

William Marsh Rice University

Consolidated Financial Statements

June 30, 2017 and 2016

William Marsh Rice University

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June 30, 2017 and 2016

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Report of Independent Auditors

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"), which comprise the consolidated statements of financial position as of June 30, 2017 and 2016 and the related consolidated statement of activities for the year ended June 30, 2017, and consolidated statements of cash flows for the years ended June 30, 2017 and 2016.

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.

Auditors' Responsibility

Our responsibility is to express an opinion on the consolidated financial statements based on our audits. We conducted our audits 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.



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 as of June 30, 2017 and 2016, and the changes in its net assets for the year ended June 30, 2017 and its cash flows for the years ended June 30, 2017 and 2016 in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note 1 to the consolidated financial statements, the University changed the manner in which it accounts for the consolidation of limited liability entities in 2017. Our opinion is not modified with respect to this matter.

Other Matter

We previously audited the consolidated statement of financial position as of June 30, 2016, and the related consolidated statements of activities (not presented herein) and cash flows for the year then ended, and in our report dated October 21, 2016, we expressed an unmodified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying summarized financial information as of June 30, 2016 and for the year then ended, before the change in the manner in which the University accounts for the consolidation of limited liability entities as discussed in Note 1 to the consolidated financial statements, is consistent, in all material respects, with the audited consolidated financial statements from which it has been derived.

PricewaterhouseCoopers LLP

Houston, Texas
October 24, 2017

William Marsh Rice University
Consolidated Statements of Financial Position
June 30, 2017 and 2016

(in thousands of dollars)

	2017	2016
Assets		
Cash and cash equivalents	\$ 39,578	\$ 35,181
Accounts receivable and other assets, net	84,879	80,190
Pledges receivable, net	171,137	175,738
Investments	6,350,278	5,829,601
Property and equipment, net	1,237,571	1,180,512
Total assets	<u>\$ 7,883,443</u>	<u>\$ 7,301,222</u>
Liabilities		
Accounts payable and other liabilities	\$ 140,152	\$ 121,747
Notes and bonds payable	957,503	931,061
Actuarial liability for annuities payable	131,958	114,127
Government refundable advances	7,638	7,554
Total liabilities	<u>1,237,251</u>	<u>1,174,489</u>
Net Assets		
Unrestricted net assets	3,143,198	2,886,078
Temporarily restricted net assets	2,369,247	2,120,993
Permanently restricted net assets	1,133,747	1,119,662
Total net assets	<u>6,646,192</u>	<u>6,126,733</u>
Total liabilities and net assets	<u>\$ 7,883,443</u>	<u>\$ 7,301,222</u>

	Unrestricted	Temporarily Restricted	Permanently Restricted		
Net Assets					
Internally designated	\$ 177,581	\$ -	\$ -	\$ 177,581	\$ 167,035
Designated or restricted by donor	191,315	79,798	-	271,113	254,657
Net investment in plant	263,503	53,095	-	316,598	318,937
Endowment and designated for long-term investment	2,507,354	2,209,642	1,118,572	5,835,568	5,334,507
Life-income trusts	-	26,712	12,247	38,959	46,242
Student loans and other assets	3,445	-	2,928	6,373	5,355
Total net assets	<u>\$ 3,143,198</u>	<u>\$ 2,369,247</u>	<u>\$ 1,133,747</u>	<u>\$ 6,646,192</u>	<u>\$ 6,126,733</u>

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, 2017
With Summarized Financial Information for the Year Ended June 30, 2016

	2017			2016	
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total	Total
<i>(in thousands of dollars)</i>					
Operating revenues					
Investment returns distributed for operations	\$ 172,695	\$ 103,348	\$ -	\$ 276,043	\$ 266,433
Student tuition and fees, net	172,558	-	-	172,558	162,949
Grants and contracts	135,256	-	-	135,256	135,177
Gifts and pledges	32,719	10,246	-	42,965	32,806
Gifts and trusts released from restrictions	109,441	(109,441)	-	-	-
Auxiliary enterprises	46,213	-	-	46,213	44,471
Other revenues	26,863	-	-	26,863	24,954
Total operating revenues	695,745	4,153	-	699,898	666,790
Operating expenses					
Salaries and wages	333,541	-	-	333,541	320,787
Benefits	77,666	-	-	77,666	77,927
Scholarships	24,967	-	-	24,967	20,003
Depreciation and amortization	62,432	-	-	62,432	68,414
Interest and bond costs	35,528	-	-	35,528	34,895
Utilities and rent	13,110	-	-	13,110	11,722
Other operating expenses	133,273	-	-	133,273	128,401
Total operating expenses	680,517	-	-	680,517	662,149
Net operating income	15,228	4,153	-	19,381	4,641
Nonoperating changes					
Gifts, grants, and pledges for property and endowment investment returns, reduced by operating distribution above	9,592	15,247	12,422	37,261	53,689
Revenues of consolidated endowment investments	183,734	279,855	13,092	476,681	(283,649)
Expenses of consolidated endowment investments	32,647	-	-	32,647	19,964
Net assets released from restrictions	(29,749)	-	-	(29,749)	(21,982)
Change in liabilities due under life-income agreements	44,696	(45,309)	613	-	-
Other nonoperating changes, net	-	(5,692)	(12,042)	(17,734)	(12,179)
Net nonoperating changes	972	-	-	972	1,441
Total increase (decrease) in net assets	241,892	244,101	14,085	500,078	(242,716)
Net assets					
Beginning of year	2,886,078	2,120,993	1,119,662	6,126,733	6,364,808
End of year	\$ 3,143,198	\$ 2,369,247	\$ 1,133,747	\$ 6,646,192	\$ 6,126,733

