



**University of Washington
Endowment Report 2004**

University of Washington Endowment Report 2004

An endowment is a permanent fund established for a specific purpose. A portion of the return generated each year is used to support current year programs. An endowment can contribute greatly to the quality of a university's teaching, research and public service mission.

The Metropolitan Tract is an outstanding example of the importance of permanent gifts. When the Territorial University was established in 1861, Seattle was a tiny wilderness village of approximately 300 settlers. The Denny, Lander and Terry families gave a ten-acre plot of land

on which the first campus building was constructed. While the University of Washington eventually outgrew the site in downtown Seattle, the income from the property has continued to provide important support to the institution for more than a century. It is unlikely anyone in 1861 anticipated the kind of value that would be placed on downtown core property in the twentieth and twenty-first centuries. Fortunately, those first donors had the foresight to provide a permanent asset that has appreciated in value with each passing decade.



The University of Washington, as built in 1861, on land donated by the Denny, Lander and Terry families known as the Metropolitan Tract.



The Metropolitan Tract as it appears today.

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The University of Washington Endowment

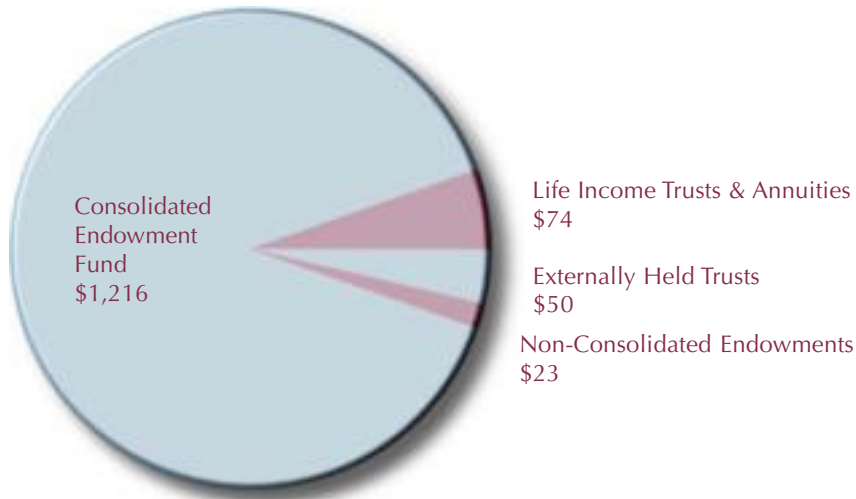
The Metropolitan Tract was the University's first and only permanent gift for over forty years. In 1905, the University received its first cash endowed gift of \$400. Thus began the accumulation of endowment and similar funds that are held today.

Those funds are in four groups. The largest pool by far is the Consolidated Endowment Fund (CEF) with a current value of \$1.2 billion. The growth, structure, investment strategy and performance of the CEF are described on pages three through eleven of this report.

The next largest group is life income trusts and annuities with a current balance of \$74 million. These trusts pay income to designated beneficiaries after which the University receives the remaining principal value. Externally held trusts total \$50 million. These funds are invested at local banks and the income earned supports University programs.

Finally, funds totaling \$23 million are held in various non-consolidated endowments. Trusts and non-consolidated endowments are described more fully on pages twelve and thirteen of this report.

Endowment and Similar Funds* as June 30, 2004 (\$ in millions)



