Financial Considerations in Planning

EDS Board of Trustees, July 12, 2016

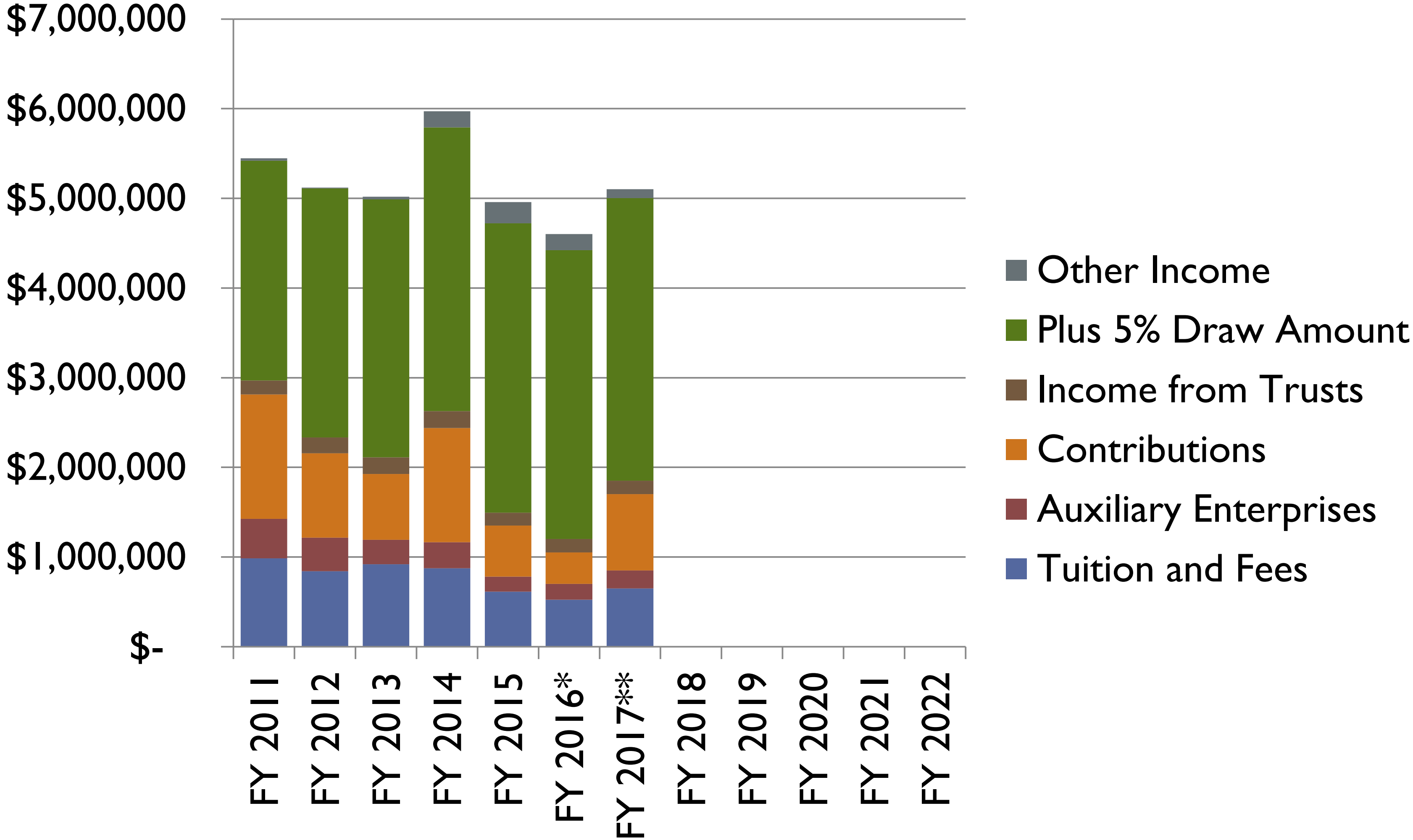
Outline

- Introduction
- What might happen financially if we project our finances using some initial assumptions?
- What are the most powerful factors that can affect EDS' future?
- What elements of the Futures Committee recommendations and Board considerations have large potential financial implications?
  - Advancement
  - Expenditure reduction through alliances
  - Property reconfiguration
- Significant Potential Financial Decisions

Notes

- Projections are not predictions.
- Projections are not plans.
- Projections are thought experiments, useful for uncovering assumptions about what is possible and realistic, and for understanding the financial dynamics of the school.
- "All models are wrong, but some are useful."

