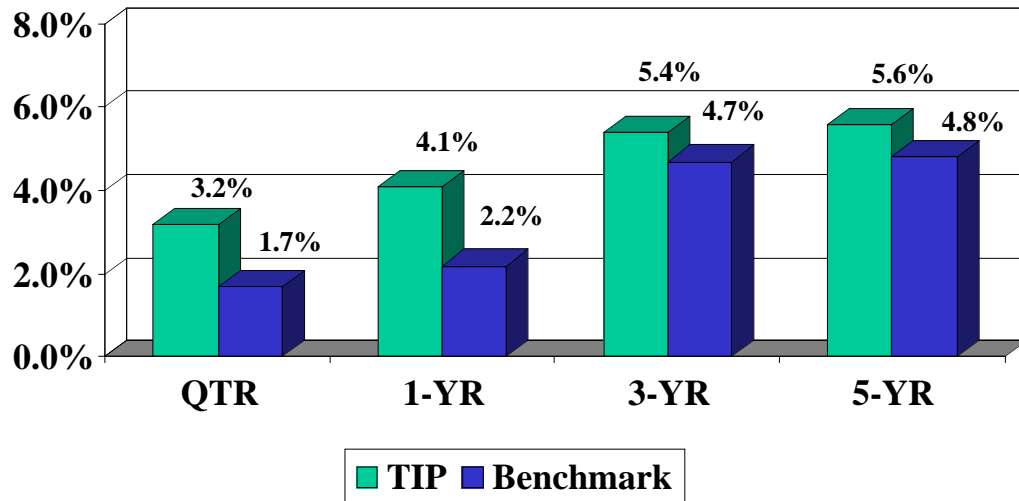


Long term performance of the CEF, when measured over five- and ten-year periods, has met or exceeded its goal to preserve the inflation adjusted value of the fund, and produced a return enabling 5 percent to be withdrawn to fund University programs.

Temporary Investment Pool (TIP)

Chart Z

TIP Returns

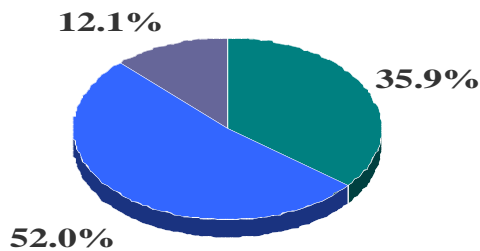


The TIP is a pool of cash generated from the operations of the University. This operating capital is invested in short-term securities intended to provide significant protection of principal amounts, and investment returns exceeding the 13-week T-Bill. By managing a diversified portfolio of primarily government securities, and agency obligations, the portfolio has consistently exceeded the selected benchmark.

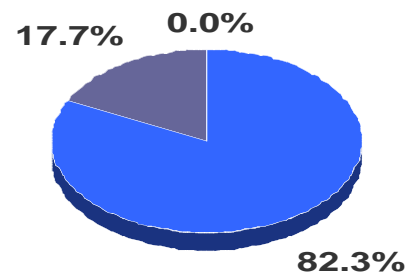
Chart AA

**Temporary Investment Pool
Sector Allocation & Quality**

Sector



Credit Quality



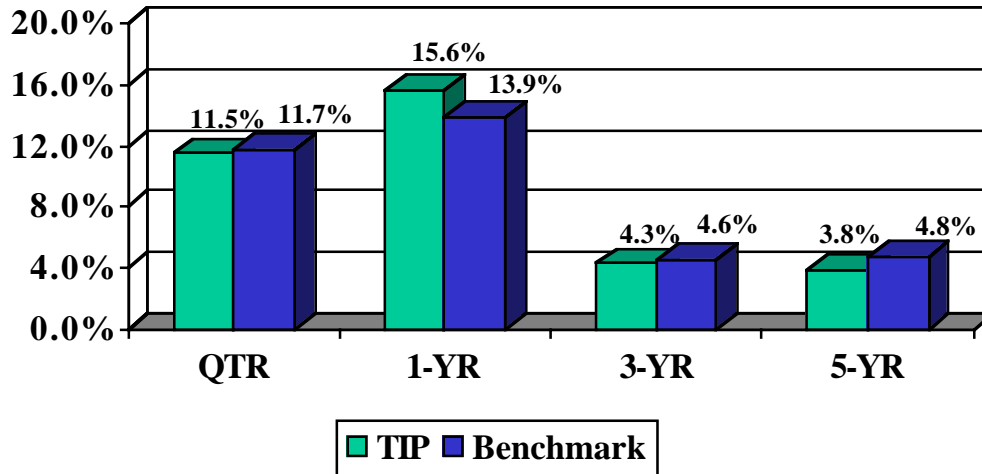
- US Treasury and Agency
- Money Market Funds
- Other Corporate Obligations

- AAA
- A
- Unrated

Group Income Pool (GIP)

Chart BB

GIP Returns



GIP is a pool of assets belonging to various departments of the University that have been directed toward asset classes that have intermediate or longer-term investment horizons as compared to those employed by the TIP. GIP is invested primarily in a broad range of fixed income investments through the use of outside investment managers.