* Does not include the Metropolitan Tract

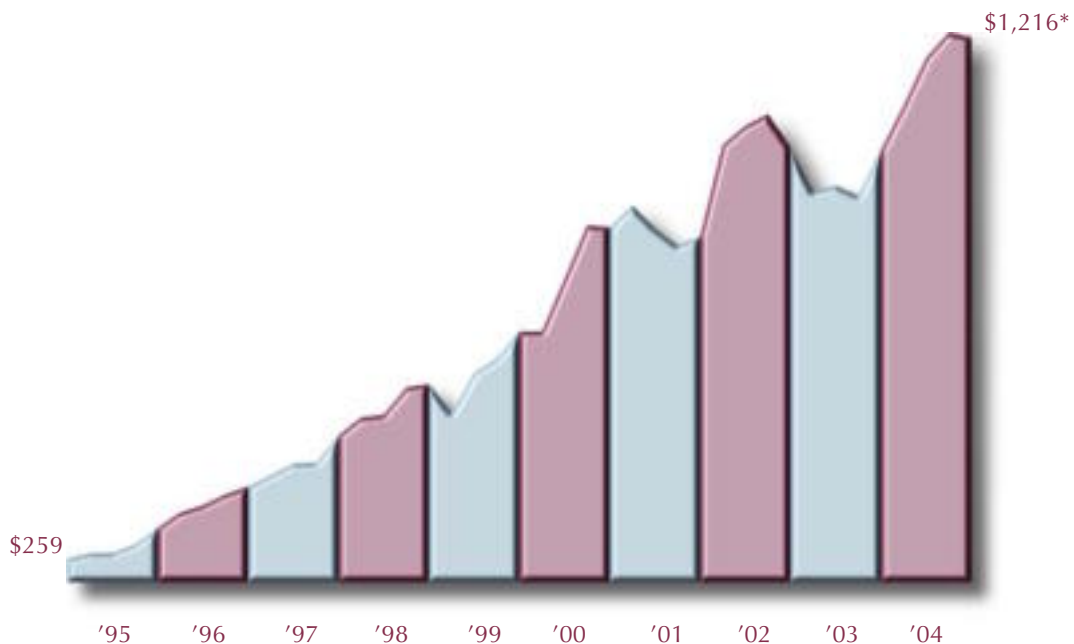
The Board of Regents of the University of Washington is responsible for the University's investments. The University of Washington Investment Committee (UWINCO) comprised of Board members and investment professionals, serves as an advisory committee. Current Regents and UWINCO members are listed on page sixteen.

The primary focus of UWINCO is the Consolidated Endowment

Fund (CEF). The CEF consists of 1,906 separate endowments. The CEF market value was \$1.2 billion at June 30, 2004 compared to \$259 million at July 1, 1994. The CEF is similar to a mutual fund in that each individual endowment buys units in the fund.

During the past ten years, gifts and transfers totaling \$403 million were added to the CEF.

Growth of the Consolidated Endowment Fund FY 1995–2004 (\$ in millions)



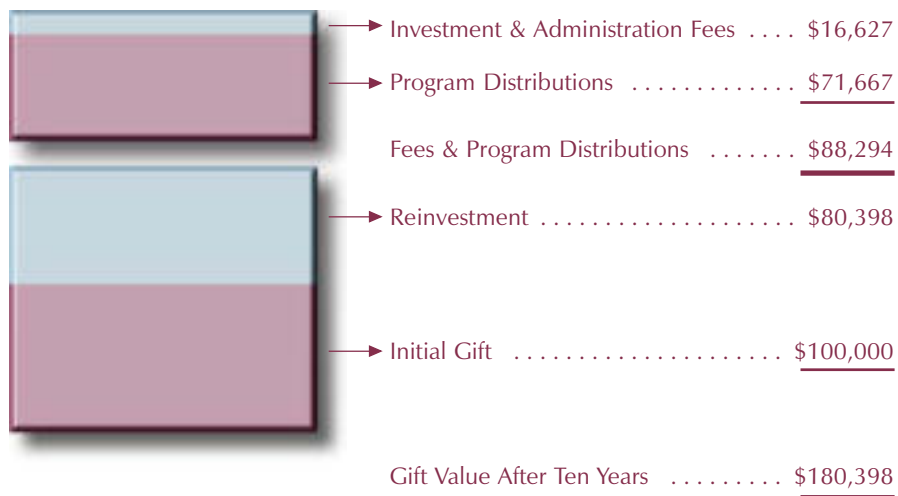
*Reflects inclusion of Invested Fund units in the Consolidated Endowment Fund starting in July 2001. Value without would be \$926 MM at June 30, 2004

Benefits of the Consolidated Endowment Fund

A gift invested in the CEF will grow over the long term. This growth results from spending a portion of the investment return on program support and reinvesting the remainder. This growing base increases program support, ensuring that a gift made today will not be eroded by inflation in the future.

As pictured below, a \$100,000 gift invested in the CEF ten years ago would have a nominal value of \$180,398 at June 30, 2004. Distributions to the donor-selected program would have totaled \$71,667.

