A Financial Primer

University Resources

It’s all about the Money

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FOLLOW THE MONEY

And your favorite cliché’ is . . . .

- He who has the gold makes the rules
- A fool and his money are soon parted
- Money is like muck, not good for anything except to be spread around
- Nothing is so secure that money cannot defeat it
- A million here, a million there . . . pretty soon we’ll be talking real money
- Money will not buy happiness, but it will let you be unhappy in nice places

A Financial Primer

University Resources

It's all about the Money

The Agenda:

Where does it come from:	**Income and revenue**
	Debt
Playing by the Rules:	**Financial Disclosure**
	Procurement Policy
Where does it go:	**Expense patterns**

Case studies

Our “Featured” Vocabulary

Some terms to get us started:

Arbitrage – borrowing money to invest to make money

Bad money – taxable money

Good money – tax exempt funds

Deferred Maintenance – maint. rolled to a future time

GAAP – Generally Accepted Accounting Principles

HEAF – Higher Education Assistance Fund

NPV – Net Present Value, or time value of money

PUF – Permanent University Fund

Sarbanes-Oxley – 2002 law on company Board oversight

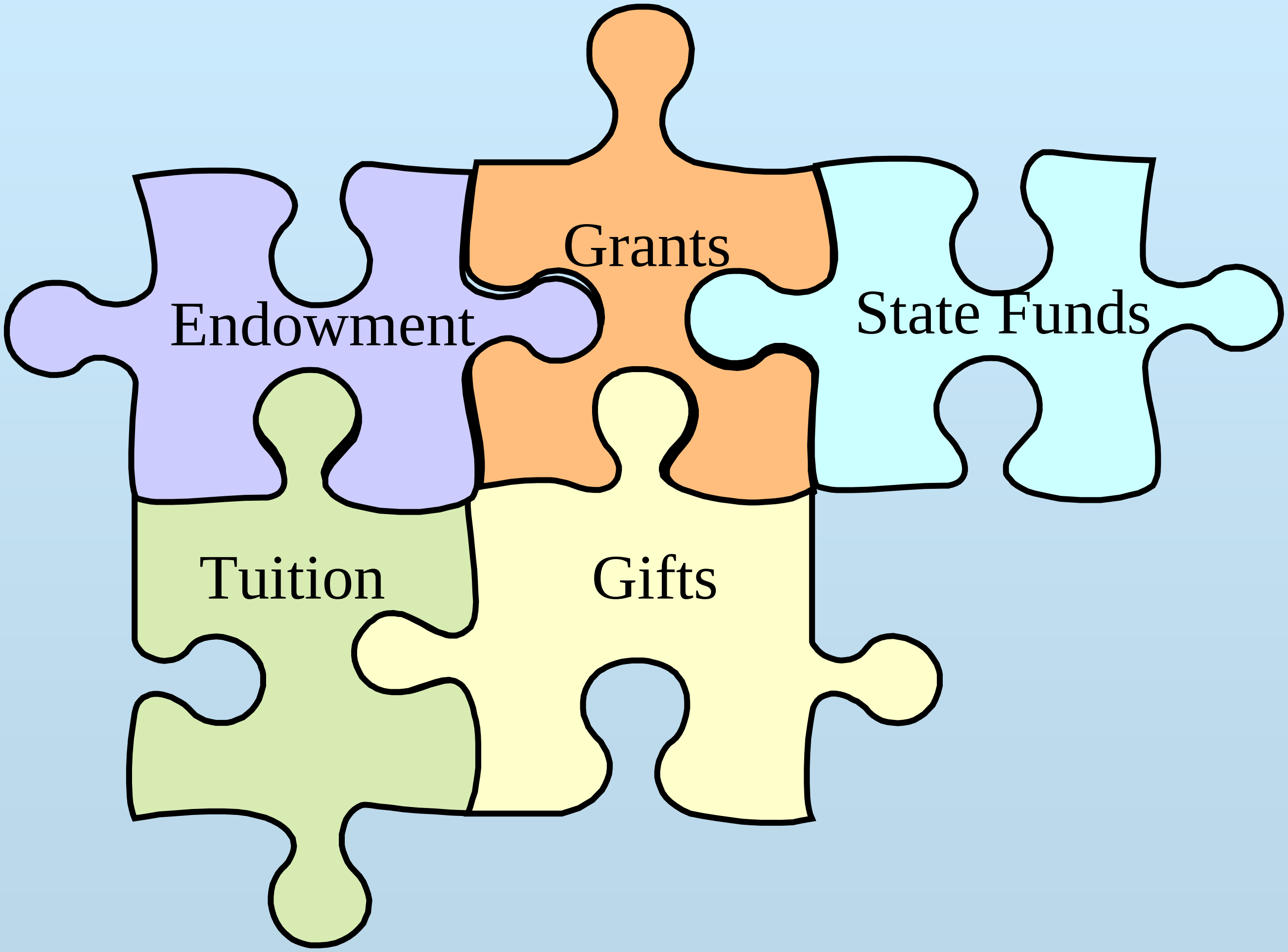
Yield – how much interest an investment is earning