Revenue History, FY2016 Forecast, and FY 2017 Budget



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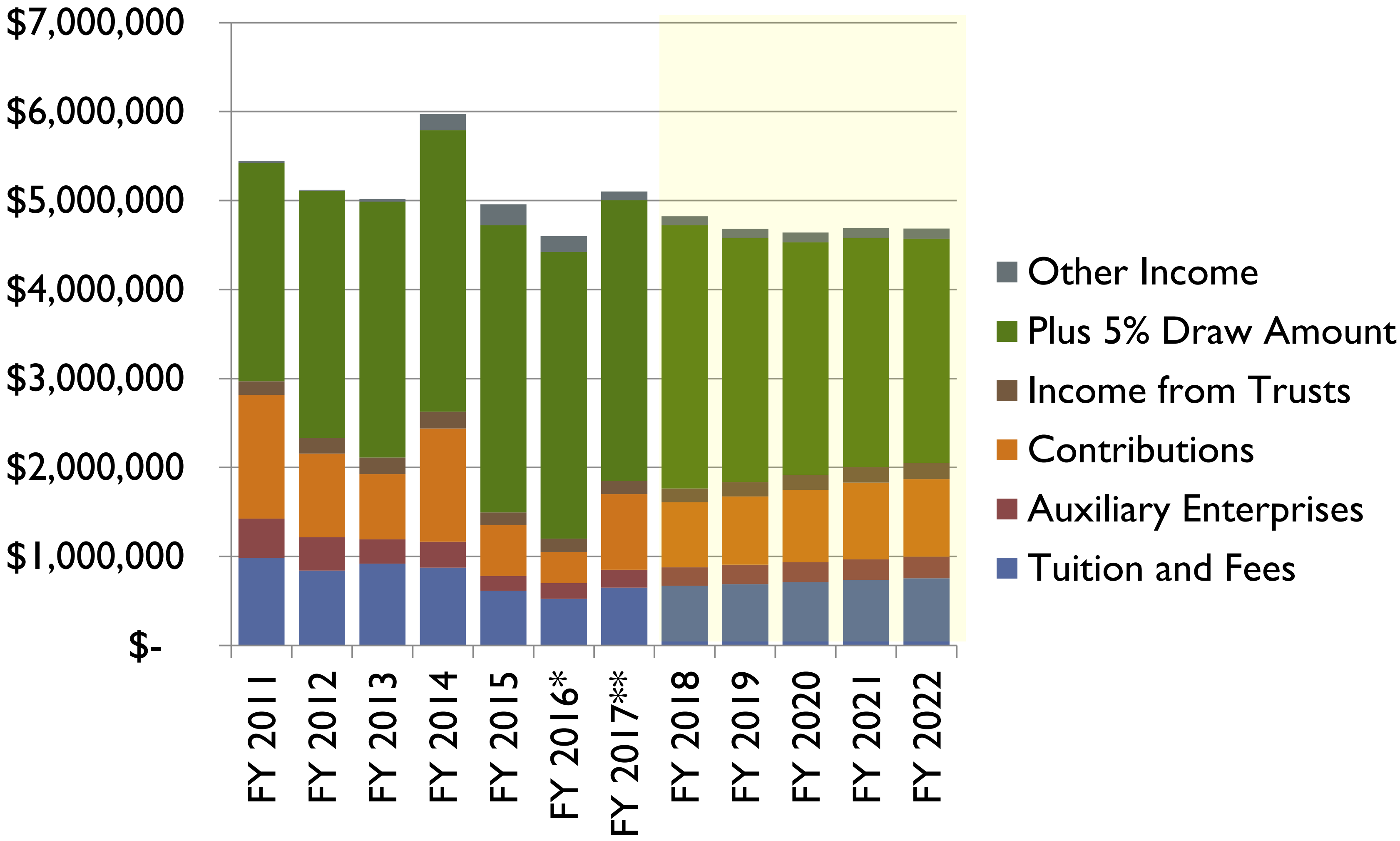
Revenue History, FY2016 Forecast, FY2017 Budget, and Projected Revenues.



