

INVESTMENT MANAGEMENT COMMITTEE

Membership of the Committee is comprised of:

A Chairperson nominated by Finance Committee

The Senior Vice-Principal

The Vice Principal & Chief Financial Officer

A member of Council appointed by the Finance Committee

Up to four other members appointed by the Finance Committee, at least three of whom should have investment expertise and be external to the University.

Current Investment Committee

The Current Committee is as follows:

Mr Robert Johanson, Chairman
Director, Grant Samuel

Professor Bob Officer
Capital Research

Mr Andrew Swan
Portfolio Manager, Cooper Investors

Mr David White
Hawker Britton

Ms Justine Hickey
Lotus Capital Pty Ltd

Mr Ian Marshman
Senior Vice-Principal
University of Melbourne

Mr David Percival
Vice Principal and Chief Financial Officer
University of Melbourne

Professor Paul Kofman
Head of Finance, Faculty of Economics and Commerce
University of Melbourne

Professor Rob Brown
Professor of Finance, Economics and Commerce
University of Melbourne

EXAMPLES OF TRUST FUNDS AT WORK

The Melbourne Research Unit for Facial Disorders and the Professorial Chair in Oral and Facial Sciences

In 2000 Mr Allan Myers, QC pledged \$1 million to establish the Melbourne Research Unit for Facial Disorders and enabled the creation of a Professorial Chair in Oral and Facial Sciences.

The Research Unit engages clinicians and scientists to advance knowledge and outcomes for children afflicted with facial disorders and works in collaboration with the University's Department of Paediatrics and School of Dental Science, and the Royal Children's Hospital Craniofacial Research Theme and Murdoch Children's Research Institute. The Professorial Chair in Oral and Facial Sciences is the principal researcher at the Unit, and the inaugural Chair, Michael Hubbard is an eminent independent researcher.

There are profound and life-changing outcomes for those who benefit from the work of the MRUFD. The existence of this Research Unit advances the treatment and prevention of facial disorders, and its research will help improve the lives of children into the future.

Mr Allan Myers, QC is a barrister, businessman and philanthropist whose professional work has led to appearances in all jurisdictions within Australia. He has lectured in law at universities in Melbourne, England and Canada, published legal articles in Australia and elsewhere, and regularly presented papers at legal, business and educational conventions. He is currently President of the National Gallery of Victoria's Council of Trustees and board member of The Ian Potter Foundation, Howard Florey Institute and The Felton Bequest's Committee.

Otti Veit Violoncello Scholarships

In 2001 Mr Robert Eisner established the Otti Veit Violoncello Scholarships at the University in memory of his late wife who taught violoncello at the Faculty of Music for many years. The endowment of \$250,000 was raised through the sale of her cello after her death.

Otti Veit was a noted professional solo performer as well as a teacher of the cello. She fled Nazi Germany for England in 1936 where she married her engineer husband in 1939; she joined him in Australia in Kalgoorlie in 1940 where he worked in the mining industry and they later moved to Melbourne.

Awarded annually to an outstanding cello student enrolled in a course in either the Faculty of Music or the Victorian College of the Arts, the scholarship provides a fee-free, HECS-debt free place for its winner, and has already laid the foundation for several young cellists embarking on successful careers.



THE UNIVERSITY OF
MELBOURNE

FINANCIAL OPERATIONS

Investment Report 2006





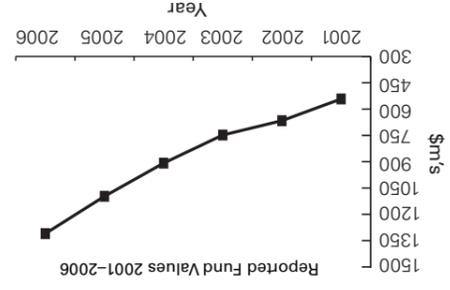
THE INVESTMENT FUND STRATEGY & AIMS

The Fund is comprised of capital reserves from a significant number of trusts and endowments and accumulated University funds surplus to immediate operating requirements.