Income and Revenue:

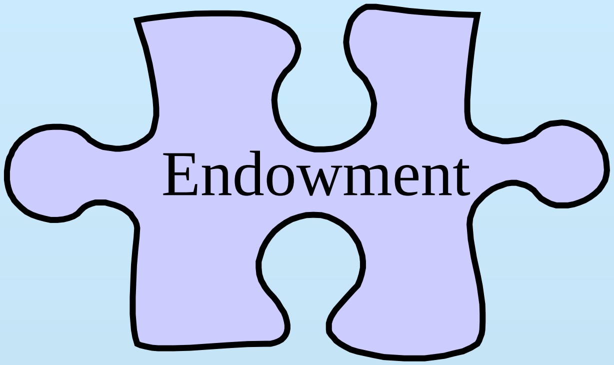
Typical Proportions of Revenue

Public	Source	Private
4%	Income from Endowment	38%
30%	State funds	0%
10%	Research	15%
32%	Tuition *	32%
16%	Gifts	8%
8%	Auxiliaries	7%

Income and Revenue:



Income and Revenue:



Basic Lexicon

1. Restricted vs. Unrestricted

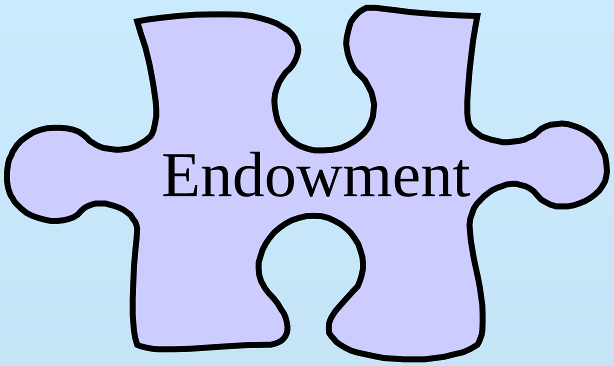
2. Market Value

2. Spending Plan

3. Funds Functioning As Endowment (FFAE)

4. Composition or pool

Income and Revenue:

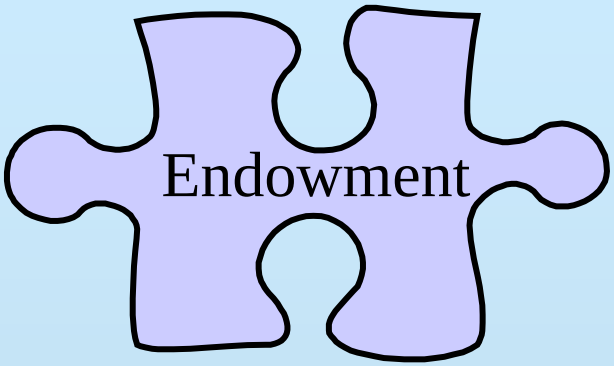


<u>Basic Rules</u>

1. Restricted - never touch the principal – it's the law!
2. Unrestricted – as a rule, don't touch the principal, but you could
3. Spending Plan – Different rules for different schools

