Rice’s Finances: Correcting the Record

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A recent public lecture about the prospects of a merger between Rice and BCM included incorrect information about Rice’s finances. The following slides provide correct information, including:

- The impact of a $1 billion reduction in endowment value on budget projections for FY2010 and beyond.
- The role of debt in Rice’s finances.
- The financing plan for a possible Rice–BCM merger.
Important facts to keep in mind:

• Endowment market value, not investments, is the basis for budgeting the endowment distribution.
• Endowment market value less debt is not a relevant measure of debt impact because Rice does not invest debt proceeds in the endowment.
• The numbers shown as “investment return” in the public lecture were actually endowment distributions allocated for operations.
### Rice’s Finances: Key Measures
($ in millions)

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Ending Endowment Market Value</th>
<th>Endowment Return Gain/(Loss)</th>
<th>Trailing 13-qtr. average MV at June 30**</th>
<th>Endowment Distribution for Operations</th>
<th>Total Operating Expenses *</th>
<th>Debt *</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000</td>
<td>3,372</td>
<td>509</td>
<td>2,743</td>
<td>124</td>
<td>240</td>
<td>145</td>
</tr>
<tr>
<td>2001</td>
<td>3,243</td>
<td>(18)</td>
<td>2,997</td>
<td>139</td>
<td>259</td>
<td>164</td>
</tr>
<tr>
<td>2002</td>
<td>2,940</td>
<td>(178)</td>
<td>3,079</td>
<td>144</td>
<td>288</td>
<td>189</td>
</tr>
<tr>
<td>2003</td>
<td>2,938</td>
<td>127</td>
<td>2,993</td>
<td>153</td>
<td>316</td>
<td>203</td>
</tr>
<tr>
<td>2004</td>
<td>3,302</td>
<td>497</td>
<td>2,946</td>
<td>160</td>
<td>334</td>
<td>210</td>
</tr>
<tr>
<td>2005</td>
<td>3,611</td>
<td>443</td>
<td>3,062</td>
<td>167</td>
<td>350</td>
<td>205</td>
</tr>
<tr>
<td>2006</td>
<td>3,987</td>
<td>517</td>
<td>3,392</td>
<td>174</td>
<td>371</td>
<td>223</td>
</tr>
<tr>
<td>2007</td>
<td>4,670</td>
<td>851</td>
<td>3,777</td>
<td>182</td>
<td>396</td>
<td>492</td>
</tr>
<tr>
<td>2008</td>
<td>4,610</td>
<td>99</td>
<td>4,151</td>
<td>201</td>
<td>424</td>
<td>681</td>
</tr>
<tr>
<td>2009</td>
<td>3,613</td>
<td>(837)</td>
<td>4,127</td>
<td>215</td>
<td>467</td>
<td>726</td>
</tr>
</tbody>
</table>

*Source: Audited Financial Statements

**Trailing 13-quarter average is used for planning endowment distributions.
<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Ending Endowment Market Value</th>
<th>Endowment Return Gain/(Loss)</th>
<th>Trailing 13-quarter Average MV at June 30</th>
<th>Endowment Distribution for Operations</th>
<th>Endowment Spending Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007</td>
<td>4,670</td>
<td>851</td>
<td>3,777</td>
<td>182</td>
<td>5.4%</td>
</tr>
<tr>
<td>2008</td>
<td>4,610</td>
<td>99</td>
<td>4,151</td>
<td>201</td>
<td>5.3%</td>
</tr>
<tr>
<td>2009</td>
<td>3,613</td>
<td>(837)</td>
<td>4,127</td>
<td>215</td>
<td>5.2%</td>
</tr>
<tr>
<td>2010</td>
<td>3,716</td>
<td>295</td>
<td>3,975</td>
<td>222</td>
<td>5.4%</td>
</tr>
<tr>
<td>2011</td>
<td>3,831</td>
<td>304</td>
<td>3,716</td>
<td>219</td>
<td>5.5%</td>
</tr>
<tr>
<td>2012</td>
<td>3,955</td>
<td>315</td>
<td>3,716</td>
<td>221</td>
<td>5.9%</td>
</tr>
<tr>
<td>2013</td>
<td>4,088</td>
<td>325</td>
<td>3,835</td>
<td>222</td>
<td>6.0%</td>
</tr>
<tr>
<td>2014</td>
<td>4,231</td>
<td>336</td>
<td>3,964</td>
<td>223</td>
<td>5.8%</td>
</tr>
<tr>
<td>2015</td>
<td>4,383</td>
<td>349</td>
<td>4,102</td>
<td>227</td>
<td>5.7%</td>
</tr>
</tbody>
</table>