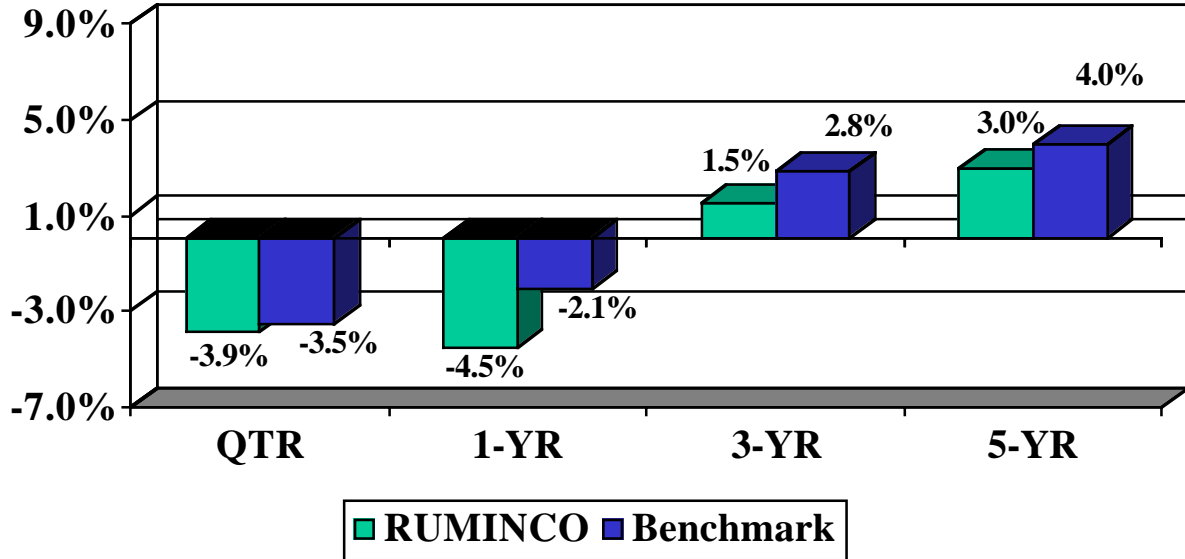
RUMINCO Reserves

The RUMINCO portfolio is the underlying reserves of the wholly owned insurance subsidiary of the University. Those reserves are intended to address the potential exposure to the University for the self-insured or the deductible portions of various property, casualty, health, or workers compensation policies in effect.

The goal of the fund is to enable the program to be self-funding, and to maintain stable or slightly declining insurance premiums. The asset allocation of the fund is 40 percent domestic equity, 45 percent intermediate and long-term fixed income securities, and 15 percent to absolute return strategies. The assets are managed by outside investment managers and the fund has performed somewhat below its benchmark over the last five years.

Chart CC

RUMINCO Returns



Summary

The University has historically accomplished its objectives of maximizing the return in each portfolio by adjusting allocations to asset classes, and selecting and monitoring high quality investment managers.

The University, in conjunction with the Investment Advisory Board and independent consultants, will continue to actively re-evaluate the asset allocation mix, the investment policies, and investment managers to insure the highest likelihood of meeting or exceeding the target performance criteria given the current economic conditions. In addition, the University is actively considering a wider array of financial instruments intended to reduce volatility and increase the benefits of diversification. During 2003, more sophisticated analytical tools and better financial tracking systems will be introduced that will enable the staff in the Office of Asset Management to respond tactically and more strategically to changes in the capital markets.

* All investment return and portfolio allocation information is as of June 30, 2002.

To increase the University's ability to withstand changes in public funding by successful fundraising, including increased financial support from alumni and top ranking in voluntary support among peer institutions.

Indicators: size of endowment, voluntary giving, alumni donors, return on invested funds

Ranking.

Size of Endowment

- In 2001, with over \$1.65 billion, the University of Minnesota Twin Cities' combined endowment ranked 5th among public, and 24th among all research institutions, according to the 2002 University of Florida rankings. In the Council for the Advancement of Education's annual survey of Voluntary Support of Higher Education (VSE), which looks at a slightly different group of schools, the University ranked 7th in 2001.
- Between 1999 and 2000, the University maintained its rank, although the size of the endowment grew nearly 20 percent. This reflects the growing size of endowments at most peer institutions.