   Ideally, use less than total earnings: extra proceeds go back to grow the endowment – the FFAE

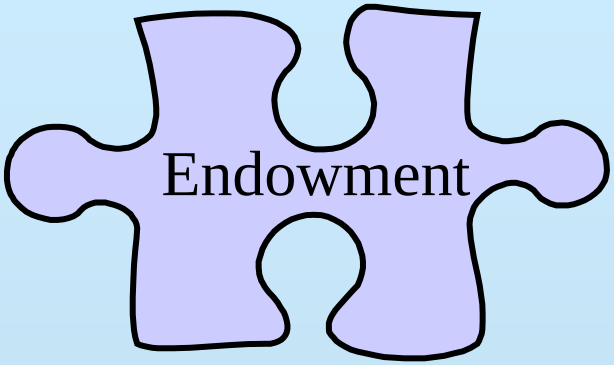
Income and Revenue:



A Sample Composition of an Endowment Pool:

Public	Investment	Private
65%	Stocks	50%
24%	Partnerships/hedge funds	25%
7%	Fixed securities/bonds	10%
2%	Real estate	10%
2%	Minerals	5%

Income and Revenue:



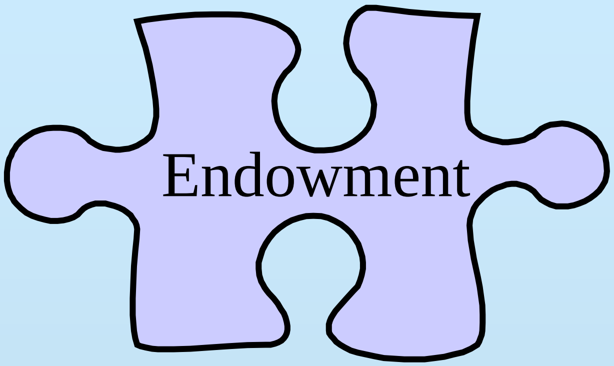
Spending Plan

Rules for distributing income from the endowment

A "typical" spending plan:

> "5 % of the market value of the endowment will be available for operating funds as long as the resulting distribution is at least 4% but not more than 6% of a 3 year moving average of endowment market value."

Income and Revenue:



Spending Plan

For example:

