MARK DEFEO/UNIVERSITY OF CALIFORNIA AT SAN FRANCISCO

IONIC STUDIOS

MAJED/UNIVERSITY OF CALIFORNIA AT SAN FRANCISCO

**California dreaming. Upper left: The first phase of UCSF's Mission Bay campus takes shape around a quad; it includes a community center that sells memberships to the public. Left: The community center's roof will include an outdoor pool. Above: The 434,000-square-foot Genentech Hall, the site's first building, was completed in 2003. It features laboratory "neighborhoods" clustered off loop corridors.**

"and it wasn't a secret at all, is that if you move a lot of people from a site like Parnassus Heights, that site has been diminished until they are replaced. The main angst is among the people who remained. They wonder, 'When are we going to be reconstituted into the kind of community that we were before?'" President Lawrence H. Summers, who has visited UCSF, and the Allston planners have to contend not only with this issue, but with wider community concerns as well.

Harvard has never suggested that it might construct an academic health center in Allston—after all, the Longwood medical area is not far away—but Summers has expressed the hope that Boston could become a center for the biotechnology industry. Regis Kelly, who is now executive director of the California Institute for Quantitative Biomedical Research, located at the Mission Bay campus, said the concept of an academic health center has gone from a two-tiered to a three-tiered structure, with basic science research, the biotech industry, and the clinical community working together to advance health science. In order to facilitate such interactions, Kelley regularly interviews every scientist in his institute. Then he talks to venture capitalists, "industry's equivalent to a knowledge broker,…to see whether they have got a company that might be interested in something we are doing. Then we can set up a confidentiality agreement." The result, he says, is good for UCSF, for patients, for industry, for venture capitalists, for the city, for developers like Catellus, and ultimately, "for the California economy."

Even the laboratories at Mission Bay are set up to facilitate this kind of technology transfer. "We group people according to scientific overlap," Kelly said, "so they can be from clinical departments, academic departments, even different schools. That, I have to say, is an administrative nightmare, but we had to make a decision: Are we here to make life simple for the administrators or for the scientists?"

Much as Allston is still in the future, UCSF Mission Bay is only a beginning, even with buildings up and running. In its next phase, UCSF aspires to integrate the research and clinical work even more closely together, and to establish additional links to adjacent commercial biomedical development. Likewise, what is being planned for Allston right now involves only the core of Harvard's extensive land holdings. Over time, it is possible to imagine closer collaborations between clinical and pure researchers there, and perhaps even spillovers into the private sector that might give life to Summers's aspirations for a major bioindustry center.

## Money-Manager Transition

The university announced on January 11 that Jack R. Meyer, M.B.A. '69, president and chief executive officer of Harvard Management Company (HMC), would "conclude his service" sometime after the close of the fiscal year in June. Meyer has been at HMC's helm since 1990. The endowment was then valued at approximately $4.8 billion; it reached a record $22.6 billion as of June 30, 2004, *after* that fiscal year's distribution of $897 million to support Harvard operations and Allston campus development (more than triple the $258 million in capital gifts received during the same period). Following the course of several other HMC investment professionals who have compiled superior performance records in recent years and then left to establish private money-management enterprises—typically with a contract to continue managing funds for Harvard—Meyer and four colleagues will launch their own firm after departing later this year.

That significant news overshadowed, and in part subsumed, the Thanksgiving-week announcement on HMC portfolio managers' compensation for fiscal year 2004 (see "Compensation Controversy, Continued," page 60). After compensation for fiscal year 2005 is reported, the issue will be moot so far as top-ranking portfolio managers David R. Mittelman and Maurice Samuels are concerned. They, Edward DeNoble (emerging-markets bond manager), and Michael Pradko (HMC's chief risk officer) are the senior personnel leaving with Meyer.

In an interview on the day the departures were announced, Meyer cited three reasons. First, he said, "It's time for a new chapter for me," after 15 years at HMC (he was previously chief investment officer of the Rockefeller Foundation and deputy controller of New York City). Second, he said, the possibility of creating a new firm with admired colleagues was "very exciting." And finally, he said, "I would like to drop out of the public spotlight a bit." At Harvard, he said, HMC's performance is subject to "close scrutiny of returns, to the last basis point," and there is the "annual compensation thorn" prompted by disclosure of the top portfolio managers' pay—and his own ($7.2 million in fiscal year 2004).

