MEMORANDUM

TO: The Finance Subcommittee:

John A. Griffin, Chair
Frank B. Atkinson
Kevin J. Fay
Victoria D. Harker
John G. Macfarlane III
George Keith Martin, Ex Officio

and

The Remaining Members of the Board and Senior Advisor:

L.D. Britt, M.D. Bobbie G. Kilberg
Frank M. Conner III Stephen P Long, M.D.
Allison Cryor DiNardo Edward D. Miller, M.D.
Helen E. Dragas John L. Nau III
Barbara J. Fried Margaret N. Gould
Frank E. Genovese Leonard W. Sandridge Jr.
William H. Goodwin Jr.

FROM: Susan G. Harris

SUBJECT: Minutes of the Finance Subcommittee Meeting on November 15, 2014

The Finance Subcommittee of the Board of Visitors of the University of Virginia met with the full Board, in Open Session, at 9:00 a.m. on Saturday, November 15, 2014, in the Great Hall of Garrett Hall. John A. Griffin, Chair, presided.

Present were Frank B. Atkinson, Kevin J. Fay, Victoria D. Harker, John G. Macfarlane III and George Keith Martin.


Consulting member Daniel M. Meyers also attended.
Present as well were Teresa A. Sullivan, Patrick D. Hogan, Richard P. Shannon, M.D., John D. Simon, Susan G. Harris, Susan Carkeek, Donna P. Henry, Mark Luellen, David W. Martel, Marcus M. Martin, M.D., Debra D. Rinker, Nancy A. Rivers, Gregory W. Roberts, Roscoe C. Roberts, Pam Sellers, Colette Sheehy, and Thomas C. Skalak.

Mr. Griffin reviewed the charge of the Finance Subcommittee and the previous meeting agendas, and gave a brief summary of the University's current financial strengths. He said the meeting would focus on key levers: the endowment distribution, optimizing the balance sheet, restructuring the debt portfolio to generate savings, philanthropic initiatives, continuing to achieve operating efficiencies, and crafting a tuition and aid model that will enhance affordability for students. He said after the meeting and feedback from the Board, the committee will go back to work with the goal of bringing a plan to the Board in February.

Ms. Harker, chair of the Finance Committee, said the exercise has been complex in working through the issues and it is not easy stuff. She complimented the management team on the work they have done. Rector Martin said it is very important work; we are at a critical stage in planning for the University’s future.

Mr. Griffin asked President Sullivan to provide remarks about the University’s strategic priorities. Ms. Sullivan said a first-rate faculty is the highest priority; we need to build the next generation of faculty. She showed statistics on the generational turnover of faculty, pointing out that the University is facing a 60% increase in the projected number of resignations, tenure denials, and retirements. An average annual investment of 3% of the academic budget will help to ensure academic excellence for future generations. The cost of ignoring generational turnover will be a great decline in STEM (science, technology, engineering and math) fields, diminished enrollment quality, fundraising decline, and possibly the loss of the University’s triple A bond rating.

Ms. Sullivan said funding the Cornerstone Plan, the University’s strategic plan, is a strategic priority. The investment will support leadership development of students, faculty, and staff; faculty excellence; research and innovation; and the student experience. Phasing the implementation of strategies enables spreading the costs over seven years.

The Cornerstone Plan commitment to students is to be the best education available through a broad range of high-impact experiences, leadership development, quality academic and career advising, a robust alumni network, ability to have a global experience, and affordability.

The commitment to the faculty is to foster a world-class community of scholars through a high-quality, diverse faculty, recruiting top teacher-scholars, a focus on interdisciplinary
collaboration, and matriculating the best and brightest students as well as developing a global community and providing leadership development for faculty.

Ms. Sullivan said we also have a commitment to the Commonwealth to provide an accessible, world-class public higher education through an institution that will drive economic growth and forge positive partnerships in the state.

Ms. Sullivan explained that among the University’s peers, the expenditure per student lags, and addressing the challenges will begin to reverse this trend. The University’s expenditure per student is 59th in the U.S. News and World Report survey, while the University is ranked overall in the top 25 of U.S. universities. The University has by far the lowest ranking in expenditure per student among the top 25 universities in the country. On the other hand, she said we must ensure that the University remains affordable despite national tuition trends. Failure to invest in excellence and affordability will result in an erosion of the quality of the academic program, decline in our ability to recruit and retain faculty talent, diminished ability to compete for top students, and reduced cultural and socio-economic diversity.