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

William Marsh Rice University
Consolidated Statements of Cash Flows
For the Years Ended June 30, 2017 and 2016

<i>(in thousands of dollars)</i>	2017	2016
Cash flows from operating activities		
Total increase (decrease) in net assets	\$ 519,459	\$ (238,075)
Adjustments to reconcile increase (decrease) in net assets to net cash used in operating activities		
Depreciation of property and equipment	62,432	68,414
Loss on disposal of property and equipment	577	1,489
Net realized and unrealized investment (gain) loss	(708,528)	60,900
Contributions restricted for long term purposes and noncash contributions	(21,428)	(33,412)
Donated securities received	(24,391)	(14,479)
Proceeds from sale of donated securities	12,824	6,661
Actuarial change in life-income agreements	17,734	12,181
Change in fair value of commodity swap agreements	(63)	(615)
Gain on settlement of beneficial interest in escrow funds	-	(1,983)
Change in		
Accounts receivable and other assets	(12,208)	19,387
Pledges receivable for current purposes	6,421	13,339
Accounts payable and other liabilities	16,096	6,537
Net cash used in operating activities	<u>(131,075)</u>	<u>(99,656)</u>
Cash flows from investing activities		
Proceeds from sales and maturities of investments	1,612,765	1,039,606
Purchases of investments	(1,417,639)	(876,113)
Purchases of property and equipment	(116,316)	(74,464)
Net cash provided by investing activities	<u>78,810</u>	<u>89,029</u>
Cash flows from financing activities		
Contributions restricted for endowment	4,987	4,397
Contributions restricted for property	12,730	7,983
Contributions restricted for trusts and other	1,179	15,511
Proceeds from sale of interest in consolidated investment company	-	10,000
Dividends paid by consolidated investment companies to non-controlling interest	-	(2,662)
Proceeds from sale of donated securities restricted for endowment	8,126	5,369
Proceeds from sale of donated securities restricted for property	3,441	2,449
Principal payment of tax-exempt bonds	(2,770)	(22,635)
Proceeds from issuance of taxable commercial paper	31,176	-
Payment of outstanding tax-exempt commercial paper	(2,291)	(6,930)
Increase in government refundable advances	84	111
Net cash provided by financing activities	<u>56,662</u>	<u>13,593</u>
Net increase in cash and cash equivalents	4,397	2,966
Cash and cash equivalents		
Beginning of year	<u>35,181</u>	<u>32,215</u>
End of year	<u>\$ 39,578</u>	<u>\$ 35,181</u>
Supplemental Data:		
Interest paid in cash	\$ 35,505	\$ 37,038
Construction in progress payments included in accounts payable	7,838	4,799
Donated Securities	<u>24,391</u>	<u>14,479</u>

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

William Marsh Rice University

Notes to Consolidated Financial Statements

June 30, 2017 and 2016

(all dollar amounts in thousands)

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, 2017 and 2016, and for the years then ended, have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP"). Accordingly, the accompanying consolidated financial statements have been prepared on the accrual basis of accounting and include the accounts of the University and all consolidated 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, 2016, from which the summarized information was derived.

The consolidated financial statements of the University include the accounts of all academic and administrative departments of the University and affiliated organizations that are controlled by the University. The non-controlling interest amount for consolidated entities not wholly-owned is not considered material for separate presentation.

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:
 1. 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;
 2. Revenues related to sponsored research and other sponsored program agreements, which are considered exchange transactions;
 3. Unrestricted funds functioning as endowment;
 4. Gifts with donor imposed restrictions, if the restriction was met within the current fiscal year of the University;
 5. Investments in plant assets; and
 6. 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

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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 provide 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 released from restrictions in the Consolidated Statements of Activities. Donor required matching from University funds and donor release or clarification of restrictions is 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. In the Consolidated Statements of Cash Flows, the University classifies cash receipts from the sale of donated marketable securities in a manner that is consistent with cash donations received if the donated marketable securities are converted into cash on receipt or shortly thereafter.