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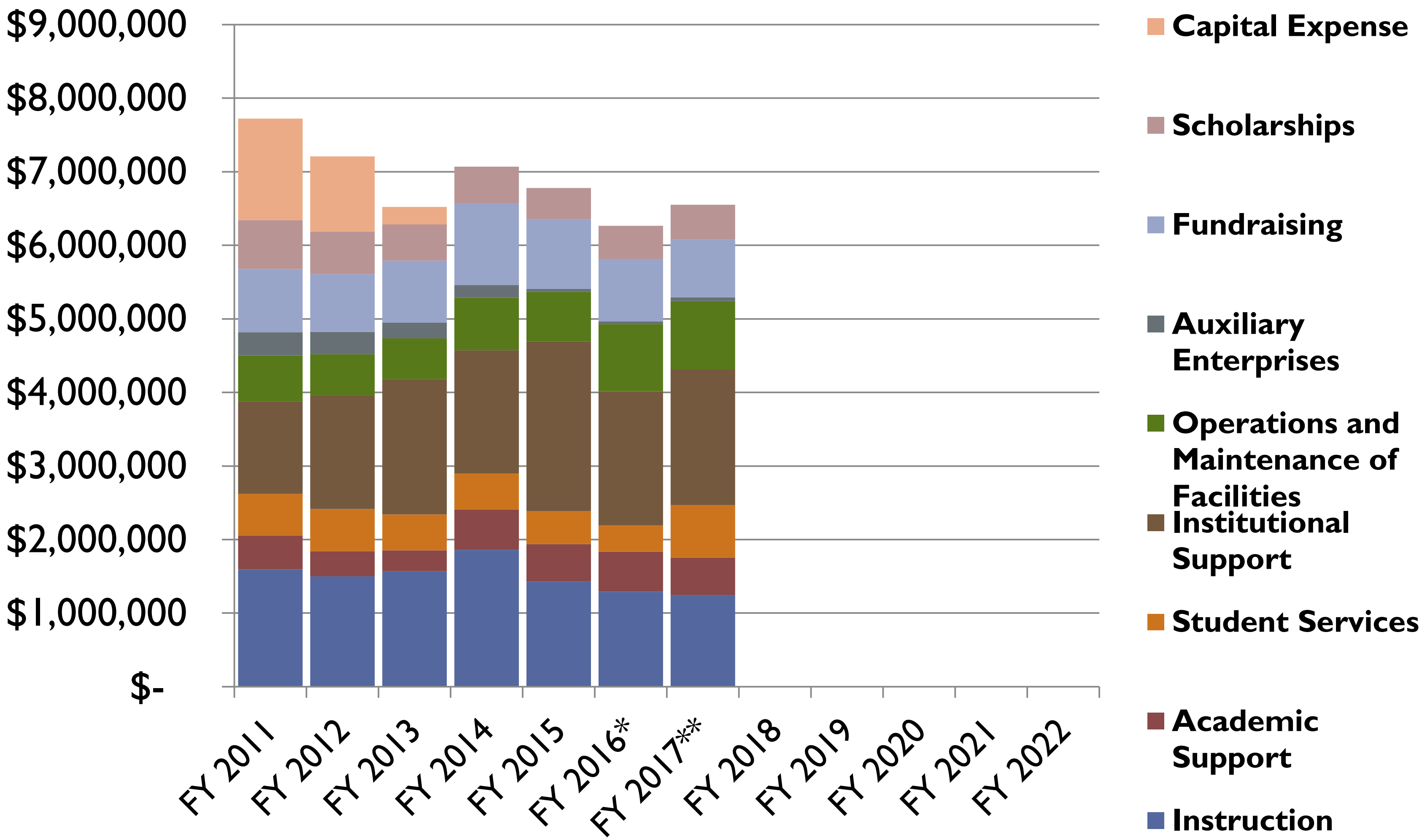
Expenditure History, FY2016 Forecast, and FY2017 Budget.