National Ranking in Total Voluntary Support

- The University's rank for 2001 among public institutions in annual giving was 5th, up from its rank of 8th for 2000, according to University of Florida rankings (6th and 9th in the VSE survey for the corresponding years).
- Its rank among all institutions also rose, from 20th to 15th, according to the University of Florida's recent rankings study, or 16th according to the VSE survey (See Table 1 on page 37).
- Total funds received increased by 18 percent.
- If the single largest gift (in the \$30 - \$70 million range) to each of the top 20 schools is taken out, the University would rank 13th among all institutions, and 4th among public institutions. Minnesota, Pennsylvania, Washington, Michigan, and University of California, Berkeley were the only institutions whose largest individual gift during FY 2001 was less than \$20 million.
- The 2002 U.S. News *Best Colleges* ranking reported that 11 percent of University of Minnesota Twin Cities alumni made voluntary gifts to the University.

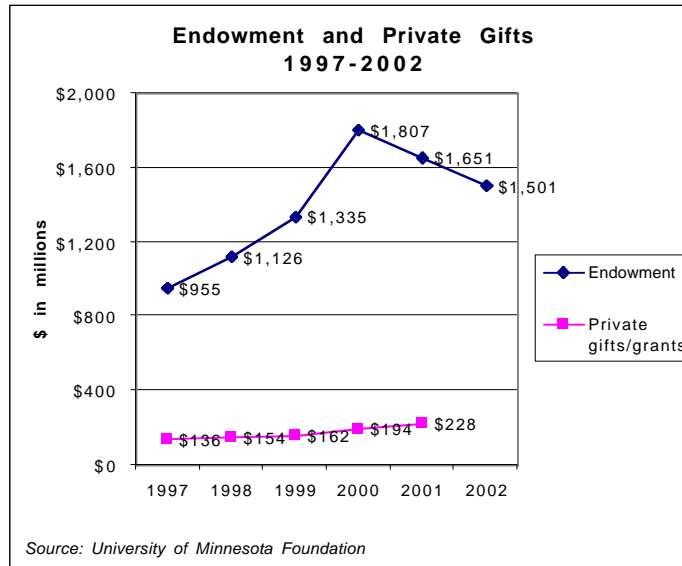
**Chart DD
University of Minnesota Ranking, Fundraising and Endowment
(University of Florida Study)
2000-2002**

	2000 (for 1999)	2001 (for 2000)	2002 (for 2001)
Endowment Assets			
Amount	\$ 1,509,769,000	\$ 1,809,305,000	\$ 1,650,969,000
Rank among publics	4	4	5
Rank among all	23	23	24
Annual Giving			
Amount	\$ 161,966,000	\$ 193,950,000	\$ 228,926,000
Rank among publics	6	8	5
Rank among all	18	20	15

Source: *TheCenter, The Top American Research Universities, 2002*

Trends.

Chart EE



Endowment

- Between 1997 and 2000, the combined University endowment (including the Minnesota Medical Foundation, University of Minnesota, and University of Minnesota Foundation) nearly doubled.
- Between 2000 and 2001, the size of the endowment declined from \$1.807 billion to \$1.651 billion. The endowment declined further in 2002, to \$1.501 billion.

Voluntary Giving

Between 1997 and 2001, private gifts and grants made to the University increased by 68 percent, from \$136 million to \$228 million.

Alumni Giving

Chart FF

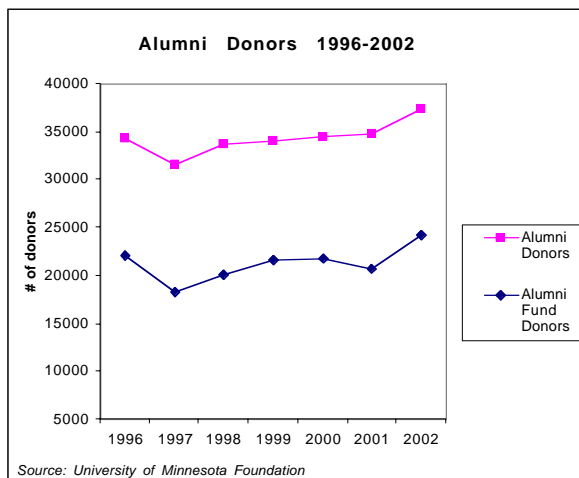
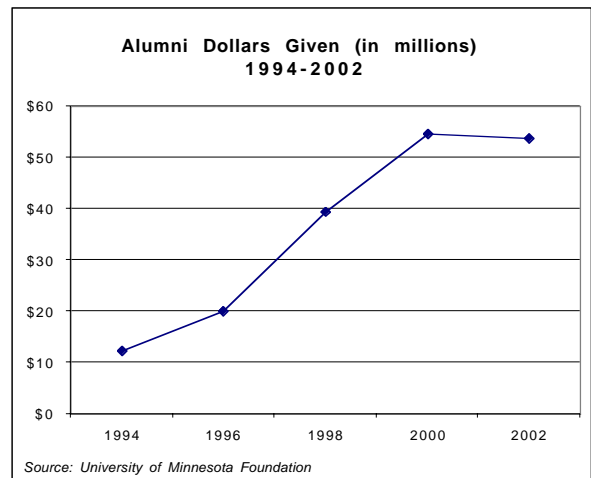