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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 Statements of Activities report 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 equivalents, except those amounts assigned to its investment managers and unspent bond and 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 income is 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 is 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.

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- 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 valuations 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.

In addition to these three valuation methodologies, as a practical expedient, the University is permitted under GAAP to estimate the fair value of its investments with external managers using the external managers' reported net asset value ("NAV") without further adjustment unless the University expects to sell the investment at a value other than NAV or the NAV is not calculated in accordance with GAAP.

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. These 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.

Direct investments in natural resources, specifically timberland and oil and gas, as well as real estate are primarily valued using a combination of independent appraisals and/or one or more industry standard valuation techniques (e.g., income approach, market approach, or cost approach). The income approach is primarily based on the investment's anticipated future income using one of two principal methods: the discounted cash flow method or the capitalization method. Inputs and estimates developed and utilized in the income approach may be subjective and require judgment regarding significant matters such as estimating the amount and timing of future cash flows and the selection of discount and capitalization rates that appropriately reflect market and credit risks. The market approach derives investment value through comparison to recent and relevant market transactions with similar investment characteristics. The cost approach is utilized when the cost of the investment is determined to be the best representation of fair value. This method is typically used for newly purchased or undeveloped assets. The valuation process encompasses a wide range of procedures that in the aggregate allow the University to assert as to the adequacy of the fair values reported as of the measurement date.

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

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(all dollar amounts in thousands)

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 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. Any resulting gain or loss on disposal is recognized in the nonoperating portion of the Consolidated Statements of Activities.

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 property and equipment.

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 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 at fair value. 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 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.

Grants and Contracts

Revenues from both government and private sources are recognized as earned in accordance with the terms of the grant or contract. Any payment received prior to it being expended is recorded as a refundable advance. Projects that incur expenses prior to payment receipt are recorded as

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revenue with a corresponding receivable. 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 11). The amount of indirect cost permitted to be recovered is determined on a per grant or contract basis.

Use of Estimates

Financial statements prepared in conformity with accounting principles generally accepted in the United States of America rely on estimates. Management makes certain estimates and assumptions that affect the reported amounts of assets and liabilities, disclosures of contingent assets and liabilities, and reported revenues and expenses during the period. Actual results could differ from these estimates.

Credit Risk

The University maintains operating cash and other cash balances in financial institutions that from time to time may exceed federally insured limits. The University periodically assesses the financial condition of these institutions and believes that the risk of loss is minimal.

The University has 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 14 subsidiary corporations that are included in the consolidated financial statements. Six of these subsidiary corporations are exempt from federal income taxes under 501(c)(2), two are exempt under 501(c)(3), one is exempt under 501(c)(4), and five 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 recorded estimated income tax liabilities of \$55 and \$150 for the years ended June 30, 2017 and 2016, respectively. The University has no financial reporting requirements for uncertain tax positions for the years ended June 30, 2017 and 2016.

Recently Adopted Accounting Standards

The University early adopted Accounting Standards Update (“ASU”) 2017-02 *Clarifying When a Not-for-Profit Entity That Is a General Partner or a Limited Partner Should Consolidate a For-Profit Limited Partnership or Similar Entity*, which discusses the consolidation of limited partnerships and similar legal entities. On January 12, 2017, the Financial Accounting Standards Board (“FASB”) issued final guidance that clarifies the model used by not-for-profit (“NFP”) entities to evaluate the consolidation of investments in limited partnerships. Under the new guidance, if a limited partner has control, consolidation is required unless the investment is part of a portfolio for which the NFP portfolio-wide fair value option has been elected. In that situation, the limited partner can instead report its interest at fair value. The University has elected the portfolio-wide fair value option for all of its investments. As a result, the University is no longer required to consolidate its investments in

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a number of limited partnerships. The impact of this adoption was to deconsolidate these investments and report the University's net interest within the Investments line on the Statement of Financial Position. The guidance requires this change to be applied retrospectively to the earliest period presented. The assets and liabilities associated with these investment entities amounted to \$141,088 and \$53,010, respectively, in the 2016 Consolidated Statement of Financial Position and are recognized as investment assets for that year rather than shown separately as assets and liabilities. In addition, non-controlling interests are no longer shown as a component of net assets in the Consolidated Statement of Financial Position and changes in net assets in the Consolidated Statement of Activities. Therefore, the non-controlling interest of \$38,304 and the change in net assets attributable to non-controlling interest of \$5,755 are no longer shown in the related 2016 comparative statements.