Keeping Pace with Inflation (A gift over ten fiscal years)

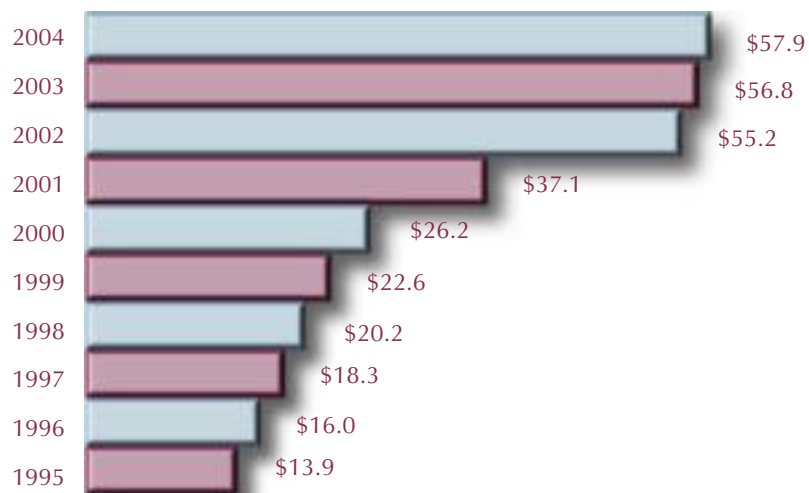


The impact to program support has been substantial, with \$324 million distributed over the past ten years.

CEF distributions increased to \$57.9 million in fiscal 2004. Two factors influenced the recent step-up in program support—at the

end of 2000, the Board of Regents modified the spending policy resulting in a higher distribution rate and, during fiscal years 2002 and 2004, the administration invested operating funds totaling \$270 million in the CEF.

Annual Program Support FY 1995–2004 (\$ in Millions)



Consolidated Endowment Fund Program Support

The CEF supports University programs as designated by its donors. Programs supported by the endowment distributions include scholarships, fellowships, professorships, chairs, and research activities.

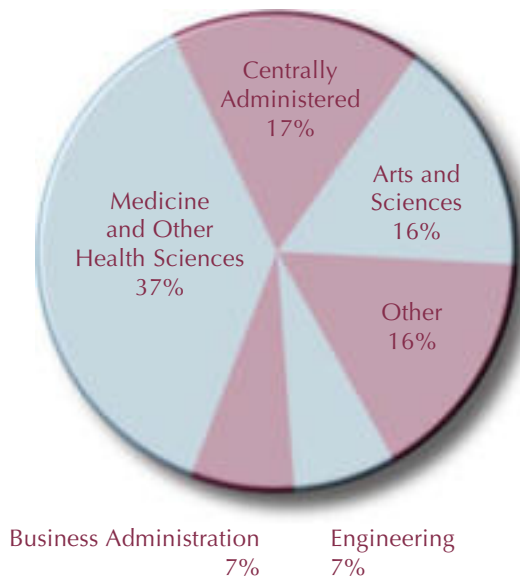
Permanent funding through endowment is critically important to advancing the University of Washington's mission. The endowment provided funding for over

200 professorships and chairs during this fiscal year.

In 2004, the UW launched the UW Matching Initiative to increase the endowment for scholarships, fellowships, professorships and faculty chairs. The university created a \$40 million matching pool, comprised of \$20 million in University funds and \$20 million in private contributions.

Endowment Support FY 2004

By School and College



By Purpose



Endowed Support by Schools, Colleges and Programs FY 2004

Schools, Colleges and Programs	Endowment Value as of 6/30/04	Number of Endowments
UW Medicine	\$303,457,571	330
Arts & Sciences	144,864,087	455
Engineering	66,583,505	176
Business School	63,713,539	118
Offices of the President and Provost	49,875,744	50
Student Financial Aid	44,198,546	141
Graduate School (includes University Press)	28,801,962	52
Undergraduate Education	25,665,820	11
Libraries	23,823,324	40
Law School	21,269,781	57
Forest Resources	17,309,624	64
Architecture & Urban Planning	14,617,737	57
Intercollegiate Athletics	14,400,938	67
Ocean & Fishery Sciences	14,353,226	53
Dentistry	14,342,318	39
Public Affairs	12,013,299	11
Nursing	11,854,277	48
Pharmacy	7,918,824	20
Alumni Association	7,453,236	2
Tacoma Campus	6,558,039	10
Public Health & Community Medicine	6,246,616	21
Education	5,749,458	21
Social Work	3,406,193	15
Office of Research	2,903,075	2
Intellectual Property & Technology Transfer	2,370,127	1
Bothell Campus	2,043,324	4
Information School	1,997,538	13
Friday Harbor Laboratories	1,577,337	8
Office of Minority Affairs	1,332,199	14
Educational Outreach	704,173	1
Office of Development	425,741	2
Evergreen State College Foundation & KUOW	3,881,937	2
Subtotal	<u>\$925,713,115</u>	<u>1,905</u>
Operating Funds	<u>\$289,858,790</u>	<u>1</u>
Total Endowed Funds	<u>\$1,215,571,905</u>	<u>1,906</u>