The Board focused on a slide that shows undergraduate enrollment growth from 12,489 in 2000 to 14,850 in 2014, and a projection of 15,588 by 2020. Even so, the number of tenured and tenure-track faculty has hardly increased over that time, from 858 in 2000 to 875 in 2014. Now, it is important to increase the number of faculty just to account for enrollment growth, with a projected need for 980 tenured and tenure-track faculty by 2020. Mr. Conner said if you go back 30 years the numbers of tenured and tenure-track faculty has stayed essentially the same, whereas the increase in student enrollment has been substantial.

Mr. Goodwin said we must respond to the needs of the University and the faculty — there is no question about it. Mr. Atkinson added we have heard from the state that we must focus on STEM, and so the priorities presented by the President are consistent with the priorities of the Commonwealth.

There was extensive discussion about the College of Arts & Sciences faculty hiring generally, and in relation to student demand for courses. President Sullivan and Dean Ian Baucom cautioned that we must not hire tenured and tenure-track faculty based on short-term student demand; rather, the focus should be on emerging areas of student interest over the long-term and on supporting the curriculum that we want to teach.

Mr. Griffin said he was hearing in the comments from the Board that members are not questioning the needs as presented by President Sullivan, and perhaps it was time to move on to the levers. Ms. Dragas said she believes the higher education landscape is going to
change because of technology and other reasons, and Mr. Griffin responded that the committee is looking at those issues as well.

Dean Baucom provided more specific data on hiring in the College. He concluded his remarks by saying that in the sciences the plan is to shift the faculty makeup from 60% theoretical and 40% experimental to 75% experimental and 25% theoretical. The blend of junior to senior faculty will be a preponderance of hiring at the junior level, but there must be senior mentors in the mix. He said the University wants to compete with Hopkins and Duke in science, and fundamental to that are the start-up packages.

Mr. Griffin asked James Aylor, dean of the School of Engineering, to provide brief comments. Dean Aylor said the University will not be strong unless it can compete in the STEM fields. Mr. Simon added that developing intellectual communities across units and disciplines is important for retention of top faculty. He used the Data Science Institute as an example; if someone leaves they leave a community of scholars.

Mr. Griffin turned to the issue of pricing the challenges. Ms. Harker said it is a seven year look at pricing, and asked Mr. Hogan to begin the presentation.

Mr. Hogan said there are two aspects to any model: understanding the investments that need to be made, and then determining how to pay for them. There is uncertainty in a seven year projection and so there must be flexibility in the model. The assumptions include hiring 572 tenured and tenure-track faculty with a net increase of 105, 75% of whom will be assistant professors and 25% full professors. One-third of the hires will be in the STEM fields, requiring significant start-up packages amortized over three years. The assumptions include 3% merit increases each year after hire, with an inflation rate of 2.5%.

Mr. Hogan said faculty hires will cost $327 million over seven years. He pointed out that the University does not make money on research, however, we will be able to recapture federal research overhead and use some of those funds to cover about one-third of the start-up costs. The projection shows 182 faculty start-up packages, with an average net cost to the University of $1.1 million per new faculty member.

In response to a question, John Simon said they are trying to plan in a way that will create stability and avoid another generational turnover situation at some point in the future. This requires hiring at different age and experience levels.

The Cornerstone Plan costs were presented, net of known philanthropy as well as people and resources that have been repurposed to support the Cornerstone Plan. Mr. Hogan said we need the faculty to do the things the Cornerstone Plan will be trying to accomplish.
The combination of the costs for the generational turnover of faculty as well as the Cornerstone Plan is $490 million over seven years. With an academic budget of $10 billion over the same period of time, this is less than 5% of the academic enterprise. Mr. Hogan pointed out that the October 23 presentation, which was discussed with each member of the Board, contains the financial details for the Cornerstone Plan.

Mr. Goodwin and others wondered about the pace of change and the consequences of not moving at the pace proposed. President Sullivan said some areas have been covered by private philanthropy, which is likely to continue. Other initiatives have been postponed. The budget must be approved every year by the Board so there is no long-term commitment of resources; the proposal for this year is to spend 1.25% to reinvest in ourselves. She said it was reasonable to assume an organization would reinvest about 2% of its budget every year, particularly a learning organization such as the University. Mr. Nau pointed out that much of the cost is in playing "catch up" in the sciences and technology, and so we must make the decision to catch up immediately or risk falling further behind. Faculty turnover also may occur faster than anticipated, and we must be prepared. Mr. Macfarlane stressed that the accountability will come each and every year in the budgeting process.