New Pronouncements

In May 2014, the FASB issued a standard on Revenue from Contracts with Customers. This standard implements a single framework for recognition of all revenue earned from customers. This framework ensures that entities appropriately reflect the consideration to which they expect to be entitled in exchange for goods and services by allocating transaction price to identified performance obligations and recognizing revenue as performance obligations are satisfied. Qualitative and quantitative disclosures are required to enable users of financial statements to understand the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. The standard is effective for fiscal years beginning after December 15, 2017. The University is evaluating the impact this will have on the consolidated financial statements beginning in fiscal year 2019.

In February 2016, the FASB issued new guidance related to leases in order to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. The new guidance is effective for fiscal years beginning after December 15, 2018. The University is evaluating the impact this will have on the consolidated financial statements beginning in fiscal year 2020.

In August 2016, the FASB issued a standard on Presentation of Financial Statements of Not-for-Profit Entities. This standard requires a different presentation of net asset classifications as well as additional note disclosures about liquidity, financial performance and cash flows. The standard is effective for fiscal years beginning after December 15, 2017. The University is evaluating the impact this will have on the consolidated financial statements beginning in fiscal year 2019.

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2. Accounts Receivable and Other Assets

Accounts receivable and other assets of the University at June 30, 2017 and 2016 were as follows:

	2017	2016
Unsettled investment sales and receivables	\$ 9,261	\$ 17,169
Investment income receivable	2,339	3,194
Student loans receivable, net of allowance of \$1,160 in 2017 and \$879 in 2016	9,199	11,465
Inventory, prepaid expenses, and other assets	14,331	10,250
Sponsored programs receivable	24,315	20,685
Swap agreements	546	483
Other accounts receivable, net of allowance of \$1,048 in 2017 and \$1,469 in 2016	<u>24,888</u>	<u>16,944</u>
Total accounts receivable and other assets, net	<u>\$ 84,879</u>	<u>\$ 80,190</u>

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, 2017 and 2016 are expected to be realized in the following periods:

	2017	2016
In one year or less	\$ 37,354	\$ 59,758
Between one year and five years	112,911	83,793
More than five years	<u>48,172</u>	<u>65,898</u>
Gross pledges receivable	198,437	209,449
Less:		
Discount to net present value	(15,394)	(21,144)
Allowance for uncollectible pledges	<u>(11,906)</u>	<u>(12,567)</u>
Net pledges receivable	<u>\$ 171,137</u>	<u>\$ 175,738</u>

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Pledges receivable at June 30, 2017 and 2016 had the following restrictions:

	2017	2016
Long-term investment	\$ 45,645	\$ 44,126
Buildings	50,812	67,855
Support of University programs and activities	101,980	97,468
Gross pledges receivable	<u>198,437</u>	<u>209,449</u>
Less:		
Discount to net present value	(15,394)	(21,144)
Allowance for uncollectible pledges	<u>(11,906)</u>	<u>(12,567)</u>
Net pledges receivable	<u>\$ 171,137</u>	<u>\$ 175,738</u>

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, 2017 and 2016. The reserve rate is reviewed annually to ensure adequate provision for uncollectible amounts. Periodically unconditional promises to give are reviewed for collectability. As a result, the allowance for uncollectible contributions may be adjusted and some contributions may be adjusted or cancelled. Such changes will be reflected in the consolidated financial statements.

At June 30, 2017 and 2016, the University had conditional pledge commitments of \$89,150 and \$54,250, respectively, for the construction of a campus building and a program initiative. These are not reported in the consolidated financial statements.

4. Investments

Investments at June 30, 2017 and 2016 were as follows:

	2017	2016
Short term investments and fixed income securities	\$ 1,086,955	\$ 886,922
Equity securities and equity funds	1,875,722	1,803,005
Limited partnerships and other funds	2,749,260	2,520,820
Real assets, oil and gas, and other	<u>638,341</u>	<u>618,854</u>
University investments	<u>\$ 6,350,278</u>	<u>\$ 5,829,601</u>

Investments include annuity and life income fund assets of \$170,020 and \$159,515 as of June 30, 2017 and 2016, respectively. Fixed income securities include unspent bond proceeds that are available to fund project expenditures in future years (Note 9).

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The following table presents investment income and net gains (losses) for the year ended June 30, 2017 by net asset classification, with summarized information for the year ended June 30, 2016:

	2017			2016	
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total	Total
Investment earnings	\$ 20,003	\$ 21,072	\$ 3,121	\$ 44,196	\$ 53,550
Net gains (losses) on investments	336,426	362,131	9,971	708,528	(70,766)
Total investment gains (losses) and earnings	356,429	383,203	13,092	752,724	(17,216)
Less: Investment returns distributed for operations	(172,695)	(103,348)	-	(276,043)	(266,433)
Net investment returns, reduced by operating distribution	\$ 183,734	\$ 279,855	\$ 13,092	\$ 476,681	\$ (283,649)

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 \$49,950 and \$49,500 for the years ended June 30, 2017 and 2016, respectively. Certain investments report net returns without specific identification of management fees.