Consolidated Endowment Fund Spending Policy and Objectives

The spending policy authorizes the annual transfer of a certain percentage of the endowment market value to support the purpose designated by the donor.

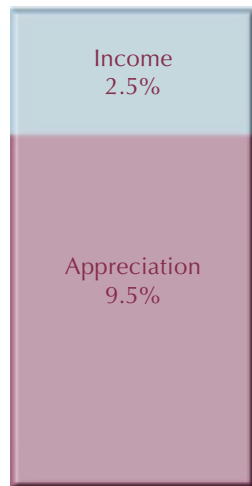
The CEF spending policy, set by the Board of Regents, is 5% of a three-year moving average market value. In addition, internal fees of .2% are charged for Treasury Office

oversight and management and .8% for University-wide development activities.

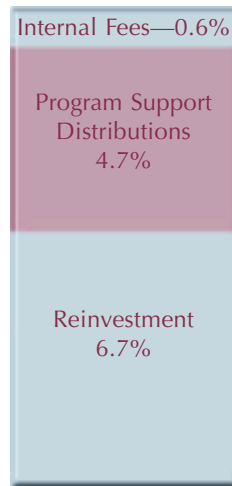
A significant majority of universities tracked by the National Association of College and University Business Officers (NACUBO) use a spending policy based upon a percentage of a moving average market value.

Spending Policy Applied to the CEF FY 1995–2004

Sources of Return—12%*



Uses of Return—12%*



Based on ten-year average annual return of the CEF

* Consistent with the standard in endowment performance reporting, returns are reported net of external investment management fees

The spending policy provides a disciplined approach to moving money from the endowment on a predictable, consistent basis.

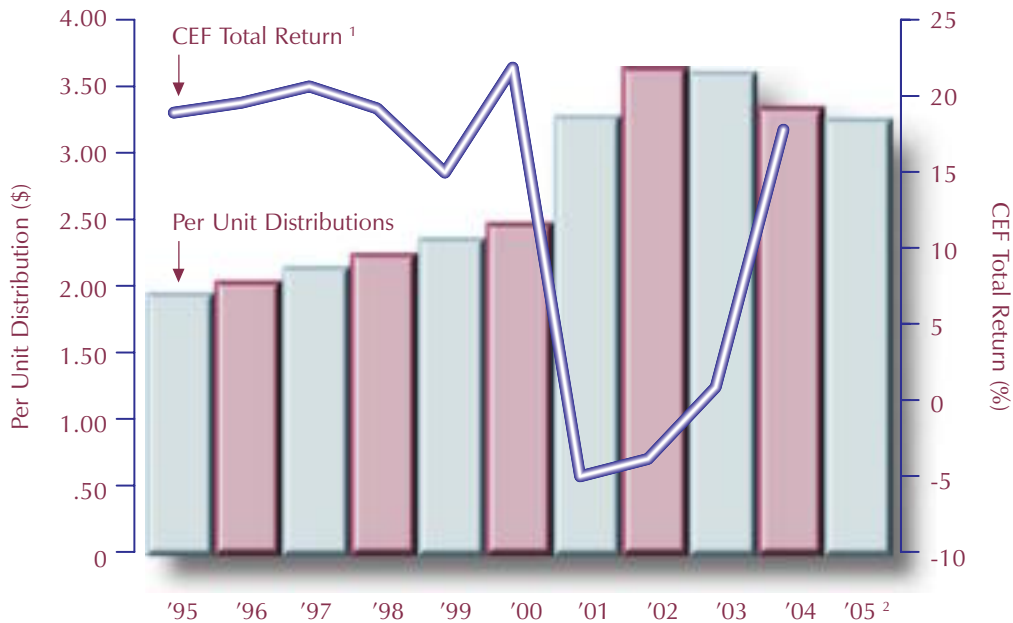
Year-to-year CEF returns reflect the up and down volatility of the financial markets (as shown by the jagged line on the chart below).