University Treasurer James F. Rothenberg, chair of HMC's board, began an interview by noting that Meyer and colleagues would be present through the end of this fiscal year, focused on maximizing returns for Harvard. "I thank him and all his associates for the tremendous job they have done for 15 years plus," Rothenberg said. HMC's diversified investment system and the structure of compensation, both created under Meyer, "produced an extraordinary result for the University."

Accordingly, Rothenberg identified the twin tasks of a steering committee he will direct as identifying Meyer's successor and ensuring a smooth transition at HMC. The news release concerning the events said the steering committee would "consider more generally how best to ensure

## Compensation Controversy, Continued

**In light of continued** strong investment returns (see "Endowment Gains: Last Hurrah?" November-December 2004, page 56), the Harvard Management Company (HMC) investment professionals who contributed most significantly to the University's fisc again earned commensurately significant bonuses in the fiscal year ended last June 30. Domestic bond-fund manager David R. Mittelman was paid salary, benefits, and bonus totaling $25.4 million; Maurice Samuels, responsible for foreign bonds, received $25.3 million. Their even higher earnings in the fiscal year ended June 30, 2003, prompted debate about the appropriateness of HMC's compensation formula, the most cost-effective way to maximize Harvard's endowment returns, and broad questions about rewards for service within a nonprofit enterprise (see "'Extraordinary' Bonuses," March-April 2004, page 69).

In an interview, HMC president Jack R. Meyer attributed "almost all the difference" in the two money managers' compensation from 2003 to 2004 to performance (see "The Top Tier"). Fiscal-year 2004 results, he said, "were spectacular but somewhat less spectacular than in 2003." In 2004, the domestic bond portfolio achieved a return 12.6 percentage points ahead of its benchmark; in the prior year, the HMC funds returned 13.8 percentage points more than market results. In foreign bonds, the 2004 return was 9.9 percentage points better than the market, compared to a remarkable 34.4 percentage point margin in the prior year.

Beyond the results in the portfolios the managers oversee directly, their compensation is affected by the results of other managers in their investment teams, Meyer said. Those factors, and the change in value of bonuses awarded in prior years (which appreciate or decline in line with the performance of the endowment itself, and are paid out contingent on the managers' own continued superior performance) determine the annual compensation paid. Changes in HMC's formula "at the high end," instituted after the record payments in fiscal year 2003, had only a "very minor" effect on the 2004 awards, he said.

A group of College alumni who had objected to the fiscal year 2003 payments reiterated their critique this year. A statement for the group released by William Strauss '69 dismissed the notion that the bonuses were "fair market" compensation and argued that "the money belonging to a university should not be treated like individual or corporate funds, and that top-quality fund managers can be hired and retained for far less than $25 million apiece."

### The Top Tier

| Manager | '04 Payout* | Performance** | '03 Payout* | Performance** |
|---|---|---|---|---|
| David R. Mittelman (Domestic bonds) | $25.4 | 9.2% vs. (3.4%) | $34.1 | 31.1% vs. 17.3% |
| Maurice Samuels (Foreign bonds) | $25.3 | 17.5% vs. 7.6% | $35.1 | 52.4% vs. 18.0% |
| Jeffrey B. Larson (Foreign equity) | $8.1 | 40.6% vs. 32.6% | $17.3 | (2.8%) vs. (6.2%) |
| Jack R. Meyer (HMC President) | $7.2 | 21.1% vs. 16.4% | $6.9 | 12.5% vs. 8.3% |

*** Payout data are in millions of dollars, for the fiscal year ended June 30.**
**** Performance data are the annual rate of return in each endowment portfolio manager's area versus the rate of return for the assets used as the benchmark for that investment class. For Meyer, the rate of return is performance for the endowment overall, compared to the benchmark returns on the endowment's "Policy Portfolio" weighted among all asset classes.**

In an indication of the vast difference in perspective between these critics and some money-management professionals, *Boston Globe* financial columnist Steve Bailey, AMP '94, published a mock help-wanted ad circulating among hedge-fund managers following the news that Meyer was leaving HMC. The ad, for an "extremely experienced investment professional," specified that applicants "should be interested in taking a 90 percent pay cut from their current, extraordinarily successful private-sector careers in exchange for public disclosure of their compensation."

HMC's future organizational strength and sound investment results." Separately, President Lawrence H. Summers said, "We will make whatever arrangements are necessary to best assure strong endowment performance" for the benefit of Harvard's students, faculty, and community.

