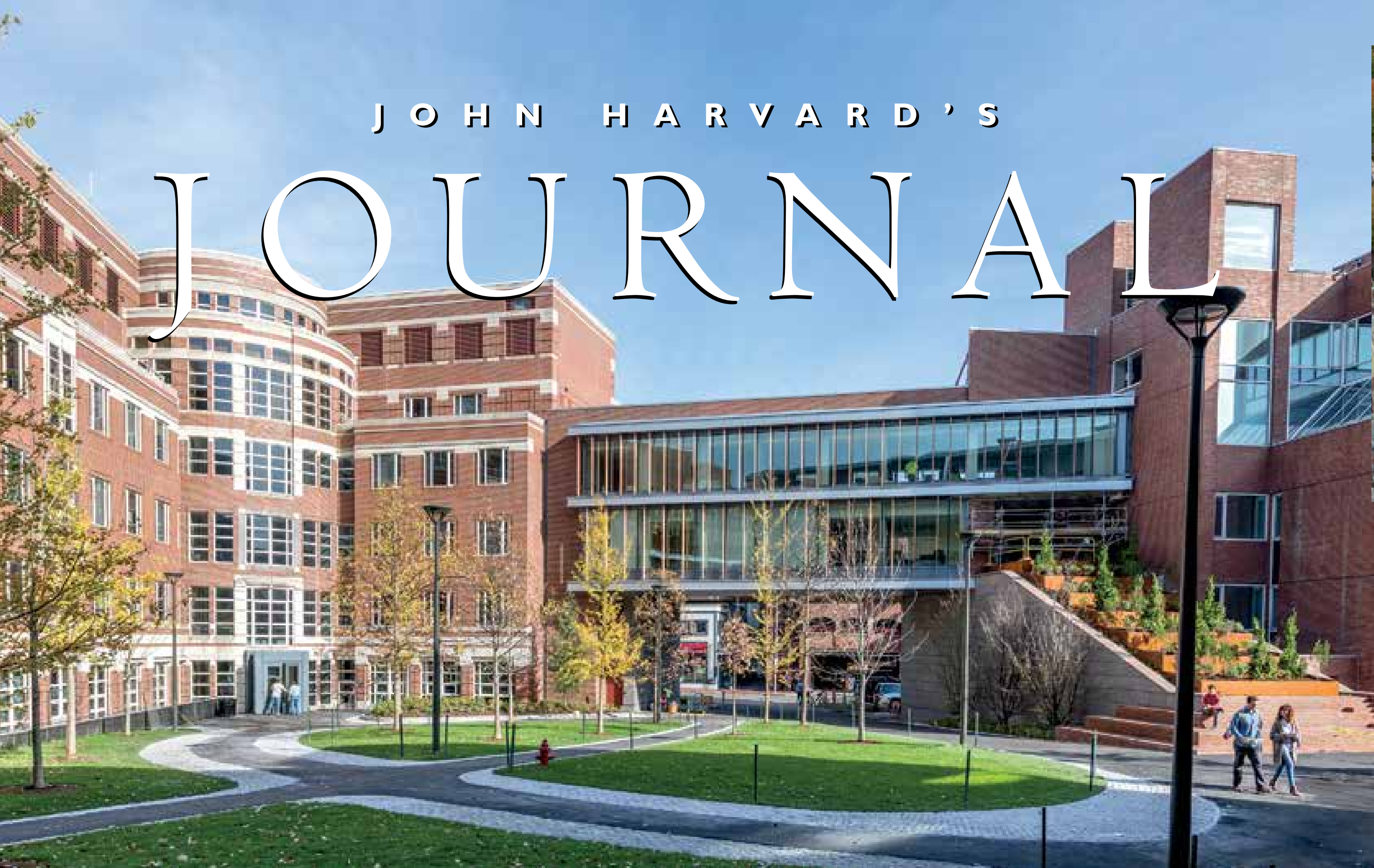
JOHN HARVARD'S JOURNAL



Strengths—and Warning Signs

For the fourth consecutive year, Harvard has reported a financial surplus—and its largest to date: $114 million for the fiscal year ended June 30, 2017. And for at least the fourth consecutive year, the University's senior financial officers have cautioned against taking the good times for granted. They cited the significant boost resulting from the refinancing of much of Harvard's debt in the fall of 2016, which bolstered the results for fiscal 2017. And they are mindful of the decision to hold the distribution from the endowment, the largest source of operating revenue, flat in the current year (reflecting weak investment returns), after relatively robust increases in prior years—making it possible that the fiscal 2018 report will be more constrained.