Endowment current market value at $5 billion

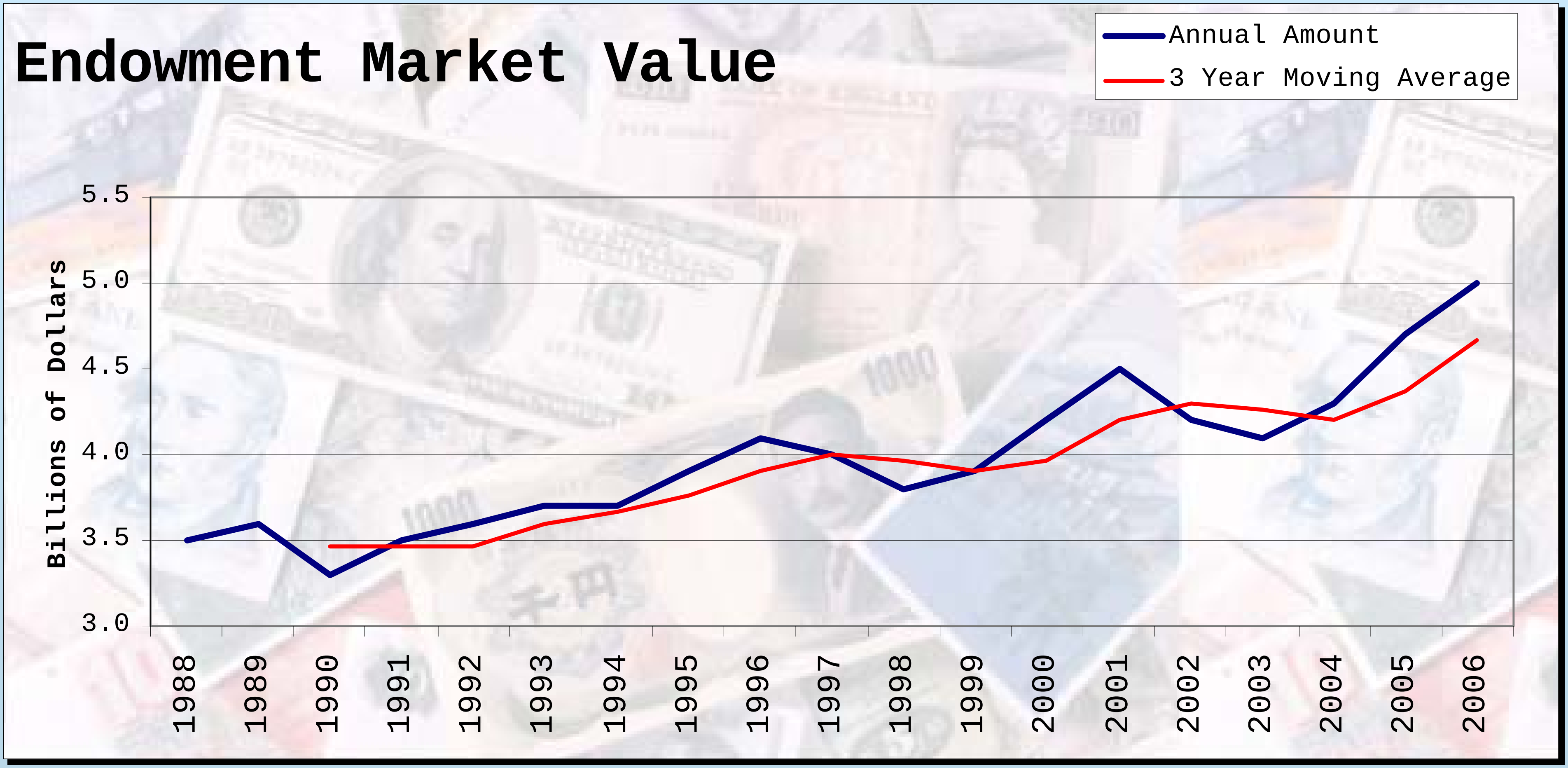
5% of $ 5 billion = $250 million

Endowment was $ 4.1 billion, $4.3 billion, and $4.7 billion at the end of each of the last 3 years

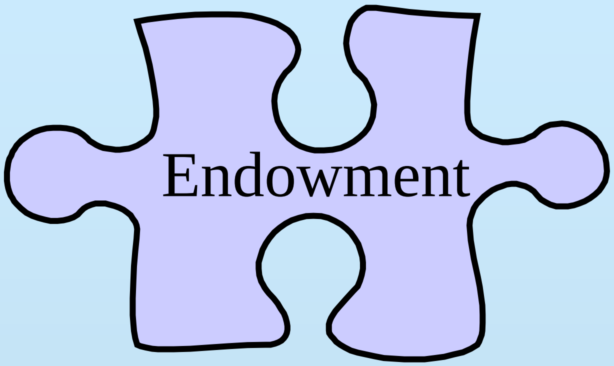
3 Year average market value = $4.36 billion

$250 million/ $ 4.36 billion = 5.7%

Income and Revenue:



Income and Revenue:



Spending Plan

So what if actual endowment income is $ 600 million:

Spending plan says 5%, or $250M distributed for use.

$ 600M earned minus $250M used = $350M available.

What do you do with the leftovers?

REINVESTED: The $350 million becomes FFAE (funds functioning as endowment) to either cover the “short” years or create even more income in future years.