Includes capital projects funded by withdrawals from financial assets in FY2011, FY2012, FY2013.



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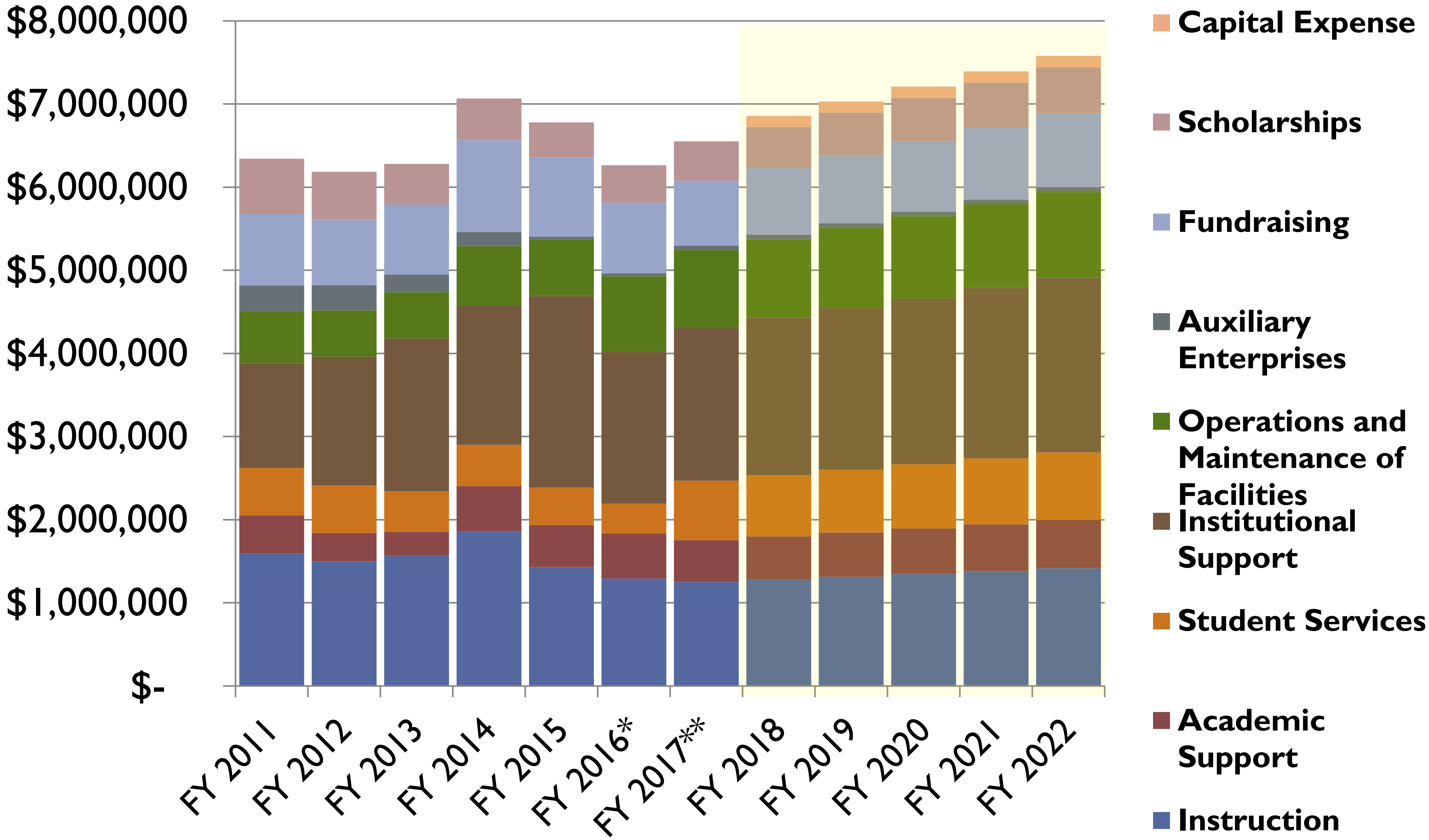
Expenditure History, FY2016 Forecast, FY2017 Budget, and Projections.