Highlights of the year included:

- revenue growth of $222 million (4.6 percent), to nearly $5 billion—largely consistent with the quarter-billion-dollar growth (5.5 percent) in fiscal 2016; and
- expense growth of $185 million (3.9 percent), to $4.9 billion, moderating from the 5.3 percent growth in the prior year,

Revenue. The income engines included the annual operating distribution from the endowment (up $81 million, to $1.8 billion: 36 percent of revenue); net tuition and fees (up $56 million, to just more than $1 billion: 21 percent of revenue); sponsored-research funding (up $40 million, to $886 million: 19 percent of revenue); and capital-campaign-driven gifts for current use (up $29 million, to $450 million: 9 percent of revenue).

Undergraduate tuition revenue rose about 4 percent, and graduate- and professional-degree programs yielded about 5 percent more revenue, but with financial-aid scholarships rising just 4 percent, *net* tuition revenue for these programs increased 6 percent. Consistent with recent experience, tuition from continuing- and executive-education programs lapped the field, rising 8 percent; financial administrators hope that momentum can be sustained, providing relief elsewhere in schools' budgets.

Funds for federally sponsored research (about 70 percent of total research support) increased about 4 percent; nonfederal support, principally from foundations, increased about 8 percent, to $267 million. That welcome growth is tempered slightly because nonfederal research sponsors typically provide less "indirect" funding to pay for building, administrative, and related overhead costs—and that was evident this year, when that indirect funding actually declined modestly.

Expenses. Salaries and wages increased 4 percent, to $1.9 billion, reflecting annual merit increases and growth in employement—the latter associated mostly with expanded sponsored research and those continuing- and executive-education programs. Benefits costs rose 7 percent to $569 million, driven by interest-rate-related increases in defined-benefit pension and post-retirement healthcare costs (a factor expected to reverse this year).

The debt refinancing and restructuring in the fall of 2016 trimmed interest expense by $33 million in fiscal 2017—a benefit that will increase during the full 12 months of the current year.

In the meantime, Harvard is conducting

CAMPUS RECONFIGURED: Harvard Kennedy School unveiled its renovated, reconfigured quarters to the public on December 1. In effect, a new ring of buildings has been inserted within the existing one, and below the prior courtyard. A view from the latter (left) shows the bridge structure created to partially enclose the pedestrian and vehicular entrance from Eliot Street. The aerial (above) reveals the layout, the bridge, and the link building that closed the gap facing the Charles Hotel complex to the upper right (west). A detail from within the courtyard; and a new social space connecting dining areas with the JFK Jr. Forum. Read more at harvardmag.com/hks-redo-17.

campus construction at an unprecedented pace: such costs totaled $906 million in fiscal 2017, up from an already torrid level of $597 million in the prior year. (They are largely capitalized and therefore not directly reflected in the annual operating results.) The work encompasses undergraduate House renewal, the science and engineering complex rising in Allston and Harvard Business School's new conference center nearby, the reconfigured and expanded Kennedy School campus (see above), and renovation of Holyoke Center into the Smith Campus Center. The fiscal 2017 total may have been somewhat elevated by a land acquisition, not otherwise described: at year-end fiscal 2017, Harvard held $968 million of land, up from $784 million the prior year (and $672 million at the end of fiscal 2015). Most universities could not afford the luxury of holding a non-earning asset of that size; much is slated for future academic development, but it will be interesting to learn the revenue-generating plans in Harvard's proposal for development of its envisioned "enterprise research campus," on 36 acres of Allston Landing when it is filed with Boston regulators in coming months (see **harvardmag.com/erc-17**).