Income and Revenue:

Tied to the amount of research

In private schools, most often from federal government, but also from state, industry, or private foundations

Unsolicited – school initiated

Solicited – response to agency RFP

50% award on proposal requests is considered very successful

Income and Revenue:

In Public Schools:

Significant State Grant for Clinics, Public Services

Federal Earmarks – “Your Pork is my Treasured Entitlement”

Increasing Grants increases other costs

Income and Revenue:

Each university has a centrally staffed proposal review group; maybe called research office

The rules:

A true "grant" – lots of flexibility in research

A "contract" – very defined scope of research

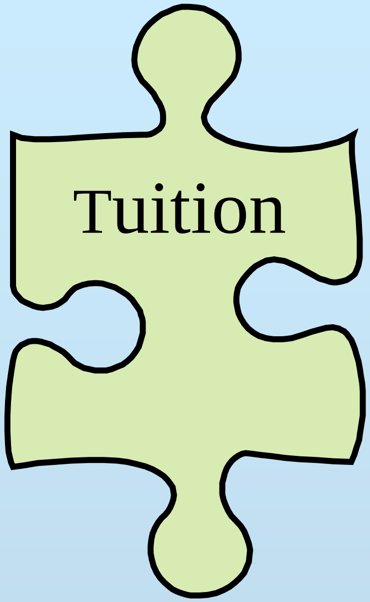
Direct costs and Indirect costs (overhead)

Always a timeline; a start and stop date

Frequently audited - >50%

Record keeping <u>very important</u>

Income and Revenue:



For private schools, tuition almost always follows endowment; maybe others

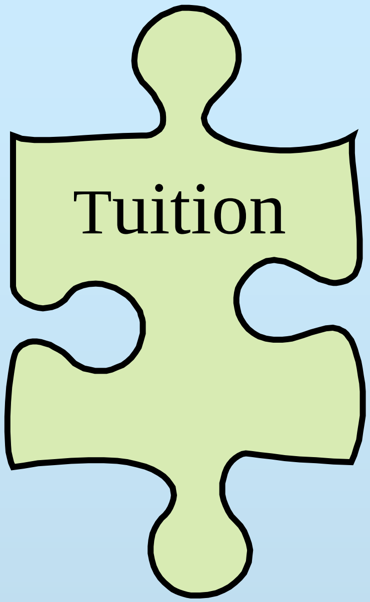
For public schools, it's the top source

Competitive - must remain best value to peer schools

Tuition at Public Schools – a more complicated process:

- Designated, Deferential, & Statutory
- Resident vs. Non-Resident
- Raising Fees vs. Raising Tuition

Income and Revenue:



Components:

Cost – actual expenses for instruction

Price – the advertised tuition

Subsidy – the “discount” between cost and price

According to NACUBO, larger universities had an average discount rate of 34%

56% of UH students receive financial aid

60% of Rice students receive financial aid

Income and Revenue:

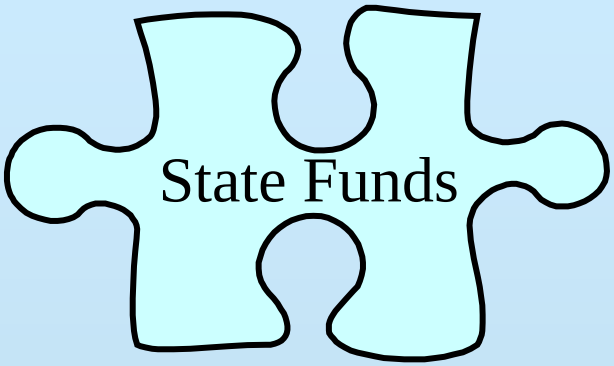
Typically for a specific use – restricted

Often come as pledges to be paid over a period of time

Development office works with donors to “package” the gift

Principal is sacred – never touched

Income and Revenue:



Moving Target:

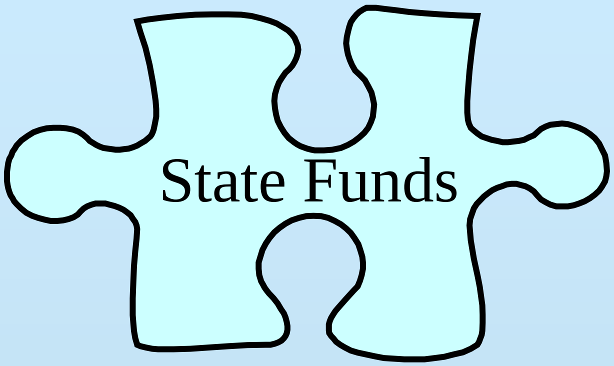
from State Funded

to State Supported

to State Assisted

- State appropriations are 30% of FY06 Budget
- State support decreasing from > 50% in 80’s to 27% next fiscal year
- Some Public schools now receive < 15% of budget from State
- State Funding a Combination of Sources/Calculations