The need to secure the latter is obvious. In his release on fiscal year 2004 compensation, Meyer noted that the portfolios of the managers most highly paid in that year—domestic bonds, foreign bonds, foreign equity, domestic equity—had exceeded market returns for those asset classes by $2.8 billion during the five years from 2000 through 2004.

The larger structural question—how best to sustain superior performance—is more vexing. Rothenberg indicated that Meyer's departure did not, by itself, mean that the HMC model of a stand-alone investment-management enterprise within the University had run its course. In recent years, he noted, the share of Harvard assets managed within HMC had declined from about 85 percent to about half the total—reflecting the earlier departures of other HMC personnel and agreements to hire their new firms to manage some Harvard funds externally. Rothenberg noted that there was an "evolution going on" in how HMC works. Although he would "never say it is not a possibility" that Harvard would move away from operating HMC, many skilled money managers are on the staff. How the evolution unfolds, he said, depends on the talents of the new leadership and that new person's ability to hire the right fund managers, internal or external.

RICHARD HOWARD/HARVARD NEWS OFFICE

Jack R. Meyer

HMC's staff, Meyer indicated separately, numbers 175, including 30 or so portfolio managers (he declined to quantify aggregate expenses or fees paid to external managers). This substantial roster includes money managers, traders, analysts, and accounting and support personnel. Some are required no matter where funds are invested; others manage money internally.

Might Meyer and his associates continue to invest for Harvard once they leave HMC—retaining expertise that has performed superbly, but further reducing the internal asset base? That "hasn't been decided yet," Rothenberg said, but "the possibility exists."

As he considers those issues, Rothenberg will have deep financial expertise to draw on, beyond his own experience at Capital Research and Management Company, where he is president. Other steering committee members include Summers and Corporation member Robert E. Rubin (now at Citigroup), both former U.S. Treasury secretaries; vice president for finance Ann E. Berman; vice president and general counsel Robert Iuliano; Peter A. Nadosy '68, former president of Morgan Stanley Asset Management; Steven M. Heller '76, J.D. '80, who has coheaded the investment-banking and merger businesses at Goldman Sachs; and corporate attorney Lewis B. Kaden '63, LL.B. '67, of Davis Polk & Wardwell. The steering committee welcomes comments and suggestions at hmcsearch@harvard.edu.

## The Payout Payoff

**Following two years** of high investment returns on endowment assets, the Harvard Corporation has approved an increase in funds distributed to support University operations in fiscal year 2006, beginning July 1—but with a new twist. During the current fiscal year, ending June 30, endowment funds distributed for operations are projected to increase by 4 percent (to about $840 million). The new formula holds to that 4 percent rise for 2006, but adds an additional sum of up to 4 percent more in support of "agreed-upon spending plans for goals identified by Larry Summers and the deans," according to financial vice president Ann E. Berman.

Harvard's schools enjoyed the benefits of large endowment distributions in the years following the sustained high investment gains that peaked in 2000, and the conclusion of the University Campaign, the $2.6-billion fundraising drive that ended in 1999. Today, such distributions account for about 31 percent of University revenues. But in the wake of negative investment returns in fiscal years 2001 and 2002, and as President Lawrence H. Summers began laying out new priorities—with expensive commitments to science, Allston development, and other goals—the Corporation tightened the spigot.

Investment performance has lately roared back: endowment investments appreciated 12.5 percent and 21.1 percent, respectively, in fiscal years 2003 and 2004. Hence the opportunity now, Berman said, "to make sure we make progress on the priorities we've identified." The kind of targeted use of extra resources proposed now has been tried in some of the faculties in the past, she noted, but not on so wide a scale.

What is distinctive here is central direction of the planning: the priorities that qualify for the additional spending are to be explicitly negotiated and agreed to by the president and each dean. Moreover, a report on the use of the additional payout is to be provided to the Corporation, which wants to be assured that the funds are applied to priority uses. What might such uses be? The sum involved—$35 million to $40 million of added annual spending—"should enable significant focus on priorities," Summers said in an interview. Among them he listed financial aid, faculty growth especially in the sciences, and the Medical School's systems-biology program (see page 67).

Pending his discussions with faculty members and Summers, Faculty of Arts and Sciences (FAS) dean William C. Kirby remained general about eligible commitments, saying only that they had to be "new in scope, new in focus." FAS has as much as an extra $12 million at stake for use next year—enough to make a difference in advancing goals identified in his annual letter (see page 66) such as international study, expanded graduate-student fellowships, or emerging fields of scientific research.