5. Endowments

The University's endowment pool consists of approximately 1,700 individual donor restricted endowment funds and approximately 200 funds designated by the Board of Trustees to function as endowment funds. 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, 2017, with summarized information for the year ended June 30, 2016.

	2017			2016	
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total	Total
Donor restricted	\$ -	\$ 2,209,642	\$ 1,118,572	\$ 3,328,214	\$ 3,024,762
Board designated	2,507,354	-	-	2,507,354	2,309,745
Total endowment funds	2,507,354	2,209,642	1,118,572	5,835,568	5,334,507
Pledges restricted for long-term investment, net of discount and allowance	-	-	(39,427)	(39,427)	(37,609)
Endowment funds excluding pledges	\$2,507,354	\$ 2,209,642	\$ 1,079,145	\$ 5,796,141	\$ 5,296,898

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;

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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; and
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 of Trustees.

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 assets 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, remain in the investment pool as temporarily restricted net assets and endowment returns on board designated endowment funds, net of operating distributions, remain 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 creating a deficit. These deficits generally result when unfavorable market fluctuations occur shortly after the investment of newly established endowments. Deficits in donor restricted endowment funds are classified as a reduction of unrestricted net assets in the year they occur and as an increase in

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unrestricted net assets in the year the fair value exceeds the gift amounts. There were no material deficits of this nature as of June 30, 2017 and 2016.

Changes in endowment net assets for the year ended June 30, 2017, with summarized information for the year ended June 30, 2016, were as follows:

	2017			2016	
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total	Total
Endowment net assets at beginning of year	<u>\$2,309,745</u>	<u>\$ 1,921,451</u>	<u>\$ 1,103,311</u>	<u>\$ 5,334,507</u>	<u>\$ 5,573,038</u>
Investment returns					
Investment income	18,544	22,126	4,093	44,763	53,530
Net realized and unrealized (losses) gains	294,220	401,185	(630)	694,775	(59,168)
Total investment returns	312,764	423,311	3,463	739,538	(5,638)
Contributions	131	6,661	11,294	18,086	20,046
Appropriation of endowment assets for expenditure	(129,061)	(145,446)	-	(274,507)	(266,494)
Other changes					
Transfers to board designated endowment funds	13,775	-	-	13,775	5,358
Donor designation			504	504	710
Other transfers	-	3,665	-	3,665	7,487
Change in endowment net assets	197,609	288,191	15,261	501,061	(238,531)
Endowment net assets at end of year	<u>\$2,507,354</u>	<u>\$ 2,209,642</u>	<u>\$ 1,118,572</u>	<u>\$ 5,835,568</u>	<u>\$ 5,334,507</u>

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6. Financial Instruments

The following tables present the financial instruments carried at fair value on the Consolidated Statements of Financial Position as of June 30, 2017 and 2016, 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, are shown at investee-reported net asset value per share:

	2017				
	Level 1	Level 2	Level 3	NAV	Total
Investments					
Short term investments and fixed income securities					
Cash and equivalents	\$ 182,575	\$ -	\$ -	\$ -	\$ 182,575
Short term investments	-	560,555	-	-	560,555
Investment grade U.S. bonds	-	278,633	-	-	278,633
Equity securities	844,932	-	-	-	844,932
Equity funds	-	-	-	940,648	940,648
Limited partnerships and other funds					
Private equity and venture capital	-	-	-	912,826	912,826
Hedge	-	-	-	1,163,591	1,163,591
Real estate	-	-	-	334,858	334,858
Energy and natural resources	-	-	-	338,092	338,092
Real assets, oil and gas, and other	66,545	-	557,003	-	623,548
Life income agreements	169,878	71	71	-	170,020
Total investments at fair value	<u>\$1,263,930</u>	<u>\$ 839,259</u>	<u>\$ 557,074</u>	<u>\$3,690,015</u>	<u>\$6,350,278</u>
Swaps receivable	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 546</u>	<u>\$ -</u>	<u>\$ 546</u>

