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 September 10, 2014

The Finance Subcommittee of the Board of Visitors of the University of Virginia met, in Open Session, at 5:10 p.m. on Wednesday, September 10, 2014, in the Auditorium of the Albert and Shirley Small Special Collections Library of the Harrison Institute. John A. Griffin, Chair, presided.

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

Present as well were Stephen D. Long, M.D., Teresa A. Sullivan, Susan G. Harris, Patrick D. Hogan, John D. Simon, Betsy V. Ackerson, Melody S. Bianchietto, Larry L. Fitzgerald, Megan K. Lowe, Mark Luellen, David W. Martel, James S. Matteo, Scott Miller, Gregory W.
Mr. Griffin reviewed the committee charge to develop a financial pricing model that promotes affordability, predictability, a sustainable student financial aid program, funding that preserves and enhances academic excellence, diversity and inclusiveness, and to process efficiencies and savings achieved through the Organizational Excellence initiative. He noted that committee members have engaged in significant outreach efforts to the Board, former rectors, nationally known educators, and others.

Mr. Griffin asked Mr. Atkinson to introduce the research discussion. Mr. Atkinson said research is not a net revenue generator. Research is not a stand-alone activity, but an integral part of the University's mission. He introduced Vice President for Research Tom Skalak.

Mr. Skalak said research is an important lever for academic excellence and supports the Cornerstone Plan, but not a lever to subsidize tuition. Federal agencies and sponsors support some indirect costs (also called "F&A"), but not all of these costs. Actual F&A costs are 67%, and the government grants provide 58%, while other research pays fewer of these costs. The blended coverage is about 39%, so the University subsidy is 28%.

Research costs the University about 17 cents on every dollar of research. Total research awards have declined since 2010; in 2014 there is an uptick with total awards slightly less than $300 million. F&A recoveries lag awards.

Mr. Skalak explained what he called the Research Eco-Cycle, showing that research is integral to the whole research university mission. He said in order to grow research, we need to seed early-stage research and plan for generational faculty turnover.

The Rector said he was reconstituting a Board special committee on research with Dr. Miller as the chair.

In answer to a question about basic versus applied research, Mr. Skalak said basic research can lead to important discoveries and an impact on the world if translated. It is a full circle from basic to applied. In some fields, there is more basic research such as in the humanities, law, and the social sciences.

Mr. Skalak discussed windfalls from research such as Gatorade at the University of Florida. Some of this is serendipitous, but requires recognizing an innovation that is marketable. For instance, Google sat idle at Stanford for some period of time. He said he cannot project the number of "home runs"; a Gatorade-type home run is going to be stochastic.
Mr. Griffin asked the Provost, Mr. Simon, to speak about the cost of bringing in researchers. Mr. Simon said this varies by rank. At the associate or full professor level, there will be a greater up-front investment, but they will bring in research dollars also. He said with the large number of retirements, it is important to bring in researchers at different levels—they cannot all be assistant professors because there will be no mentors for the young faculty. He said faculty have years where they excel in research, and other years where they excel in teaching; it is important to take a holistic view of a faculty career.

Mr. Skalak said he thought for the nation to be strong, the government research funding pendulum will have to swing back. Corporate research is unlikely to be more than 30-35% of the total research portfolio, but it is increasing somewhat.

Mr. Simon pointed out that 4,000 undergraduates last year took on a one-on-one independent study, and this is one of the benefits of research for undergraduates—students learn how to think about research problems. He said 1,700 faculty offered these experiences.

Philanthropy

Senior Vice President for Advancement Robert Sweeney spoke about the future bicentennial capital campaign and the infrastructure that will be needed to launch the campaign.

Mr. Sweeney said it would be extraordinary if $1 billion of the future capital campaign could be designated for need-based financial aid. He introduced Mark Luellen, Associate Vice President for Development. He said Mr. Luellen led Penn State in a process of development officer metrics and performance evaluation.

The wealth disparity in the country provides an opportunity for large gifts, but also great need. Mr. Sweeney said Bill Gates and Warren Buffett together have wealth that equals the wealth of the bottom 40% of the country. There is good news because of the quality of the University’s alumni population. In the past campaign, 90 donors gave $1.3 billion or 48% of the total raised.

Mr. Sweeney showed tiers of donors, and said they have identified 168 $1 million plus prospects. The issue is creating a compelling message that will result in action by potential donors. There are more than a couple thousand prospects at the $500,000 plus level.

Mark Luellen spoke about restructuring and rebuilding the Development function. He said they were looking at the regional fundraiser program and redeploying individuals to work on specific initiatives, particularly the Cornerstone initiatives. He mentioned other areas including principal gifts, gift planning, expanding the parents program, focusing on foundations and corporations, and the new
Discovery Team to initiate conversations with alumni who have not been contacted before.