In prospect. Building activity will continue at a high level through the duration of the marquee projects, necessitating some additional Harvard borrowing in the future. The capital campaign concludes next June 30, so the future flow of current-use gifts merits attention. Gifts for endowment were $551 million in fiscal 2017, up smartly from the prior year, and should continue to flow in as campaign pledges are fulfilled, but they, too, will peak at some point.

The known constraint is internal: the decision to keep the operating distribution per endowment unit level with fiscal 2017. The relatively tepid investment returns during the year, and the multiyear restructuring of Harvard Management Company (HMC; see **harvardmag.com/hmc-summary-17**), aimed at boosting lagging performance, would have kept the distribution under pressure in succeeding years, too, according to the formula the University uses. Accordingly, the Corporation has decided to adopt a "collar" for the next three fiscal years: it has told schools to plan for per-unit distributions to rise between 2.5 percent and 4.5 percent annually, starting with 2.5 percent for 2019 (beginning July 1). That gives deans some budget guidance, while maintaining a relatively conservative posture during Harvard's presidential transition, the changes at HMC, and an uncertain economic and political environment.

I N   T H I S   I S S U E

Photographs ©Peter Vanderwarker. Aerial photograph courtesy of Lee Kennedy & Co.

HARVARD PORTRAIT

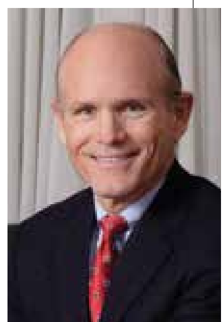
Megan Sniffin-Marinoff

"Want to see some cool stuff?" asks University archivist Megan Sniffin-Marinoff with an expectant grin, reaching for a library cart loaded with treasures from the vault. In one folder, a plaintive letter from then-undergraduate John Hancock to his sister in 1754 ("I wish you would spend one hour in writing to me…"); in another, pictured above, an 1837 "class book" in which senior Henry David Thoreau reflects on his Harvard career ("those hours that should have been devoted to study have been spent scouring the woods…"). There's W.E.B. Du Bois's 1895 doctoral dissertation, with his handwritten corrections; a 1980s Lampoon letter jacket; a 1963 interview request to Malcolm X from journalist Theodore White '38. Harvard archivist since 2004, Sniffin-Marinoff grew up on Long Island and studied journalism at Boston University; working at local newspapers afterward, she found herself a researcher more than a reporter. A master's at NYU—in history, with a secondary focus on archives—led to a job at NYU's archives. Stints at Simmons College and MIT followed, then the deputy directorship at Radcliffe's Schlesinger Library, and, finally, the post at Harvard. Its vast archives are the oldest of their kind in the country. She and her staff are finishing a project to digitize and catalog half a million colonial-period records; soon they'll tackle the nineteenth century. Along the way, they're finding long-buried stories of women and people of color indirectly documented in centuries-old diaries, letters, and ledgers. "We spend a lot of time thinking about what it means to 'document Harvard,'" says Sniffin-Marinoff. One important answer: unearthing the hidden layers of a campus—and a country—"that was always more complex than it seemed." ~LYDIALYLE GIBSON

(More details are available at **harvardmag.com/fas-octmtg-17**. Endowment distributions are explained at **harvardmag.com/distribution-16**.)

A substantial unknown, revealed after the financial report was released in late October, is U.S. tax policy—including, for the first time, a proposed excise levy on endowment income (see "Taxing Matters," facing page).

Even before that news, Harvard's financial leaders were cautioning the community not to expect the 5 percent to 6 percent revenue growth of the past two years to continue. Both economic growth (which has lasted for an unusually long time, with unusually low interest rates and robust financial markets) and the capital campaign are long in the tooth. Continuing and executive education and current-use giving are sensitive to economic conditions and to fundraising fatigue. A weaker economy would increase families' need for financial aid, driving up those costs. And all that construction drives higher campus operating costs and depreciation, both of which are already rising.