	2016				
	Level 1	Level 2	Level 3	NAV	Total
Investments					
Short term investments and fixed income securities					
Cash and equivalents	\$ 109,483	\$ -	\$ -	\$ -	\$ 109,483
Short term investments	-	480,450	-	-	480,450
Investment grade U.S. bonds	-	282,790	-	-	282,790
Equity securities	726,128	-	-	-	726,128
Equity funds	-	-	-	945,731	945,731
Limited partnerships and other funds					
Private equity and venture capital	-	-	-	821,873	821,873
Hedge	-	-	-	1,159,452	1,159,452
Real estate	-	-	-	274,277	274,277
Energy and natural resources	-	-	-	265,217	265,217
Real assets, oil and gas, and other	65,417	-	539,268	-	604,685
Life income agreements	158,586	822	107	-	159,515
Total investments at fair value	<u>\$1,059,614</u>	<u>\$ 764,062</u>	<u>\$ 539,375</u>	<u>\$3,466,550</u>	<u>\$5,829,601</u>
Swaps receivable	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 483</u>	<u>\$ -</u>	<u>\$ 483</u>

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The following tables present the changes in amounts included in the Consolidated Statements of Financial Position for financial instruments classified by the University within Level 3.

Investments

	Real Assets, Oil and Gas, and Other	Life Income Agreements	Total
Fair value July 1, 2016	\$ 539,268	\$ 107	\$ 539,375
Realized gains	9,550		9,550
Unrealized gains (losses)	6,314	(36)	6,278
Capital calls/purchases	25,598		25,598
Distributions	(22,054)		(22,054)
Other	(1,673)		(1,673)
Fair value June 30, 2017	<u>\$ 557,003</u>	<u>\$ 71</u>	<u>\$ 557,074</u>

	Real Assets, Oil and Gas, and Other	Life Income Agreements	Total
Fair value July 1, 2015	\$ 498,545	\$ 107	\$ 498,652
Realized gains	19,211		19,211
Unrealized losses	(19,358)		(19,358)
Capital calls/purchases	60,302		60,302
Distributions	(17,374)		(17,374)
Other	(2,058)		(2,058)
Fair value June 30, 2016	<u>\$ 539,268</u>	<u>\$ 107</u>	<u>\$ 539,375</u>

Swap Agreements

	2017	2016
Fair value July 1	\$ 483	\$ (132)
Unrealized gains	63	615
Fair value June 30	<u>\$ 546</u>	<u>\$ 483</u>

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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 the external managers' reported NAV exists.

Asset type	Fair Value		Valuation Technique	Unobservable Input	2017 Rates	2016 Rates
	2017	2016				
Real estate	\$ 289,754	\$ 265,978	Discounted cash flow	Discount rate	5.5%-8.5%	5.5%-8.5%
Timber	81,000	82,000	Income approach	Discount rate	5%-7%	5%-7%
Oil and gas	104,000	102,000	Discounted cash flow	Discount rate	8%-25%	8%-25%
Directly held private stock	47,853	57,188	Varies	Varies	Varies	Varies
Other	34,396	32,102	Varies	Varies	Varies	Varies
	<u>\$ 557,003</u>	<u>\$ 539,268</u>				

The University recognizes transfers between levels as of the end of the reporting period. There were no transfers between Level 1 and Level 2 in 2017 and 2016.

As a practical expedient, the University is permitted under GAAP to estimate the fair value of its investments with external managers using the external managers' reported NAV without further adjustment unless the University expects to sell the investment at a value other than NAV or the NAV is not calculated in accordance with GAAP. Investments valued at NAV primarily consist of the University's ownership in alternative investments (including limited partnerships and interests in certain hedge and other similar funds). For those investments not valued at NAV, 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. 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. 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 NAV or partners' capital per share is an appropriate measure of fair value as of June 30.

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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, semiannually, 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 at NAV included investment lockups that will expire over the next 12 to 36 months of \$439,849 and \$306,754 at June 30, 2017 and 2016, respectively, and side pockets of \$52,291 and \$50,412 at June 30, 2017 and 2016, 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 a pair of agreements to hedge a portion of the cost of electricity that took effect on January 1, 2016 and extends through December 31, 2020. The estimated fair value of the arrangement was an asset of \$545 and \$483 at June 30, 2017 and 2016, respectively. The change in value is reported as other nonoperating change on the Consolidated Statements 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 U.S. 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.

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7. Property and Equipment

Property and equipment at June 30, 2017 and 2016 were as follows:

	Estimated Useful Lives (Years)	2017	2016
Land	-	\$ 42,279	\$ 23,803
Buildings and improvements	20-50	1,548,004	1,474,699
Equipment, furniture and library books	2-20	439,921	424,970
Art	-	11,766	11,055
Construction in progress	-	66,485	63,181
Less: Accumulated depreciation	-	<u>(870,884)</u>	<u>(817,196)</u>
Total property and equipment, net		<u>\$ 1,237,571</u>	<u>\$ 1,180,512</u>

8. Accounts Payable and Other Liabilities

Accounts payable and other liabilities at June 30, 2017 and 2016 were as follows:

	2017	2016
Unsettled investment purchases and advances	\$ 4,968	\$ 5,698
Vendor accounts payable	28,439	22,382
Accrued payroll and employee benefits	21,560	14,991
Sponsored programs unearned income	25,121	33,097
Other unearned income	39,627	30,670
Asset retirement obligations	4,617	5,348
Accrued interest payable	4,439	4,408
Other liabilities	<u>11,381</u>	<u>5,153</u>
Total accounts payable and other liabilities	<u>\$ 140,152</u>	<u>\$ 121,747</u>

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9. Notes and Bonds Payable

Notes and bonds payable at June 30, 2017 and 2016 were as follows:

	2017	2016
Taxable bonds, Series 2015, maturing 2016, 2045 and 2055, with an average coupon of 3.686% per annum payable semiannually	\$ 680,000	\$ 680,000
Taxable bonds, Series 2013, maturing 2061 through 2063, with an average coupon of 4.63% per annum payable semiannually	113,985	113,985
City of Houston Higher Education Finance Corporation (CHHEFC)		
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 coupon of 0.43% per annum payable monthly for Series 2010B	121,250	121,250
Tax-exempt revenue bonds, Series 2007A & 2007B, maturing 2010 through 2047, with an average coupon of 4.75% per annum payable semiannually in 2014 and maturing 2016 through 2017	-	2,770
Total bond liability	915,235	918,005
Taxable commercial paper notes, Series A, with interest ranging from 0.97% to 1.22% at June 30, 2017 and from 0.14% to 0.58% at June 30, 2016 per annum payable upon maturity	44,320	15,435
Net of deferred financing costs, premiums and discounts on bond issuances	(2,052)	(2,379)
Total notes and bonds payable	\$ 957,503	\$ 931,061

The University incurred interest expense and bond costs, net of interest earned, of approximately \$34,974 and \$34,895 in 2017 and 2016, respectively. Of these amounts, interest expense of \$35,528 and \$34,895 was charged to operations in 2017 and 2016, respectively. Interest expense of \$554 and \$0 was capitalized in 2017 and 2016, respectively. The University made interest payments of approximately \$35,505 and \$37,038 in 2017 and 2016, respectively.

Taxable Bonds
Series 2015

On April 22, 2015, the University issued taxable bonds with a par value of \$700,000 with an underwriters discount of \$4,045 and issuance costs of \$662. Both will be amortized over the term of the bond issue. Interest payments on the bonds are payable semiannually. In May, 2016 \$20,000 matured and was repaid. The remaining bonds mature in the amount of \$340,000 due on May 15, 2045 and \$340,000 due on May 15, 2055. Mandatory sinking fund redemption payments are required in each of four years leading up to the maturity dates.

Proceeds from these bonds were used to advance refund the Series 2013A and 2013B debt of \$247,180 and a portion of Series 2007A and 2007B revenue bonds of \$292,635 by irrevocably placing assets with a trustee to pay principal, interest and call premium on the obligations,

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terminate interest rate swap agreements and provide the University with \$92,930 proceeds to be used for future capital projects. The University recognized a loss on the extinguishment of debt of \$27,197 in 2016, which includes the write-offs discussed below and a gain on the termination of the interest rate swap agreements. Both of these items are included in the other nonoperating changes, net in the Consolidated Statements of Activities.

Unspent bond proceeds of \$85,451 and \$97,939 at June 30, 2017 and 2016, respectively, were invested in a mutual fund holding U.S. government securities.

Series 2013

On June 26, 2013, the University issued taxable bonds. Interest payments on the bonds are payable semiannually beginning November 15, 2013. Principal payments start 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, refund a portion of the outstanding commercial paper notes of \$13,000, and pay the costs of issuance of the bonds of \$985.

Tax-Exempt Revenue Bonds

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, were issued as fixed rate debt with an average coupon of 5%. The Series 2010B revenue bonds, with a face value of \$39,765, 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.

In the event that the University receives notice of any optional tender on its Series 2010B bonds, or if these bonds become subject to mandatory tender, the purchase price of the bonds will be paid from the remarketing of such bonds. However, if the remarketing proceeds are insufficient, the University is obligated to purchase the bonds tendered at 100% of par value on the tender date.

The Series 2010A bonds were issued with a \$5,637 original issue premium and issuance costs of \$606 and are being amortized over the term of the bond issue. The Series 2010B bonds were issued without an original issue premium or discount. 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 date on May 15, 2048. On June 20, 2013, the University returned \$13,000 of unspent Series 2010B bond proceeds.

Unspent bond proceeds of \$0 and \$11,329 at June 30, 2017 and 2016, respectively, were invested in a separately managed short-term investment fund.