Mr. Atkinson said when the subcommittee first started their work he, and possibly others, expected a more aggressive spend than this. Some costs have been postponed and spread out. Mr. Goodwin asked for some metrics on what this funding will accomplish: what are our aspirations? Are we hoping to stay where we are, or aspire to be the number one public university in the country? President Sullivan said one-half of the cost of the Cornerstone Plan is the commitment to raise faculty salaries to get up to the top third of the AAU, and we need to accomplish that level to retain the faculty we have now. She said we aspire to provide the best educational institution in the country with students studying in new areas such as the Data Science Institute. We will bring in faculty to transform the ways we teach and the areas in which we teach. Mr. Macfarlane suggested a dashboard that measures each of the Cornerstone Plan objectives in as quantitative a way as possible, and revisit the dashboard as often as necessary. Mr. Griffin said some of the metrics will be qualitative. Mr. Macfarlane said we should budget high and if we do, the philanthropic dollars should come. Many others agreed that we need to come up with some sort of a quality metric.

Following a break, Mr. Hogan presented the financial levers. He said the University is strong financially and could leverage the performance of the balance sheet. He turned to John Macfarlane to explain the risks inherent in increasing the endowment spending distribution using different scenarios. Mr. Macfarlane said the endowment distribution could be increased by 25 basis points and still stay within the upper distribution limit of 6%, as specified in the
Board of Visitors policy. This would provide up to $4.5 million in unrestricted resources.

Mr. Hogan said it was also possible to access bank lines of credit to diversify sources of liquidity and working capital. The potential opportunity would generate between $10 and $50 million.

To better optimize the mix of fixed to variable rate debt, Mr. Hogan said the Board could consider restructuring the current debt portfolio with more variable rate debt. Although fixed rates are at historical lows, variable rates are very low. It is important to strike the right balance, perhaps targeting 20% in variable rate debt. The annual opportunity is about $2.7 million in reduced interest expense. There was a discussion among members about the appropriate balance of variable rate and fixed rate debt.

Mr. Hogan said executing a robust philanthropic campaign is a lever. The bridge campaign is targeted to raise $250 million for faculty excellence. AccessUVA fundraising has an initial fundraising goal of $360 million by 2019; an endowment of $1 billion would generate sufficient revenue to fund the current annual level of institutional investment. John Nau said it is a harder “sell” on AccessUVA and we may need to repackage in order to raise significant funds for scholarships. There was discussion about ways to bring donors to the table to fund scholarships.

Mr. Hogan reported on organizational excellence: continuing to identify and achieve operational efficiencies and developing new academic revenues. The fiscal year 2015 cost target is $11.5 million in efficiencies, with a potential opportunity of $125 million over seven years. He used Human Resources redundancies as an example of an area that has potential for savings. He said the goal is more efficiency, but also higher performance. Information Technology is another area with potential for cost savings: for instance, two e-mail systems could be combined for better security and better service. There is also opportunity for generating revenues for academic programs.

Mr. Hogan moved on to thoughts on developing a tuition and financial aid model. He said the subcommittee is studying various approaches to enhance affordability and predictability for Virginians. Mr. Atkinson said affordability can mean many things, but we should focus on reducing the amount of indebtedness for Virginia students when they leave school. It needs to be addressed holistically, including looking at how to get the cap for middle income students down. He said there is a mandate from the General Assembly on in-state affordability. He said it is a use of funds issue and net price, rather than list price, is the key number. He said we ought to consider the option of a four-year contract so the cost would be more predictable for families. Mr. Hogan said students in AccessUVA annually take on $22 million in loans and so it would take $10 to $12 million annually to cut the loan cap in half.
Mr. Griffin asked Mr. Roberts, Dean of Admission, about how to advertise the net price when the list price has increased. Mr. Roberts said when AccessUVA was first implemented, there was a significant public relations effort that has declined over time and this would need to be revived. Mr. Griffin said William & Mary significantly increased list price but lowered net price for low income Virginians. Mr. Martin and Mr. Roberts agreed that educating high school students about net price and the availability of aid is crucial.

Mr. Griffin asked for an explanation of how families earning between $100,000 and $200,000 can qualify for financial aid. Mr. Hogan said it involves family size and the level of other assets a family can bring to the table. Mr. Hogan said the aid would be in the form of a loan at that income category in most cases. Mr. Atkinson reiterated his point that the Board ought to be looking at ways to reduce debt; the University meets 100% of need now, but the one lever we have available is the percentage of loans versus grants.

There was some discussion about scaring away the high income, full pay students if tuition is increased. Mr. Nau said out-of-state students pay about 140% of cost, and they are not scared away because it is a quality product. He said if there is a decrease in quality, then pricing will become soft.

In closing, Mr. Hogan reviewed next steps culminating in presenting a complete affordable excellence model to the Board in the spring.

Mr. Griffin adjourned the Finance Subcommittee meeting at 1:00 p.m.

SGH:dr
These minutes have been posted to the University of Virginia’s Board of Visitors website: http://www.virginia.edu/bov/financesubcommitteeminutes.html