A fiscal roller-coaster ride. "Since Harvard thinks and acts in long-term timeframes," Shore and Rothenberg write, "we believe it is important" to consider fiscal 2012 "in the broader context of Harvard's changed financial circumstances and prospects." Beginning in 2002, "the University enjoyed substantial growth through fiscal 2008 driven by large increases in both net assets and debt"; a chart accompanying their text demonstrates that as the endowment more than doubled (to $37 billion), so did borrowings (to nearly $4 billion). Faculty ranks expanded 10 percent. Campus facilities were enlarged by more than four million square feet (20 percent), heavily funded with debt—and all entailing expenses for operations and maintenance. The financial-aid budget boomed.

In millions of dollars	For the year ended June 30 2012	2011
Operating Revenue:		
Total student income	$776.8	$740.6
Total sponsored research	832.6	851.8
Endowment distributions	1,422.1	1,321.7
Other income*	1,005.7	993.3
Total Operating Revenue	**4,037.1**	**3,907.5**
Operating Expenses:		
Salaries and wages	1,497.9	1,420.0
Employee benefits	476.4	461.0
Interest	287.1	298.8
Other expenses**	1,780.3	1,727.8
Total Operating Expenses	**4,041.7**	**3,907.6**
Deficit	(4.6)	(0.1)

Adapted from *Harvard University Financial Report Fiscal Year 2012;* numbers may not total exactly because of rounding.
*Gifts for current use, other investment income, all other income
**Depreciation, space and occupancy, supplies and equipment, scholarships, all other expenses

Revenue increased $130 million, to just over $4.0 billion—but expenses increased a few million dollars more (also to more than $4.0 billion), yielding a negligible $4.5-million operating deficit. Endowment distributions for operations drove revenue growth in fiscal 2012. Student income increased about 5 percent, to just above three-quarters of a billion dollars (after $357 million in financial aid is subtracted from tuition and fee revenue). But sponsored research support declined. Increased expenses reflected higher compensation—the people costs that account for nearly half Harvard's annual spending. Interest expense declined; in fiscal 2012, the University redeemed about $300 million of outstanding debt.

Then, they continue, "The global financial crisis changed the University's financial profile in a sudden and consequential way." The endowment lost $11 billion in value. Harvard incurred $3 billion in additional losses on various financial and investment transactions, and had to take on additional debt. Interest costs doubled, to nearly $300 million from fiscal 2008 to fiscal 2011, as endowment funds for operations—the schools' largest source of revenue—suddenly declined. Worsening matters, "over the past 10 years the University experienced only minimal inflation-adjusted growth in key non-endowment

An Allston Accounting Adjustment

Harvard's 2012 financial statements reclassify for this year and last the "administrative assessment" (an annual decapitalization, equal to 0.5 percent of the endowment's value) from a capital item to an operating expense—a different way of presenting about $129 million of funds in fiscal 2011, and slightly more in fiscal 2012. That change tells a story about Harvard's altered financial circumstances, a useful accompaniment to the narrative from chief financial officer Daniel S. Shore and University treasurer James F. Rothenberg.

In 2001, late in his presidency, Neil L. Rudenstine and the Corporation created a "strategic infrastructure fund" (SIF) to prepare for campus development in Allston. Each school's endowment would be tapped 0.5 percent annually, for five years, to yield $500 million to indirectly reimburse the central administration's investments in necessary infrastructure and improvements in Allston, on the grounds that all Harvard would benefit as new facilities were funded by their tenant schools and created in coming decades.

President Lawrence H. Summers then advanced a sweeping vision for accelerated Allston development (science labs, new homes for the schools of education and of public health, cultural facilities), and in early 2004 the SIF was extended to 25 years and applied to broader uses, including the renovation of facilities vacated by units relocating to Allston and the cost of new buildings there. Given the endowment value then (about $19 billion), the assessment would yield an additional $2 billion over its extended life, even if the endowment did not appreciate—a sum that could support billions of additional borrowing to build in Allston. Meanwhile, as Shore and Rothenberg note, the University was already increasing its debt financing substantially. Centrally managed liquid funds were invested long term, alongside the endowment, to take advantage of the bull market, and Harvard put in place interest-rate exchange agreements meant to stabilize the costs of the anticipated future borrowings for the Allston work.

Today, *none* of the assumptions equating the administrative assessment with capital investment in Allston development remain. The University cannot borrow substantially more if it wishes to retain its top-tier credit ratings, and has much higher, continuing debt-service costs. The endowment, one-sixth smaller than at its fiscal 2008 peak, must support a larger faculty, physical plant, and financial-aid budget. After punishing losses on the interest-rate swaps and from lack of liquidity, the University is pursuing a lower-risk strategy for investing all its assets, including the endowment. That more cautious strategy must fund not only past Allston-related costs but also the extra, University-wide debt service. And the new Allston master-planning proposal (see "Economic Realities in Allston," page 46) is vastly reduced from prior schemes. Much of the land is now a blank slate, for potential academic use far in the future.

Thus, treating the SIF as an Allston-related decapitalization item no longer makes sense; rather, it is an operating item—an assessment on endowment assets that defrays central operating expenses. A financial-reporting change thus reflects almost revolutionary upheaval in Harvard's fiscal assumptions, operations, and position.