Thomas J. Hollister

PAIGE BROWN/COURTESY TUFTS MEDICAL CENTER

Given those factors, vice president for finance Thomas J. Hollister (the University's chief financial officer) and University treasurer Paul J. Finnegan, used their message in the annual report to look past the bounty to the concerns that come naturally to their species. The fiscal 2017 operating surplus, they stressed, "may represent a high-water mark for the foreseeable future," given revenue constraints throughout higher education. The entire sector's business model, they maintained, "is under enormous pressure," because a half-century of growth (in enrollments, federal research funding, and endowment-fueled investment income) has run its course. "Higher education has matured as a industry….The industry is showing financial strain, even in these comparatively healthy economic times"—and even with the welcome complement of a supernova capital campaign that has recorded more than $8 billion in pledges and receipts.

"Our deans and administrative staff are first focused on mission excellence," they continued, "but they are also increasingly focused on cost containment and newer sources of mission-related revenues….We raise this

Photograph by Stu Rosner

not as a matter of discouragement, but simply to signal to the University's many friends, supporters, alumni, faculty, students and staff that the University, and its schools and units, will need to further adjust to the environment, change, and embrace new ways of extending Harvard's excellence in the future."

A detailed report appears at **harvardmag.com/budget-17**. ~JOHN S. ROSENBERG

Taxing Matters

THE FEDERAL TAX LEGISLATION being considered in Congress as of press time—drafted by Republicans without consulting Democrats, and advanced without benefit of hearings—contains a *lot* of surprises for higher education. At least one version of the bills proposed:

- ending deductions for interest on student loans (which would affect the overwhelming majority of students who do *not* attend well-endowed institutions with need-blind admissions that can extend aid for students' full financial need);
- eliminating a tax-code provision many institutions rely on to aid graduate students (making those students liable for *cash* taxes on *imputed* income; Harvard hasn't yet been able to determine if the precise language would affect its graduate students); and
- ending the tax-exempt status of bonds routinely issued by universities, and other nonprofit institutions, to fund buildings and construction projects (effectively raising their costs).

Whatever their collective implications, if enacted, for U.S. higher education and the skills of future citizens, a separate provision—to impose a 1.4 percent excise tax on the endowment income of several dozen private colleges and universities—has prompted the greatest concern at Harvard. It represents the first time a proposal to tax endowments has advanced this far; if enacted, it would set a precedent for taxing endowments more heavily.

It is no surprise that the tax-bill authors would seek any possible, politically palatable sources to offset the multi-trillion-dollar losses of revenue accompanying their proposed tax cuts (they seek to contain the net 10-year cost to $1.5 trillion). Nor is their interest in tapping endowment wealth news: Senator Charles Grassley (Iowa) has long sought to mandate a minimum annual distribution, and Representative Tom Reed (New York) has more recently sought to mandate that 25 percent of endowment income be spent on financial aid. That the current proposal would target private institutions more or less follows: that's where the money is; and recent polls indicate wide disaffection toward higher education among Republican-leaning voters. Of note, *The Chronicle of Higher Education*'s most recent tally of selective colleges whose students incur the *least* federal loan debt to pay for their educations overlaps almost exactly with the list of those highly endowed institutions.

In Harvard's fiscal year ended June 30, 2017, funds distributed from the endowment to support the academic enterprise totaled $1.8 billion, or 36 percent of revenue. Were the excise tax in effect, the University's bill that year would have been about $40 million (see the calculations at **harvardmag.com/endowment-tax-17**): slightly less than 1 percent of revenue. Because the Corporation aims, over time, to distribute about 5 percent of the endowment's value each year to support the University's operations, that tax payment has the same effect as wiping out nearly $1

COUNTERCLOCKWISE FROM TOP RIGHT: RENDERING BY BARKOW LEIBINGER ARCHITEKTEN; STEPHANIE MITCHELL/HPAC; MARTHA STEWART/HARVARD LAW SCHOOL; COURTESY OF UNITED STATES COAST GUARD HISTORIAN'S OFFICE; STEPHANIE MITCHELL/HPAC