Distributions to programs climbed steadily from the adoption of a new spending policy in 1988 through 2002.

Endowment distributions were limited to a 5% year-to-year increase during the 1990's. The Board of Regents removed that requirement late in 2000. The result was a significant increase in the payout beginning in January 2001.

The current and projected decline in distributions reflects the effect of adverse capital markets in fiscal years 2001–2003.

Endowment Distributions vs. Total Return FY 1995–2004



¹ CEF returns are shown net of external management fees of .6%.

² The estimated payout for fiscal year 2005 is \$3.26 per unit.

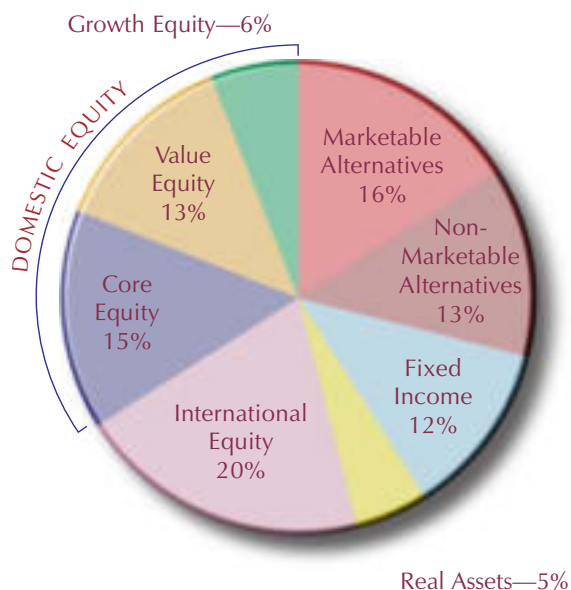
Consolidated Endowment Fund Investment Strategy and Performance

At June 30, 2004, 83% of the CEF was invested in equities, 12% in fixed income and 5% in real assets. CEF investments are all externally managed by investment professionals.

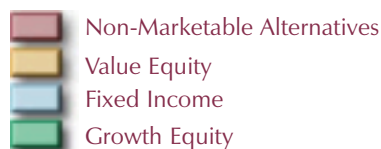
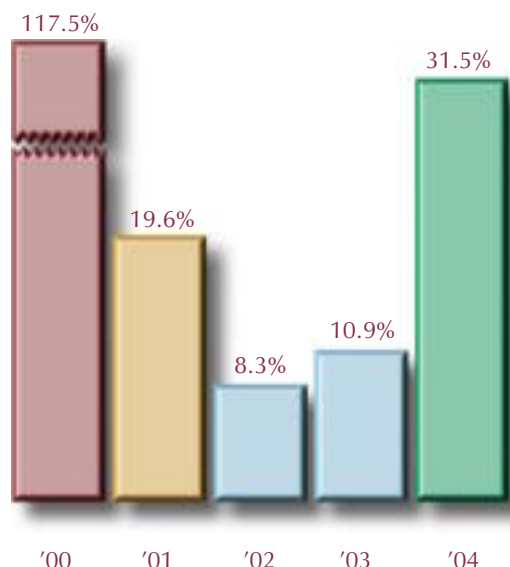
The CEF is broadly diversified. The value of diversification is dem-

onstrated below. The best performing asset one year may be the worst some other year. Given that it is not possible to predict performance in advance, the University's investment policy requires exposure to a variety of asset classes. This reduces overall risk (volatility).