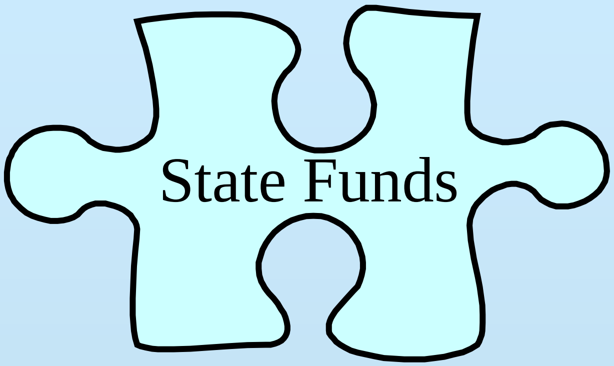
Income and Revenue:



Formula Funding:

- Most States funding enrollment based on Quantity not Quality
- Based on “Type of Student:
  - $1 for freshman Liberal Arts
  - $26 for Medical Student
- Texas funds 65% of “Formula Calculated Need”
- Equal to 60% of TX State higher Education Funding in FY06

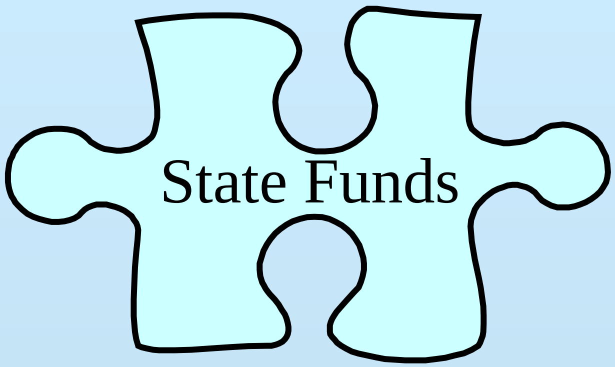
Income and Revenue:



Position Funding/ State Benefits:

- States vary in how calculate/fund Positions
- Texas funds only benefits of “E&G positions”
  - assumes wages and other costs in formula
- Some states fund positions directly but assume more control
- Equal to 13% of TX State higher Education Funding in FY06

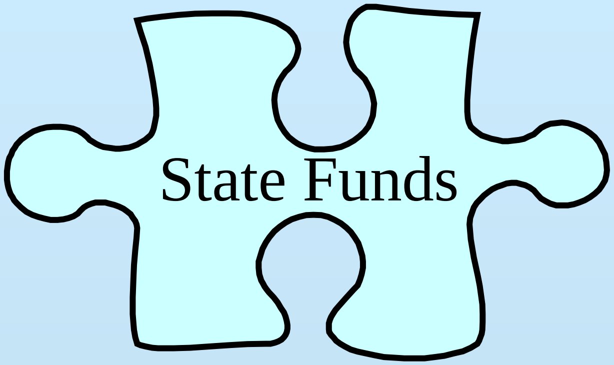
Income and Revenue:



Capital construction and
Tuition Revenue Bonds (TRBs)

- Capital Construction funded as economy permits
- Expect TRBs to decrease in the future or State to Only Fund %
- Equal to 5% of TX State higher Education Funding in FY06

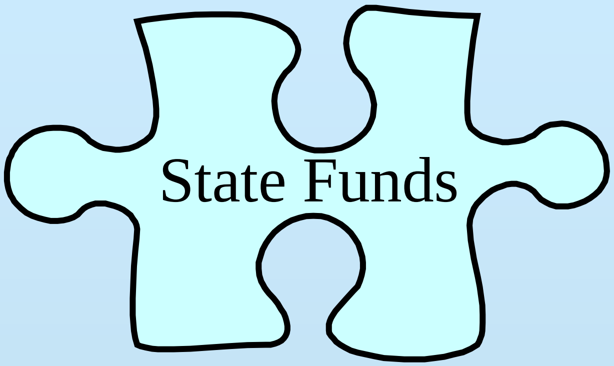
Income and Revenue:



Deferred Maintenance:

- Higher Education Assistance Fund (HEAF)
- Public University Fund (PUF)
- States vary in deferred maintenance funding
  - most leave it to the University
- Equal to 12% of TX State higher Education Funding in FY06

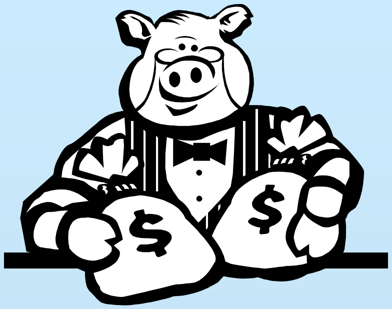
Income and Revenue:



Those “Special” Items:

- “Political Appropriations” designated for very specific uses
- Equal to 10% of TX State higher Education Funding in FY06

Debt:



Used for major capital expenses

NOT used for routine maintenance or operations

General idea is to leverage the endowment:
let your endowment earn a higher yield than the interest you pay on the debt

Typical Types:

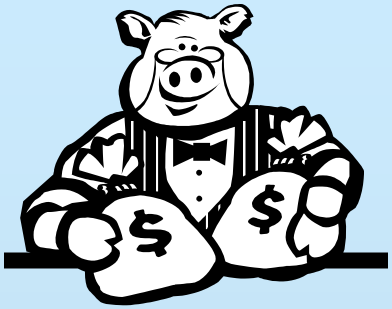
Bonds

Commercial Paper

Either can be taxable or non-taxable

Debt:

Bonds:



Bond sales are effort intense – lots of work

Sold in blocks; you get cash

Strict time frame for spending the money

Illegal: Cannot profit from proceeds of tax exempt bonds

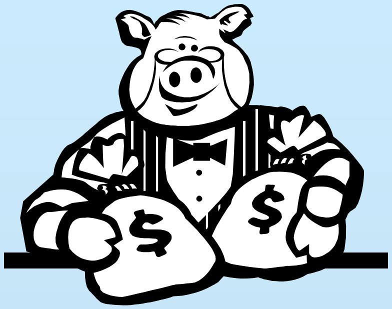
You will jeopardize your tax free status

Consider:

Postpone repayment of principal

Interest only for the first few years

Debt:



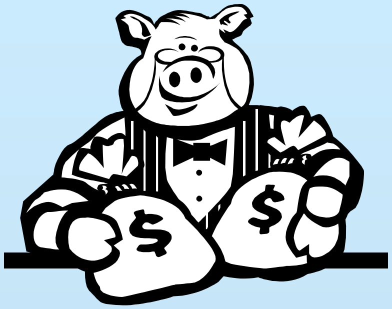
Bonds (continued):

Tax-exempt bonds only for typical university functions

Must use taxable bonds for:

- Unrelated income producing activities
- Religious activities

Debt:



Commercial Paper

Very short term

maximum period NTE 270 days

Limited volume – funding ceiling in effect

Quicker – fast turn around

Think of CP as a line of credit

Typically use a follow-on issue to pay off an earlier draw

Financial disclosure:

No debt without good credit!

Bond ratings:

Top agencies: Standard and Poor
Moody
Fitch

Rating scale: AAA, Aaa, A1, etc.