The Fund aims to meet the intergenerational requirements of the University. This includes the ability to fund daily operations and enable trust funds to fulfil obligations as per their trust deed, whilst at the same time ensuring the Fund's perpetuity. This is achieved by selecting a portfolio structure that provides long term capital growth, despite short-medium term fluctuations, as well as reliable income streams to fulfil current obligations.

On the 22nd of November 2002, the University outsourced its Long Term Fund to an external "Manager of Managers". Currently this Manager is the Victorian Funds Management Corporation (VFMC).

PORTFOLIO HIGHLIGHTS

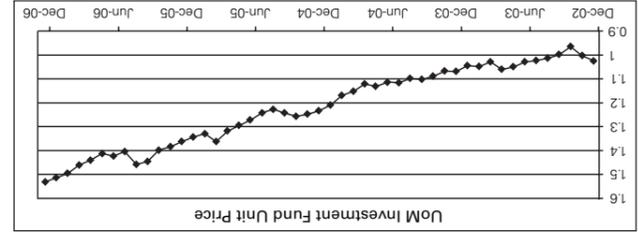


\$m	2001	2002	2003	2004	2005	2006
Long Term Portfolio*	364.2	616.2	704.6	864.2	1094.7	1288.5
Short Term	177.9	50.0	43.3	44.0	2.5	21.3
TOTAL	542.1	666.2	747.9	908.2	1097.2	1309.9

*Includes growth and additional contributions from Trust Funds and general University

Upon the outsourcing of the Long Term Fund, the University's investment pool moved to a unitised Fund structure. On the changeover date, 22nd November, 2002 units were allocated to Fund holders on a one unit for each dollar invested basis. As can be seen in the graph below, the growth in the unit value of the Fund has been quite impressive, with a unit price of \$1.53 as at 31 December, 2006.

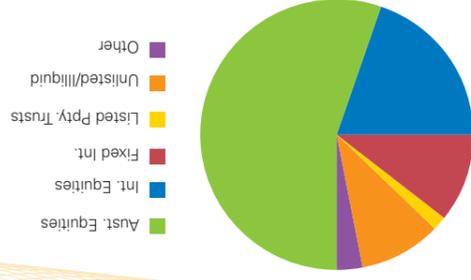
The portfolio has been a great source of income for the University. In 2006 the Fund generated income of approximately \$101m, \$71m of which was distributed to unit holders (in line with a distribution cap of 5.50% for 2006), with the remainder added to the capital value of the pool and reflected in the unit price. Income from the Fund is playing an increasingly important role in the finances of the University and in the future continued support from alumni and private benefactors will be crucial.



ASSET ALLOCATION - LONG TERM PORTFOLIO

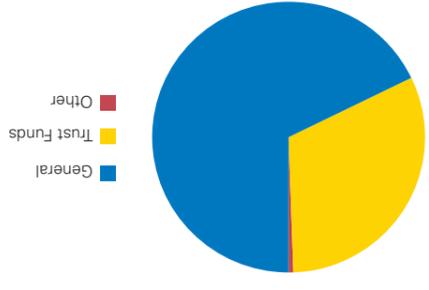
Australian Equities %	International Equities %	Fixed Interest %	Listed Pty / Illiquid Assets %	Unlisted Cash / Other %	
64.94	2.39	28.37	4.30	0	
51.70	15.70	18.50	9.00	0	
46.36	16.33	14.76	14.13	2.47	
2003	46.36	16.33	14.76	14.13	2.47
2004	52.20	18.70	14.10	9.24	5.66
2005	51.90	20.80	13.90	8.24	5.05
2006	55.50	19.50	10.7	1.70	9.60

2006 ASSET ALLOCATION



As highlighted in the graph above, the University portfolio has a bias towards Australian Equities. This strategy was employed to maximise the tax advantages and yield benefits available to a tax exempt entity such as the University with a very long term investment horizon.

The University is also expanding the asset classes in which it is prepared to invest in an effort to take advantage of the long term nature of the Fund and to ensure the Fund's growth and perpetuity. This has resulted in a move to investments in less traditional asset classes such as infrastructure and private equity (currently \$30m is invested in these classes).



2006 FUND OWNERSHIP

The Long Term Fund objectives given to VFMC were:
 → Outperform benchmark return by 1% p.a. over a rolling 3 year period; and
 → Achieve long term income yields of at least 4% p.a. and growth of at least 4% p.a.