He said new performance metrics for fundraising staff were launched recently. These are results-based metrics rather than tracking activity. Foundations and schools are interested in implementing the performance metrics with their staff.

Mr. Hogan spoke about operational excellence initiatives in gift accounting and other areas of Advancement, including developing an annual statement for donors of all gifts to the University and related foundations for the year.

Mr. Luellen spoke about need-based scholarship fundraising that included a direct mail appeal from the President. A little over $9 million has been raised since late 2013, some in endowment and some in current gifts. He compared the plans to the University of Pennsylvania campaign that raised over $600 million for scholarships. Matching incentives encouraged over 65 people to give more than $2 million each. He said Penn State raised $500 million for scholarships for Pell grant eligible students. He said matching programs are very effective.

Mr. Fay said money follows mission, and matching funds incentivize individuals to give. Mr. Luellen said student stories are part of the process. Leveraging the foundations will be a key to success as we go forward.

Observations from Completion of Recent Admission Cycle

Mr. Roberts, Dean of Admission, said undergraduate applications had increased to over 31,000 this year. He explained the reason for the early action program, which was adopted after discontinuing the binding early decision program. Early action is unrestricted, so students can apply to other schools and compare financial aid offers in the spring.

Mr. Roberts gave an overview of the entering class. Selectivity, at 29%, has slightly declined because of the larger number of applications. The largest class in history was enrolled this year, with 31% underrepresented minority, 34% financial aid recipients, including 110 Blue Ridge Scholars, 56% of whom are first generation college students. Mr. Roberts said the class is extremely diverse, and the fairly new multi-race category changes the way students report their race. He said the most influential factors in student decisions are academic reputation or prestige, the value and return on investment, and the fact that the University is need-blind and meeting full need. He mentioned the partnership with the Posse Foundation in Houston, which locates low income, high achieving students from Houston.
Mr. Roberts said financial aid for out-of-state students is extremely important for diversity and other reasons. The yield on out-of-state students is 24% because we are competing with many of the top privates, and the pool is very strong. Low yield is not a bad thing if you get a good group of students, and he believes we did so this year.

Mr. Griffin asked Chief Communications Officer David Martel to speak about communicating the University story. Distribution channels include those owned by the University, those earned, and channels that are paid for by the University as well as social media. He said they are working on Twitter feeds and growing the Instagram account, both channels used by students. Mr. Martel then showed a short video of students talking about their experiences at the University.

Mr. Martel spoke about the “Uncommon Thinking” advertising campaign, and showed a second video about talented students who were able to attend the University because they received Blue Ridge scholarships. He said this video may be used for scholarship fundraising, but also to show potential students that the University may be an option for them regardless of their ability to pay.

Mr. Martel said they plan to put a full-page ad in Forbes magazine in October because the issue will include a ranking that names the Commonwealth as one of the top places for business development and innovation in the nation.

Report on Strategies to Leverage the University’s AAA Balance Sheet

Mr. Macfarlane opened the presentation on leveraging the University’s balance sheet. He said they are in the sixth inning of a nine-inning game, but the good news is that they are optimistic; there are areas where there is a potential to free up funds for strategic initiatives. These will require taking on some additional risk.

Mr. Hogan said they are working toward delivering a six-year financial plan in November that brings together all the components. He said the debt is 20% variable currently, but Board policy allows them to go up to 40% variable. They are challenging their current practices and looking at all aspects of the financial picture. He said it is important to keep in mind the triple A rating, so we must be sure the bankers understand the steps the University is taking. It is also important to consider the risks over the next six years. State appropriations are likely to be cut further, and we need to consider the longer term.

Mr. Hogan reviewed slides on the ongoing engagement of the University of Virginia Investment Management Company (UVIMCO). He showed a slide on a sensitivity analysis of a 15% decline in market value of the endowment. Even with this decline, the spending distribution would stay within the tunnel of 6% ceiling and 4% floor,
assuming a 7.5% return in years 2016-21. Mr. Macfarlane added that the market is due for a correction, so this is a possible scenario. If we keep our current spending rate under this scenario, we would be bumping up against the ceiling in 2021. His conclusion was that it is important to keep the spending rate reasonable. A second scenario showed an increase in the spending rate by 19 basis points with the same assumptions as the first scenario. If the spending rate was raised by 19 basis points, the 6% ceiling would be reached in 2021. This spending rate would be 4.47% or an $8 million increase over the current projected spending for 2016.

Mr. Griffin said they would need to get together to figure out their next meeting time, and he adjourned the Finance Subcommittee meeting at 8:00 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