FOCUS
Fiscal Officers of Colleges and Universities State Supported
Spring 2009

Yoke San L. Reynolds
Vice President and Chief Financial Officer
University of Virginia
ysr4n@virginia.edu
Challenging Times – One CFO’s Perspective

I. Current macro-economic reality and how we got here

II. Impact of the economic and banking turmoil on colleges and universities

III. Selected topics
Stock Market Decline

Dow Jones Industrial Average
(May 1999 – May 2009)

Source: Wall Street Journal (May 12, 2009)
Unemployment at 25-year high

Unemployment Rate
(January 1948 – May 2009)

Source: Bureau of Labor Statistics (May 12, 2009)
Current Macro-Economic Picture and How We Got Here:
One CFO’s Perspective

- Sub-prime mortgages
- Low savings rate
- Over leveraging
- Complex investment vehicles
- Financial market bubble
- Failure of:
  - regulatory oversight
  - corporate governance
  - risk management
  - controls (fraud)
Impact on Colleges and Universities

- Existing approaches under challenge
- New critical risks and concerns
- Strategic plans giving way to tactical responses
- Opportunities to be seized
- Objectives, success metrics and risk management even more important
Impact on Colleges and Universities

1. Enrollment management
2. Tuition and financial aid
3. Working capital and liquidity
4. Receivables
5. Research revenues and F&A recoveries
6. Gifts
7. Endowment value and distribution
8. Debt for operations and capital
Impact on Colleges and Universities

9. Investment in human resources
10. Investment in physical capital
11. Investment in programmatic priorities
12. Operating budget shortfall
13. Patient revenues
14. State support of public universities
15. American Recovery and Reinvestment Act
16. FASB change regarding mark to market
Selected Topics:
I. Endowment

- Existing approaches under challenge:
  a. Investment return and risk tradeoff
  b. Distribution and spending
Endowment Investments

New Risks and Concerns

1. Liquidity:
   - Hedge funds putting down gates
   - Private equity commitments and distributions
2. Distressed selling
3. Congressional action affecting returns

Opportunities

1. Bargains
Distribution and Spending

- Provide reliable, predictable distributions to support programs
- Re-invest appropriate amount to preserve purchasing power of endowment principal to fund programs in perpetuity
- Other
Endowment Payout
Comparing Two Spending Rates

on $1 million endowment assuming 10% annual return
Investment Return versus Spending

Growth of Hypothetical $100mm Investment
(1982 – 2008)

Source: NACUBO 2008 Endowment Study,
Median Investment Returns (1983-2008) net of median spending
Investment Return versus Spending

Growth of Hypothetical $100mm Investment
(2005 – 2009)

Source: NACUBO 2008 Endowment Study,
Median Investment Returns (2005-2008) net of median spending

† 2009 Investment Returns based on S&P 500 index (July 1, 2008 – May 11, 2009)
Source: Wall Street Journal (May 12, 2009)
UPMIFA on Spending: Seven “Prudence” Factors

1. The duration and preservation of the endowment fund;
2. The purposes of the institution and the endowment fund;
3. General economic conditions;
4. The possible effect of inflation or deflation;
5. The expected total return from income and the appreciation of investments;
6. Other resources of the institution; and
7. The investment policy of the institution.
Endowment Distribution

New Risks and Concerns

1. Drop in distribution
2. Some endowments “under water”
   - Gift agreements
   - Donor relations

Opportunities

1. Fund-raising
Selected Topics:

II. Working Capital and Liquidity

- Historically, cash was invested by source of funds:
  - “Public funds” daily cash settlements with State Treasurer (short-term pool)
  - “Local funds” invested with UVIMCO in the Aggregate Cash Pool
  - “Private funds” invested with UVIMCO in the Aggregate Cash Pool or Long-Term pool

- Aggregate Cash Pool investment policy maximizes return, within constraints of Investment of Public Funds Act (IPFA)
For a number of years the University of Virginia had Code of Virginia authority to manage investments of endowment funds, endowment income and private gifts, and to invest these funds in vehicles beyond the provisions of the Investment of Public Funds Act (IPFA).