CEF Asset Allocation as of June 30, 2004



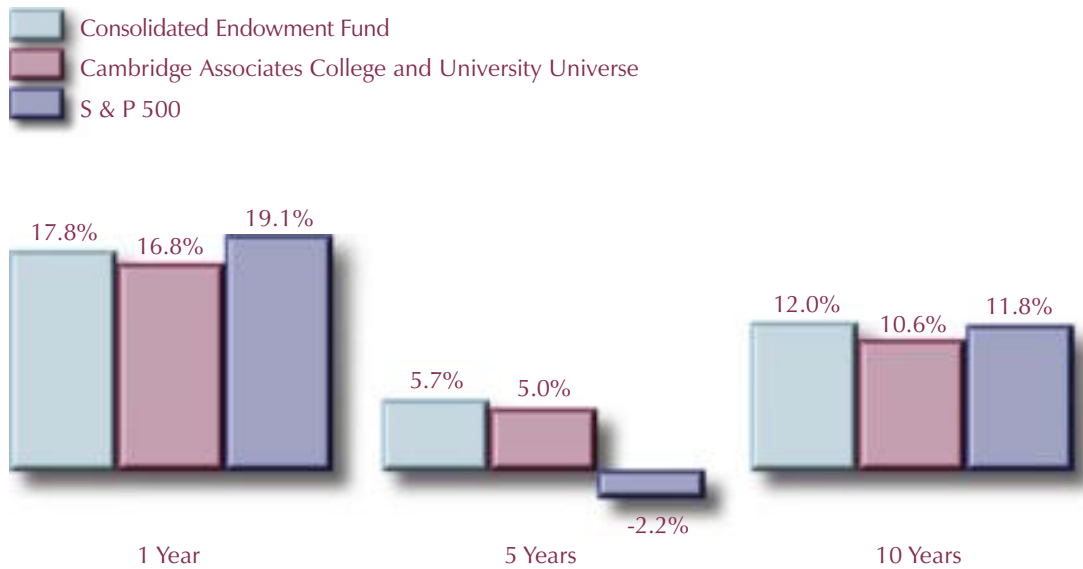
Strongest Asset Class Performance, FY '00-'04



The CEF has performed well over time compared to that of peer colleges and universities as measured by Cambridge Associates. This exceptional performance placed the CEF in the top quartile of the Cambridge Associates College and University (CA) universe over the

past 10 years. The CEF also compares favorably against broad capital market indices, returning 12% over the 10 years ending June 30, 2004. During this period, the S&P 500 returned 11.8% and the Lehman Brothers Government Bond Index returned 7.2%.

Performance Comparisons 1, 5 and 10 Year Fiscal Periods



CEF returns are shown net of external investment management fees.

Trusts and Non-Consolidated Endowment

Non-Consolidated Endowed Funds

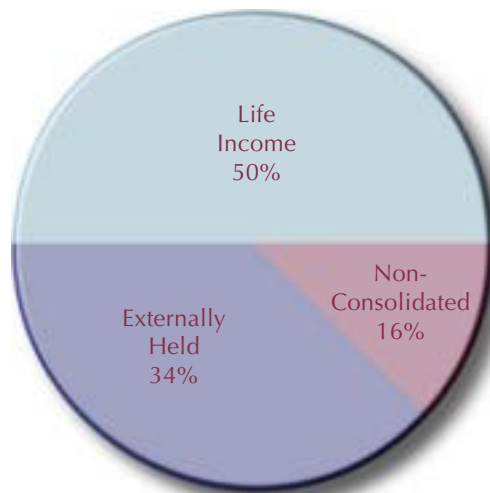
The University of Washington non-consolidated endowment funds totaled \$23 million as of June 30, 2004. These gifts include limited partnership interests, real property, closely held securities and externally-managed trusts.

While some may eventually be invested in the CEF, most are illiquid or have donor restrictions that do not allow consolidation.

Externally Held Trusts

The University of Washington receives income annually from funds held in irrevocable trusts managed by trustees other than the University. The market value of these funds at June 30, 2004 was \$50 million. During the last ten years, these funds have provided over \$15 million to support schools, colleges and programs at the University.