Series 2007A and 2007B

On June 12, 2007, the University issued Series 2007A and 2007B revenue bonds through the CHHEFC; Series 2007A bonds with a face value of \$209,165 and Series 2007B bonds with a face value of \$100,000. Interest payments on the bonds are payable semiannually.

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On April 22, 2015, substantially all of the bonds were refunded in the amount of \$292,635 with proceeds of the Series 2015 taxable bonds. At June 30, 2016, there was \$2,770 outstanding, which was paid in May 2017 through regularly scheduled debt service payments.

The Series 2007A bonds were issued with a \$5,832 original issue premium and the Series 2007B bonds were issued net of a \$365 original issue discount. The underwriters discount and issuance costs of both issuances of \$2,538 were capitalized by the University and all are being amortized over the term of the bond issue. Remaining unamortized issuance premium, discounts and costs of \$2,088 were recognized as a loss at the time of refunding.

Principal maturities for notes and bonds payable as of June 30, 2017, excluding commercial paper and unamortized discounts and premiums, were as follows:

2018	\$	-
2019		-
2020		-
2021		-
Thereafter		<u>915,235</u>
	<u>\$</u>	<u>915,235</u>

Commercial Paper Notes

The University has a tax-exempt commercial paper program that provides for borrowings in the form of individual notes up to an aggregate of \$100,000. 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 \$0 at both June 30, 2017 and 2016.

The University established a taxable commercial paper program in May 2015 that provides for borrowings in the form of individual notes up to an aggregate of \$100,000. 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 \$44,320 and \$15,435 with an average interest rate of 1.10% and 0.55% and an average maturity of 37 and 33 days at June 30, 2017 and 2016, respectively.

10. Student Financial Aid

Gross student tuition and fees of \$274,304 and \$261,186 in 2017 and 2016, respectively, are presented in the consolidated financial statements net of scholarship and fellowship awards of \$101,746 and \$98,237, respectively. Auxiliary enterprises revenue was reduced by scholarship awards applied to room and board charges of \$4,938 and \$6,394 in 2017 and 2016, respectively. Scholarship and fellowship awards in excess of the above amounts are reported as expense.

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11. Grants and Contracts

The major components of grants and contracts revenue for the years ended June 30, 2017 and 2016 were as follows:

	2017	2016
Government		
Direct	\$ 79,719	\$ 76,552
Indirect	21,952	20,701
Total government	101,671	97,253
Foundation, industrial, and other		
Direct	29,431	33,578
Indirect	4,154	4,346
Total foundation, industrial, and other	33,585	37,924
Total grants and contracts	\$ 135,256	\$ 135,177

The University receives funding from state and 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. The recovery of indirect costs, also referred to as facilities and administrative costs, is recognized based on predetermined rates negotiated with the federal government, which are predetermined through fiscal year 2019.

12. Functional Expenses

Expenses of the University by major functional category for the years ended June 30, 2017 and 2016 were as follows:

	2017	2016
Instruction and department research	\$ 308,510	\$ 306,258
Sponsored research and other sponsored programs	125,045	117,351
Library	27,723	33,138
Scholarships and fellowships	24,967	20,003
Auxiliary enterprises	61,410	56,841
Student services	74,837	69,975
General administration	32,025	34,040
Institutional development and other activities	26,000	24,543
Total operating expenses	\$ 680,517	\$ 662,149

The above table includes depreciation expense of \$57,411 and \$58,005 and operations and maintenance expense of \$51,789 and \$45,795 in 2017 and 2016, respectively, which were allocated to the major functional categories based on space usage. Depreciation of library books of \$5,021 and \$10,409 was recognized as library expense in 2017 and 2016, respectively. Interest of \$35,528 and \$34,895 in 2017 and 2016, respectively, was recorded by functional category based on identification of related construction projects.

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13. 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 or senior management 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.

14. Retirement Plans

Substantially all employees are eligible to participate in a defined contribution retirement plan, which is administered by a third party. 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 a range of investments. The University's contributions to the plan of \$24,606 and \$23,586 were recorded as expense in the appropriate functional categories in 2017 and 2016, respectively.

15. 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.

The University receives funding from federal government agencies for research and other programs conducted under government grants and contracts. The costs recovered by the University in support of sponsored programs are subject to audit and adjustment.

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, 2017 and 2016, the University had unfunded commitments of approximately \$912,000 and \$723,000, 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, 2017 and 2016 for capital construction and improvements and major maintenance of approximately \$61,966 and \$59,853, 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 \$10,026 and \$8,420 were also outstanding at June 30, 2017 and 2016, respectively.

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16. Subsequent Events

The University evaluated subsequent events from July 1, 2017 to October 24, 2017, the date these consolidated financial statements were issued, for events that occurred after the financial position date that would have a material impact on the University's consolidated financial statements. No material items were noted that require disclosure.