Disclosure information:

1. Financial Statements
2. Market position
3. Strength of School/Administration
4. Condition of the State (government) for Public Schools

Financial disclosure:

1. Financial Statements:

Balance sheet:

- Snapshot in time of assets, liabilities, and equity

Income Statement:

- Revenues, expenses, and income over a given period
- Potentially the most analyzed of the financial statements

Cash flow statement:

- Cash turnover

GAAP standards

Financial disclosure:

Balance Sheet:

Le' Balance Sheet

Assets:	
Cash	$1,000,000
Land	5,000,000
Pledges	500,000
Total	$6,500,000
Liabilities:	
Bills due	$ 750,000
Loans	150,000
Pesky lawsuit	100,000
Total	$ 1,000,000
Equity:	
Net worth	$5,650,000

Financial disclosure:

Income Statement

Also known as profit/loss statement:

Le' Income Statement

Income:	
Endowment	$10,000,000
Tuition	9,000,000
Research	3,000,000
Gifts	198
Total	$22,000,198
Expenses:	
Salaries	$ 6,000,000
Depreciation	1,250,000
Interest paid	250,000
Total	$ 7,500,000
Net income:	$14,500,198

Financial disclosure:

Cash Flow Statement:

Le' Cash Flow Statement

Cash on hand 4/30		$2,000,000
Net cash inflow:		
Cash receipts	$	100,000
Bond sale		150,000
Endowment earning		75,000
Total	$	325,000
Cash out:		
Interest paid	$	50,000
Payroll		75,000
Project costs		100,000
Total	$	225,000
Cash on hand 5/31		$2,100,000

Financial disclosure:

The Other Disclosures:

2. Market Position:

i. Market value of the endowment

ii. Existing debt

3. Strength of School/Administration:

i. Number of applicants

ii. Number of students

iii. Acceptance rate

iv. Caliber of administrators

plus other items of importance to the lenders

4. Strength of State

Procurement rules:

Private Schools:

Best management practices

School reputation

Typical controls:

Approval authority hierarchy

Contracting standards

Number of bidders by dollar value threshold

Procurement rules:

Public Schools:

More restrictions and approvals required

Expanded reporting requirements

Restrictions on State Expenses:

No food, travel, entertainment, gifts, awards, auxiliaries, parking, religious, or athletic expenses allowed

Other restrictions on gift acceptance

Procurement rules:

Public Schools (cont'd):

State Coordinating Board Regulations

Federal & State HUB Requirements

Energy & Utility Regulations

TX, GLO, SECO, Governor's Office

State Insurance Restrictions – SORM

Tuition & Scholarship Restrictions/Regulations

Texas Middle Income Requirements

Private Business Competition

Real Estate Prohibitions

Procurement rules:

Public Schools (cont'd):

Advantages:

State Procurement Consortiums

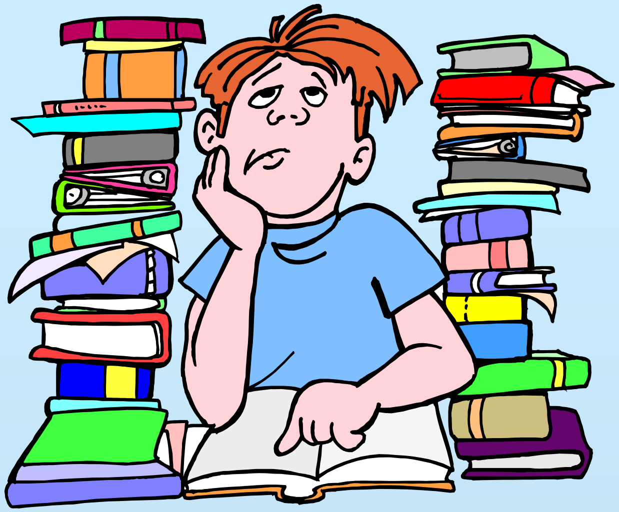
Texas Marketplace Requirements

Expenses:

Sample Distribution of Expenses

Public	Expense	Private
51%	Labor/Compensation	55%
22%	Maintenance/Operations	23%
8%	Capital improvements	4%
5%	Equipment	3%
2%	Interest	3%
10%	Scholarships *	11%
2%	Other	1%

Expenses:



- Little discretionary room in budgets – under 5% at UH
- Research is expensive; government grants are increasingly important
- Growth in government research grants are low or flat
- Low student/faculty ratios are attractive, but inefficient
- Utility, healthcare, and insurance costs are skyrocketing

CASE STUDIES