Trusts and Non-Consolidated Endowments at June 30, 2004



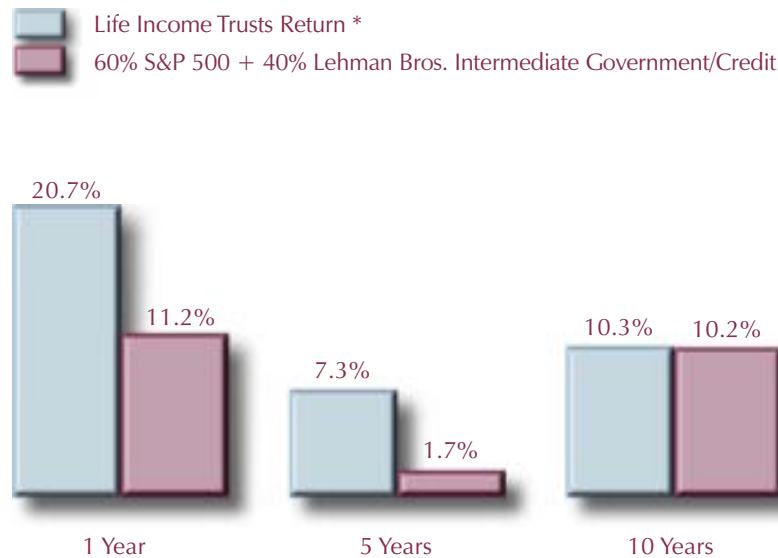
Life Income Trusts and Annuities

Life income trusts and annuities are invested in separately managed irrevocable trusts. Money or other property is contributed to the University on the condition that the trust will make payments to the donor or other designated beneficiaries for a specified term or life of the beneficiaries. At the end of that time, the remaining trust principal passes to the University.

As of June 30, 2004, the total market value of the UW's life income program was \$74 million. Life income gifts added \$12 million to the Consolidated Endowment Fund over the last ten years.

The equity portion of life income plan investments is tilted toward value. This lowers volatility and downside risk which is particularly important in fulfilling the fiduciary responsibility the University has for these gifts.

Returns Compared to Benchmark



* Represents return for Growth portfolio which holds over 60% of Life Income assets

Glossary

Asset Allocation. The distribution of endowment assets among various asset classes. Asset allocation affects both risk and return and is a central concept in investment management.

Asset Classes. Including but not limited to domestic equity, international equity, domestic fixed income, international fixed income, cash, real assets, marketable alternatives and non-marketable alternatives.

Buyout Funds. Investments in potentially profitable businesses in need of growth capital or operating improvements, at favorable prices.

Cambridge Associates. A leading provider of investment and financial research and consulting services to nonprofit endowed institutions in the country.

Cash. Cash and short term liquid assets (e.g., Treasury bills, commercial paper, and non-convertible bonds with remaining maturities of under one year).

Closely held securities. Securities of a corporation whose voting stock is owned by only a few shareholders.

Core Equity. Equity that typically sells at normal price to earnings ratios.

Custodian. A bank or other financial institution that keeps custody of the endowment assets for guaranteed safekeeping.

Equity. Investments where the underlying asset is the ownership interest in a company.

Fixed Income. This usually refers to government, corporate, or municipal bonds which pay interest until the bonds mature and to preferred stock, which pays a fixed dividend.

Growth Equity. Equity that typically sells at a relatively high price to earnings ratio due to the expectation of high earnings.

Investment Manager. An individual, firm or committee responsible for making decisions to buy, hold, or sell assets.

Lehman Brothers Government Bond Index. An index made up of the Treasury and Agency Bond indices that aims to measure total return of the domestic, taxable government bond market.

Lehman Brothers Intermediate Government/Credit Index. An index of all publicly held U.S. Treasury, government agency, quasi-federal and corporate debt guaranteed by the U.S. government with maturities of 1 to 9.99 years.

Limited partnership. A partnership that includes one or more partners who have limited liability. The partnership is managed by a general partner.

Marketable Alternatives. An investment strategy which focuses predominantly on insulating the investor to some extent during declining markets while enhancing overall portfolio returns over complete market cycles.

NACUBO. National Association of College and University Business Officers. Since 1971 NACUBO has published an annual endowment study.

Nominal Return. Return on an investment before adjusting for inflation.

Non-Marketable Alternatives. Higher risk investments, generally held in limited partnerships, with the potential for significantly higher returns. Examples include venture capital, opportunistic and buyout funds.

Real Assets. Investments in real estate, natural resources and inflation protection vehicles.

Spending. The amount withdrawn from an endowment for program support and investment expenses.

Spending Policy. The guideline used to determine the frequency and amount of distributions from the endowment.

Total Return. The accepted method of measuring the performance of equity and bond funds. The total return is the combination of income (interest and dividends) and appreciation/depreciation in the fund's value for a specified period of time.

Value Equity. Equity in companies with low market values relative to book value, intrinsic value or normalized earnings.

Venture Capital. Investments in non-marketable securities of new companies with high risk and the potential for high return.