Chart GG



- The number of alumni donors has gradually increased, from 31,599 in 1997 to 37,431 in 2002, an 18 percent increase.
- The trend among annual fund donors follows a similar upward path, increasing from 18,276 in 1997 to 24,236 in 2002. This represents a 33 percent increase.
- Dollars donated by alumni have increased by 375 percent over the past 10 years, from \$11.3 million in 1992 to \$53.7 million in 2002, reflecting the success of Campaign Minnesota.

Return on Invested Funds

- For the year ending June 30, 2002, the annualized return for the University of Minnesota Foundation was 0.67 percent, compared to 0.43 in 2001. This rate of return maintains the University's position in the top quartile among peer institutions, based on preliminary results. For the quarter ending June 30, 2002, this rate of return places the University in the top 5 percent with a return of -0.8 percent. (See Table 2 on page 37.)
- Over the period 1997-2002, the UM Foundation rate of return averaged 7.80 percent.

Table 1

**Voluntary Support Rankings 2001
(\$ in millions)**

1.	Harvard	\$683
2.	Stanford	\$469
3.	Columbia	\$359
4.	Yale	\$350
5.	Johns Hopkins	\$347
6.	Cornell	\$309
7.	Indiana	\$301
8.	Emory	\$298
9.	UW Madison	\$292
10.	U Pennsylvania	\$286
11.	USC	\$281
12.	UCSF	\$272
13.	Duke	\$264
14.	UCLA	\$264
15.	U Washington	\$232
16.	U Minnesota	\$228
17.	U Michigan	\$218
18.	Ohio State	\$210
19.	UC Berkeley	\$203
20.	Michigan State	\$202

Source: *University of Minnesota Foundation,
Council for Advancement of Education*

Table 2
University of Minnesota Foundation
Investment Pool Returns
National Patterns

	1-year (2001-2002)		3-year (1999-2002)		5-year (1997-2002)	
Mean	-4.26		2.32		6.96	
Median	-4.45		1.78		6.50	
N	339		319		291	
Percentile						
	National	UMF	National	UMF	National	UMF
5 th	2.16		8.91		12.10	
25 th	-2.27	0.67	4.35	6.09	8.35	
75 th	-6.61		-0.09		5.30	7.80
95 th	-9.70		-2.45		3.21	

Source: University of Minnesota Foundation; Cambridge Associates

Table 3
University Medical Foundation Assets
As of September 30, 2002

	Amount (000s)	Percent
Bond Segment	\$63,108	38.8%
Domestic Equity Segment	\$92,191	56.5%
International Equity Segment	\$7,579	4.7%
Total Endowment	\$162,878	100.0%
Special Programs Segment	\$32,935	100.0%

Table 4
University Medical Foundation
Investment Performance
As of September 30, 2002

	<u>Quarter</u>		<u>1 Year</u>		<u>3 Years</u>		<u>5 Years</u>		<u>10 Years</u>	
	Actual	Index	Actual	Index	Actual	Index	Actual	Index	Actual	Index
Bond Segment	4.0%	4.6%	6.1%	8.6%	9.5%	10.8%	7.5%	7.8%	7.2%	7.4%
Domestic Equity	-17.8%	-18.0%	-22.9%	-18.6%	-17.6%	-11.4%	-2.8%	-1.5%	9.3%	9.1%
International Equity	-17.6%	-19.7%	-12.8%	-15.5%	-13.2%	-14.6%	n/a	n/a	n/a	n/a
Total Endowment	-9.8%	-9.0%	-12.0%	-6.4%	-8.0%	-2.6%	1.5%	3.3%	9.0%	8.8%
Special Programs	0.4%	0.4%	1.9%	2.0%	4.2%	4.0%	4.9%	4.3%	n/a	n/a