LONG TERM FUND PERFORMANCE RESULTS

Year	2001	2002	2003	2004	2005	2006
Performance (after fees) % p.a.	9.50	0.40	10.51	21.84	18.23	18.03

As can be seen in the table above, the Fund has performed exceptionally well for many years. This strong performance continued in 2006 with the Long Term Fund generating returns of 18.03 (after fees). This return comprised capital growth of 9.41% and income of 8.62%, well in excess of the yield and growth objectives of the fund. Australian Equities and Property contributed to the strong results with returns in excess of 20% for both asset classes.

ASSET CLASS PERFORMANCE - 2006

Asset Class	Return %
Aust. Equities	24.79
Int. Equities	10.66
Property	20.34
Fixed Interest	3.18

THE SHORT TERM FUND

VFMC invests the University's surplus cash in two cash-enhanced funds (Global and Australian). Allocations to the funds are at the University's discretion. A small portion of cash is managed in-house via an 11am facility. The Fund's primary aim is to meet the short term and cyclical cash requirements of the University. Ownership of this fund is on a dollar for dollar basis.

GOVERNANCE AND INVESTMENT POLICY

The investment Fund is run using a "manager of managers" approach. The fund management contract is bound by specific performance criteria and subject to tender every three years.

An Investment Management Committee exists to supervise, monitor and evaluate the investment performance of the University's funds. It ensures the stated objectives of the Fund are being met. The Committee is comprised of both University staff and industry professionals. In addition independent asset consultants Watson Wyatt are engaged to provide asset allocation advice; the Committee also draws on the expertise contained within the University's Faculty of Economics and Commerce. Currently it meets six times throughout the calendar year with the second meeting of the year designated specifically to review the asset allocation strategies.

MONITORING AND REVIEW PROCEDURES

The Investment Management Committee provides advice on investment guidelines, policies and strategies. They supervise the Fund manager and custodial administrator and monitor the performance of the portfolio. The Investment Management Committee reports through the University's Finance Committee to Council.

ACKNOWLEDGEMENT OF INVESTMENT RISK

The University Investment Policy sets specific objectives for volatility levels.

As part of these objectives it is acknowledged that a negative return is likely in one in every four years. Such short term fluctuations form part of the consideration of appropriate fund structure and the long term asset allocation.

INVESTMENT AND MANAGEMENT COSTS

The Long Term Fund has investment management costs of less than 0.30%. The investment returns quoted in this report are all net of fees. Trust and Endowment funds, where the University is the trustee, incur an administration fee of 2.5% of the distributed income. This amounts to less than 0.15% of the capital value of trust funds under investment. The administration fee covers a dedicated trust fund office, with two full time lawyers and administration support staff to effectively manage the 700+ trust funds currently held by the University.

INVESTING IN VARIOUS ASSET CLASSES

In determining the appropriate asset classes in which to invest to achieve the Fund's objectives, the following criteria are considered:
 → Access to and size of markets;
 → Ability to generate income;
 → Capital growth over the medium - long term; and
 → Degree of liquidity.

The long term nature of the Fund and tax-free status may also influence investment activity embraces investment in physical financial securities and instruments.

The University is conscious of its responsibilities as a shareholder and actively asserts those responsibilities by voting at company meetings. Investment in physical securities must comply with the criteria set forth for each asset class. For example, the University does not wish to invest in companies involved in the production or manufacture of tobacco or tobacco related products.

Class of Security	Asset Allocation Range
Aust. Equities	50% to 60%
Fixed Interest	10% to 20%
Listed Property	0% to 8%
Hedge Funds	0% to 10%
Internat. Equities	15% to 25%
Emerging markets	0% to 5%
Infrastructure	0% to 10%
Unlisted Property	5% to 15%
Private Equity	0% to 5%

INVESTMENT INCOME RECORDING AND DISTRIBUTION

Distribution is proportionate to the unit holdings in the Fund. Income is distributed monthly subject to the maximum earnings threshold of 5.5% per annum. Income earned in excess of 5.5% is reflected in the capital holdings of the Fund.