

THE UNIVERSITY OF TENNESSEE
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2016

Investment Maturities (In Years)

Investment Type	Fair Value	Less Than 1	1 to 5	6 to 10	10+	Unknown	Cost
<u>Cash Management</u>							
<u>Pool</u>							
<u>Cash Equivalents</u>							
<u>Debt Securities</u>							
Commercial Paper	\$ 14,997,750.00	\$ 14,997,750.00					\$ 14,997,733.33
U.S. Agencies	965,085,990.56		457,849,899.57	433,580,403.50	73,655,687.49		942,342,738.07
	<u>\$ 980,083,740.56</u>	<u>\$ 14,997,750.00</u>	<u>\$ 457,849,899.57</u>	<u>\$ 433,580,403.50</u>	<u>\$ 73,655,687.49</u>		<u>\$ 957,340,471.40</u>
<u>Investments</u>							
<u>Debt Securities</u>							
U.S. Treasury	\$ 7,704,942.07	\$ 363,815.95	\$ 3,496,594.35	\$ 3,844,531.77			\$ 7,270,865.09
U.S. Agencies	2,850,280.05	767,646.45	1,234,685.50	827,016.80	\$ 20,931.30		2,644,314.87
Corporate Bonds	12,133,752.70	2,143,392.30	8,238,248.31	1,546,940.33	205,171.76		11,819,622.46
Municipal Bonds	1,782,033.45		682,274.00	1,099,759.45			1,735,634.00
Pooled Investment Vehicles-Bonds	71,224,283.16		21,395,627.15	41,486,694.30	2,617,111.09	5,724,850.62	69,261,571.77
	<u>\$ 95,695,291.43</u>	<u>\$ 3,274,854.70</u>	<u>\$ 35,047,429.31</u>	<u>\$ 48,804,942.65</u>	<u>\$ 2,843,214.15</u>	<u>\$ 5,724,850.62</u>	<u>\$ 92,732,008.19</u>
		<u>\$ 18,272,604.70</u>	<u>\$ 492,897,328.88</u>	<u>\$ 482,385,346.15</u>	<u>\$ 76,498,901.64</u>	<u>\$ 5,724,850.62</u>	
<u>Other Investments</u>							
Corporate Stocks:							
Domestic	\$ 21,727,682.85						\$ 17,731,899.84
International	4,293,090.99						4,519,183.53
Pooled Investment Vehicles-Equity	252,332,608.61						251,312,010.31
Alternative Investments:							
Pooled Investment Vehicles- Real Estate	35,358,943.00						25,118,614.76
Private Capital Investments	202,618,125.78						202,299,207.56
Hedge Funds	242,286,695.58						193,861,240.51
Real Estate Gifts	3,414,496.87						4,295,888.37
Assets with Trustees	6,567,674.20						6,309,934.55
Other	8,671.45						16,303.56
Total Investments & Cash Equivalents	<u>\$ 1,844,387,021.32</u>						<u>\$ 1,755,536,762.58</u>
Less: Cash Equivalents	<u>980,083,740.56</u>						<u>957,340,471.40</u>
Total Investments	<u>\$ 864,303,280.76</u>						<u>\$ 798,196,291.18</u>

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Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of a debt investment. The university does not have a formal investment policy that limits investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates.

Credit Risk

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The university's debt investments as of June 30, 2016, were rated by Moody's Investors Service, Standard & Poor's, and /or Fitch Ratings and are reported below using Moody's rating scale.

The university is authorized by statute to invest funds in accordance with University of Tennessee investment policies. Funds, other than endowment and annuity and life income funds, may be invested in collateralized Tennessee bank or savings and loan association certificates of deposit, U. S. Treasury obligations, U.S. government agency obligations and repurchase agreements of those securities, highest quality commercial paper, prime bankers' acceptances, and money market mutual funds meeting certain criteria. Endowment and life income funds can be invested in equity securities and various other securities given prudent diversification. The university has no investment policy limiting its investment choice based on ratings issued by nationally recognized statistical rating agencies. As of June 30, 2016, the institution's investments were rated as follows:

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Rated Debt Instruments	Fair Value	Aaa	Aa1	Aa2	Aa3	A1
Cash Management Pool:						
Commercial Paper	\$ 14,997,750.00					\$ 14,997,750.00
U.S. Agencies	\$ 965,085,990.56	\$ 655,041,860.74	\$ 24,010,805.65		\$42,305,264.40	
Investments:						
U.S. Agencies	\$ 2,850,280.05	\$ 2,850,280.05				
Corporate Bonds	12,133,752.70			\$ 378,546.00	\$ 370,680.80	\$ 1,414,541.09
Municipal Bonds	1,782,033.45	327,297.00	\$ 354,977.00		1,099,759.45	
Pooled Investment Vehicles - Bonds	71,224,283.16					
Money Market Funds in Custodial Accounts	5,338,978.73					