Note: Trailing 13-quarter average is used for planning endowment distributions; endowment spending rate is the fiscal year distribution as a percent of the prior 13-quarter average. Planning assumptions: FY2010–15 investment returns are assumed to be 8.5 percent annually with a 2 percent reduction in distribution in FY2011, a flat base distribution in FY2012–14 and $30 million of new gifts and associated distribution each year.
Rice’s endowment spending policy provides for flexibility in determining the annual payout. This is important because the endowment distribution supports or provides:
- 46 percent of all operating revenues.
- 62 percent of revenues that support the core budget (A1 and endowment-funded budget).

Rice is more endowment-dependent than other universities.

The endowment market value is averaged over 13 quarters to smooth fluctuations in the endowment payout from year to year.

The board-approved endowment spending policy calls for the university to distribute (“the payout”):
- Between 4 percent and 6.5 percent of a 13-quarter average of the endowment market value.
- Ideally within a range of 4.5 percent to 5.5 percent of the 13-quarter average market value.

The board approves the annual distribution to support the budget.
Impact of Endowment Loss on Rice’s Operating Budget

• The FY2009 decrease of $1 billion impacts the 13 quarter average used in calculating the endowment distribution for FY2010, FY2011 and FY2012.
  – The lower average market value results in a higher endowment spending rate, which requires action to bring spending back to the target range of 4.5 to 5.5 percent of the 13-quarter average.

• In FY2011, the distribution will likely be reduced by $4 million to $6 million and may stay flat for several years thereafter (except for distributions from new gifts).

• This endowment strategy means less revenue for the operating budget at a time when costs are increasing, especially for new facilities and resumption of pay raises.
  – Our initial projections for the capital plan assumed 4 to 4.5 percent annual growth in the endowment distribution. The financial downturn significantly changed those projections.
  – This situation is a major reason further cuts are needed in the FY2011 budget.
Role and Impact of Debt on Rice’s Finances

• The charter was revised in 1998 to allow Rice to issue debt to fund capital project costs not covered by gifts or spending from the endowment.
  – Rice does not use debt in management of the endowment portfolio. Therefore, the leverage ratio for the endowment is zero.
  – Debt financing costs are built into budget projections.
  – The Board of Trustees approves the overall level of debt issued by the university.

• Both Moody’s (Aaa) and Standard and Poor’s (AAA) have given Rice their highest rating.
  – Ratings are important because they are a statement of credit strength (i.e., financial flexibility) and hence impact the cost of borrowing.
  – S&P reaffirmed Rice’s AAA rating in October.
  – There are 11 private universities, one theological seminary and six liberal arts colleges rated Aaa by Moody’s.

• Moody’s has Rice on a watch list pending resolution of the merger.
  – Acquiring a medical school could result in a rating downgrade.
  – Rice can afford to achieve its strategic goals if downgraded to AA/Aa. The cost of borrowing would increase slightly.
  – Many peer institutions are rated Aa: University of Chicago, Carnegie Mellon, Duke, Brown, Cornell, Emory, Penn, Vanderbilt and Johns Hopkins. CalTech is rated AAA by S&P and Aa1 by Moody’s.
How Is a Merger Financed?

- Rice will not bear the cost alone but will make a substantial investment to support the merger.
  - Rice would provide about 25 percent of the resources needed.
  - Rice does not plan to own or complete the BCM hospital, although others may.

- As a condition for proceeding with a merger, the following are required:
  - Written commitments for substantial philanthropy.
  - Contractual agreements with hospitals for their support.
  - A sustainable plan for BCM’s finances, including a solution for the McNair campus and associated debt, and elimination of BCM’s operating deficit.

- Rice does not propose a “bailout” but rather financial and clinical conditions under which BCM can thrive and enhance Rice.