In 2007 the Virginia General Assembly passed legislation (HB1740) that extends to the University the unique authority to manage investments of all funds except state General Funds in a comprehensive range of instruments beyond IPFA.
Working Capital and Liquidity Since July 1, 2007

- Revised working capital investment philosophy from source of funds (public, local, private) to projected liquidity needs (short, medium, long-term)
- Established Internal Bank
- Modified investment objective of aggregate cash pool from maximizing return subject to IPFA to maximizing security
- Invested some working capital in UVIMCO long-term pool
- Infrastructure established
- First (partial) year of implementation: additional revenue $15 million
Working Capital and Liquidity: New Risks

- Frozen access to short-term investments
- Principal not guaranteed on short-term investments
- Quality names for banking and financial services partners not dependable

Opportunities

- Taxable bonds for working capital
III. Debt Portfolio Program

Objective: Reduce long-term borrowing costs and increase financial flexibility

Strategies to Achieve Objective:

- Use a diversified portfolio of debt instruments including fixed and variable rate bonds, taxable and tax-exempt Commercial Paper, mixed maturities
- Manage timing of long-term debt by using Commercial Paper for bridge financing
- Minimize opportunity cost of using internal funds
Debt Portfolio Program

Objective: Manage debt portfolio risk

Strategies to Achieve Objective:
- Limit exposure to Variable Rate debt
- Build a reserve for interest rate volatility
- Use derivatives strategically
University's History of Tax-Exempt Debt Issuance

Interest Rates as of October 4, 2002

Note
1. The Bond Buyer Revenue Bond Index has a 30 year maturity and is rated A1 by Moody's
2. The Bond Market Association Municipal Swap Index (formerly the PSA Index) tracks non-AMT, weekly-reset bonds and began in 1989
Note: 30-Year Aaa Fixed Rate reflects 30-year MMD adjusted for yield to maturity assuming ten-year par call VRDN Resets reflect the SIFMA index and reflect average weekly resets for high-grade variable rate bonds.
The new Debt Portfolio Program was implemented in 2002, with the first bonds issued in the spring, 2003. Under this new approach, the University has experienced a substantial decrease in its portfolio cost of capital.

Note: Includes University and Hospital long-term debt but excludes Commonwealth debt
Savings From Issuance of Series 2003A as Floating Rate Bonds

Note: UVa Variable Rate does not include liquidity or remarketing fees.

<table>
<thead>
<tr>
<th>Period</th>
<th>Savings (in 000s)</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY2003</td>
<td>$780</td>
</tr>
<tr>
<td>(Since inception in March 2003)</td>
<td></td>
</tr>
<tr>
<td>FY2004</td>
<td>$2,905</td>
</tr>
<tr>
<td>FY2005</td>
<td>$2,190</td>
</tr>
<tr>
<td>FY2006</td>
<td>$1,250</td>
</tr>
<tr>
<td>FY2007</td>
<td>$705</td>
</tr>
<tr>
<td>FY2008</td>
<td>$1,360</td>
</tr>
<tr>
<td>FY2009-to-date</td>
<td>$1,645</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$10,835</strong></td>
</tr>
</tbody>
</table>
Debt and Credit

New Risk: Access to Credit Markets

- Commercial Paper

- 2003A VRDB - $82 million
  - Remarketing agent was Lehman Brothers
  - New remarketing agent is JP Morgan

- Back-up line of credit for variable rate debt

- Long-term debt
Opportunity:

1. Allocating Debt Capacity

- Debt capacity is a scarce resource
- Should establish a transparent process for allocating capacity among internal borrowers and/or projects
- Criteria should be aligned with mission, strategic direction and institutional priorities
- Financial and operational factors
- Other factors
Opportunity: 2. Build America Bonds

- BABs available only to governmental issuers
- Bonds are sold to taxable investors rather than tax-exempt investors
- The University pays taxable interest rates and receives a 35 percent credit from the federal government on interest paid
- Potential for significant cost savings on 30-year debt (rates as of 3/31/09)

<table>
<thead>
<tr>
<th>TE Rate</th>
<th>Taxable Rate</th>
<th>35% Credit</th>
<th>Net BAB Rate</th>
<th>Savings</th>
</tr>
</thead>
<tbody>
<tr>
<td>4.92%</td>
<td>6.20%</td>
<td>(2.17%)</td>
<td>4.03%</td>
<td>.89%</td>
</tr>
</tbody>
</table>
Lessons Learned

- If something seems too good to be true….
- If you wonder how it is sustainable….
- Whole new meaning to risk management
  - Test existing approaches
  - Understand the fundamental economics
  - Consider backup counter-parties
- Do not over-react
- It’s okay to abandon strategic plans temporarily
- Tactical changes = opportunities
- Discipline of objectives and measures of success
Yoke San L. Reynolds
University of Virginia
Vice President and Chief Financial Officer
P.O. Box 400210
Charlottesville, VA 22904
ysr4n@virginia.edu
www.virginia.edu/vpfinance