Rated Debt Instruments (continued)	A2	A3	Baa1	Baa2	Baa3	B2
Cash Management Pool:						
Commercial Paper						
U.S. Agencies						
Investments:						
U.S. Agencies						
Corporate Bonds	\$ 951,575.00	\$ 2,879,254.00	\$ 3,819,294.50	\$ 2,132,266.05	\$ 140,595.26	\$ 47,000.00
Municipal Bonds						
Pooled Investment Vehicles - Bonds						
Money Market Funds in Custodial Accounts						

Rated Debt Instruments (continued)	Unrated
Cash Management Pool:	
Commercial Paper	
U.S. Agencies	\$243,728,059.77
Investments:	
U.S. Agencies	
Corporate Bonds	
Municipal Bonds	
Pooled Investment Vehicles - Bonds	\$ 71,224,283.16
Money Market Funds in Custodial Accounts	\$ 5,338,978.73

Custodial Credit Risk – Investments

Custodial credit risk is the risk that, in the event of a failure of the counterparty, the university will not be able to recover the value of the investment or collateral securities that are in possession of an outside party. At June 30, 2016, the university had \$6,567,674.20 of uninsured and unregistered investments held by a counterparty but not in the school's name.

Concentration of Credit Risk

Concentration of credit risk is the risk of loss attributed to the magnitude of the university's investment in a single issuer. Other than the restrictions placed on the cash management investment pool described in the investment policies above, the university places no limit on the amount the university may invest in any one issuer.

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Foreign Currency Risk

Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of a deposit or investment. The university has \$4,293,090.99 invested in foreign corporate equities and \$14,247,797.92 invested in foreign corporate bonds at June 30, 2016.

Alternative Investments

In its Consolidated Investment Pool, as part of its endowment assets, the university has investments in one hundred limited partnerships, limited companies, corporations, and limited liability corporations (LLCs).

The estimated fair value of these assets is \$480,263,764.36 at June 30, 2016.

Total capital contributions less returns of capital equal \$421,279,062.83 at June 30, 2016.

The university believes that the carrying amount of its alternative investments is a reasonable estimate of fair value as of June 30, 2016. Because these investments are not readily marketable, the estimated value is subject to uncertainty and, therefore, may differ from the value that would have been used had a ready market for the investments existed, and such differences could be material. These investments are made in accordance with the university's investment policy that approves the allocation of funds to various asset classes in order to ensure the proper level of diversification within the endowment pool. These investments (real estate assets, private capital investments, and hedge funds) are designed to enhance diversification and provide reductions in overall portfolio volatility. These fair values are estimated by the general partner of each limited partnership or manager of each corporate entity using various valuation techniques.

The methods and assumptions used in estimating fair value vary based upon the asset class, but uniformly all start with the latest audited financial statements for the funds. Most funds issue audited financial statements on a calendar year basis. Using those audited fair values as a beginning point, valuations are adjusted for net capital activity and marketplace considerations to ascertain the reasonableness of estimated fair values provided by the fund managers. Marketplace activity includes subsequent independent appraisals for real estate assets, subsequent rounds of capital financings that include new investors for private/venture equity, and asset confirmations from brokers and fund administrators for hedge funds.

Note 3: Fair Value Measurements

The university categorizes its fair value measurements within the fair value hierarchy established by accounting principles generally accepted in the United States of America. The university has the following recurring fair value measurements as of June 30, 2016:

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	6/30/2016	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Investments in Entities That Calculate NAV per share
Investments and cash equivalents by fair value level					
Debt securities					
U.S. Treasury	\$ 7,704,942.07	\$ 7,704,942.07			
U.S. agencies	967,936,270.61	57,243,575.10	\$ 910,692,695.51		
Municipal bonds	1,782,033.45		1,782,033.45		
Corporate bonds	12,133,752.70		12,133,752.70		
Corporate commercial paper	14,997,750.00		14,997,750.00		
Total debt securities	\$1,004,554,748.83				
Equity securities					
Common stock	\$ 25,901,343.84	24,894,150.84		\$ 1,007,193.00	
Preferred stock, public	119,430.00	119,430.00			
Total equity securities	\$ 26,020,773.84				
Pooled investment vehicles (exchange traded funds; open-end and closed-end)					
	\$ 43,860,583.35	43,860,583.35			
Pooled investment vehicles (other open-end funds with published values)					
	\$ 98,971,065.00	98,971,065.00			
Other assets					
	\$ 9,990,842.52			9,990,842.52	
Private capital investments					
Private equity	\$ 77,715,285.78			77,715,285.78	
Private credit/debt	38,715,876.00			38,715,876.00	
Private real assets	85,730,037.00			85,730,037.00	
Private, other	456,927.00			456,927.00	
Total private capital investments	\$ 202,618,125.78				
Investments measured at the net asset value (NAV)					
Pooled investment vehicles (other open-end funds)	\$ 216,084,186.42				\$ 216,084,186.42
Hedge funds, long/short equity	64,785,732.87				64,785,732.87
Hedge funds, credit	53,716,273.64				53,716,273.64
Hedge funds, diversified	123,784,689.07				123,784,689.07
Total NAV Investments	\$ 458,370,882.00				
Total investments and cash equivalents valued at fair value	\$ 1,844,387,021.32				