Investment Managers as of June 30, 2004

Investment Consultant

Cambridge Associates

Custodial Bank

The Northern Trust

Domestic Equity Managers

AXA Rosenberg Investment Management

Credit Suisse Asset Management LLC

Reich & Tang Capital Management

Sands Capital Management

Snyder Capital Management

Tukman Capital Management

Fixed Income Managers

Deutsche Asset Management

Payden & Rygel

Pugh Capital Management

Wellington Management

International Equity Managers

Axiom International Investors LLC

City of London Investment Management

Harris Associates L.P.

Lazard Asset Management

Silchester International Investor

Marketable Alternative Managers

Adamas Partners

Chesapeake Partners International

Fir Tree Partners

Highline Capital

Lone Pine Capital

Lone Pinion Capital

Och Ziff Capital Management

Standard Pacific Capital

Satellite Asset Management

Sirios Capital Partners

Varde Partners

Real Assets Managers

Aetos Capital

Beacon Capital

Cabot Industrial Value Fund (not funded)

The Campbell Group

Commonfund Capital

Crow Holdings Realty

Merit Energy Company

PIMCO Funds

Wellington Management

Non-Marketable Alternative Managers

Angelo, Gordon & Company

Arch Venture Partners

Archlight Energy Partners

Battery Ventures

Code, Hennessey & Simmons

Commonfund Capital

Domain Partners

Endeavor Capital

Frazier & Company

General Catalyst Group

HarbourVest Partners

Ignition Partners

InterWest Partners

MatlinPatterson Global Advisors

Morgens, Waterfall, Vintiadis & Company

New Enterprise Associates

Oak Management

Oaktree Capital Management

Parthenon Capital

Paul Capital

Polaris Venture Partners

Pomona Capital

Riverside Partners

Sevin Rosen Funds

TA Associates

Texas Pacific Group

Vestar Capital Partners

Voyager Capital

Weston Presidio Capital

Life Income Trusts and Annuities

Kaspick and Company

General Information

Board of Regents

as of June 30, 2004

Gerald Grinstein, President
Jeffrey H. Brotman,* Vice President
Ark G. Chin*
Craig W. Cole
Daniel J. Evans*
William H. Gates*
Sally Jewell*
Darlene Mortel*
Constance L. Proctor
Shelly Yapp*

* Members of the Finance and Audit Committee

University of Washington Investment Committee

as of June 30, 2004

Regent Jeffrey H. Brotman (Chair)
Regent Daniel J. Evans
David Bonderman
Jeff Greenstein
Michael Larson
Susan Rasinski McCaw
Mary Pugh

This report, published November 2004, on the management of the University's endowed funds was prepared by the Treasurer of the Board of Regents for donors and other interested parties. Reports are also available, upon request, to donors and fund administrators for each of the 1,906 separate funds in the Consolidated Endowment Fund.

For Further Information

If you have questions or comments about this report, or would like copies of the Consolidated Endowment Fund investment policies, please contact:

V'Ella Warren
Treasurer of the Board of Regents
(206) 685-1822
email: vwarren@u.washington.edu

or

Judy Peterson
Senior Associate Treasurer
(206) 685-1822
email: jp01@u.washington.edu

If you would like to receive information on how you can support the University's programs, please contact:

Connie Kravas
Vice President for Development & Alumni Relations
(206) 685-1980
email: ckravas@u.washington.edu

Cover photograph courtesy of Dr. Lloyd Heath

Endowment Highlights

In Fiscal Year 2004

- The market value of the University of Washington endowment and similar funds increased \$223 million to \$1.4 billion
- The CEF:
 - Added 105 new endowments
 - Received funds from the UW Matching Initiative program
 - Made \$57.9 million in distributions to programs, up from \$56.8 in fiscal year 2003
 - Increased asset allocations to real assets, international equities and domestic equities
 - Returned 17.8% in investments
- Life income trusts and annuities returned 20.7%, by far exceeding benchmark

In The Past Ten Years

- The market value of the University of Washington endowment and similar funds increased over a billion dollars
- The CEF:
 - Added 983 new endowments
 - Rose from \$259 million as of July 1, 1994 to \$1.2 billion as of June 30, 2004
 - Distributed over \$324 million to programs
 - Provided predictable, consistent funding for programs through its spending policy
 - Diversified the portfolio for higher returns with lower risks by adding marketable alternatives, non-marketable alternatives and real asset classes
 - Averaged a 12% annual return placing it in the top quartile of university and college endowments
- Life income trusts and annuities annual returns averaged 10.3%, again exceeding benchmark