Includes capital projects funded by withdrawals from financial assets in FY2011, FY2012, FY2013, FY2018 and beyond.



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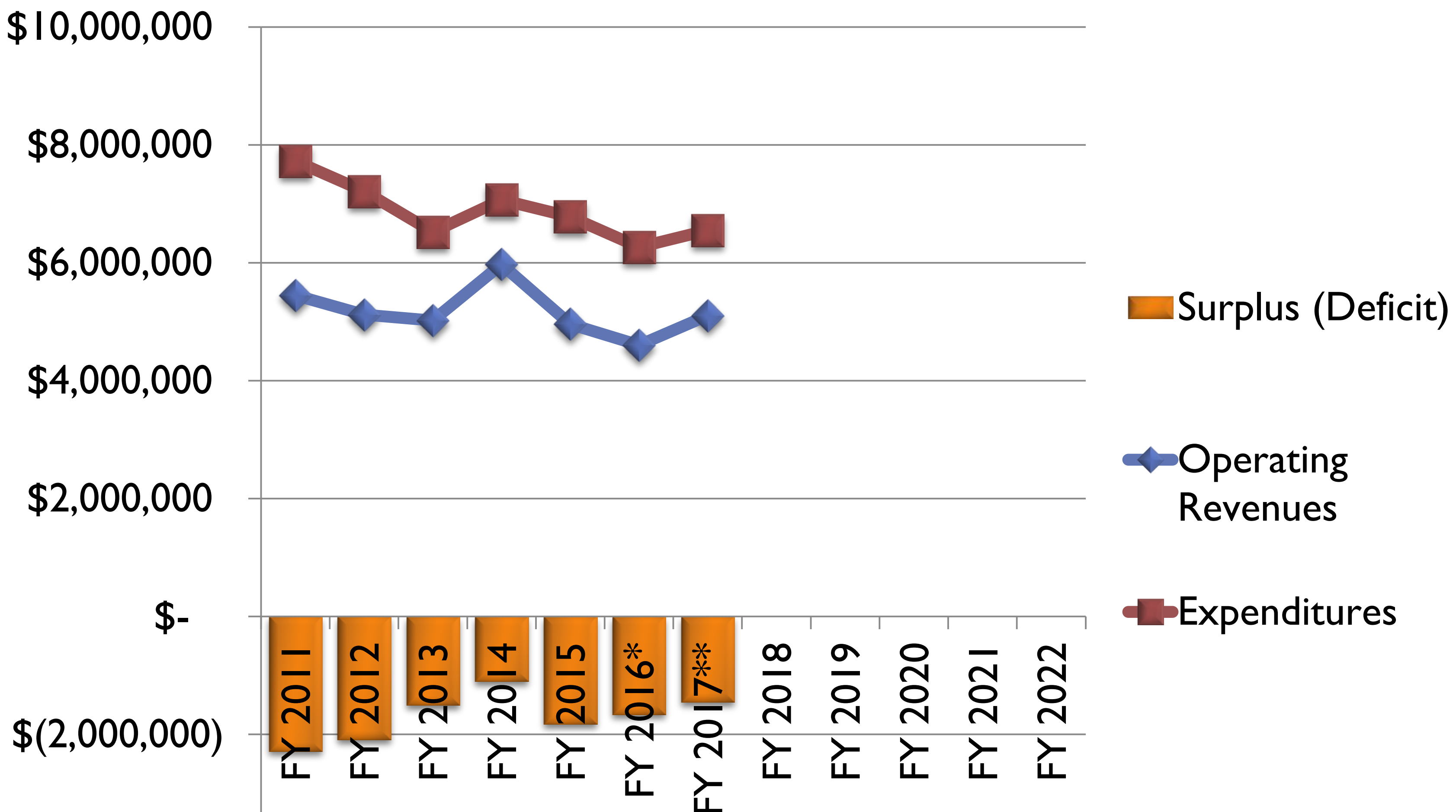
Actual and Projected Operating Results***



*** including capital expenses financed by withdrawals from invested assets.

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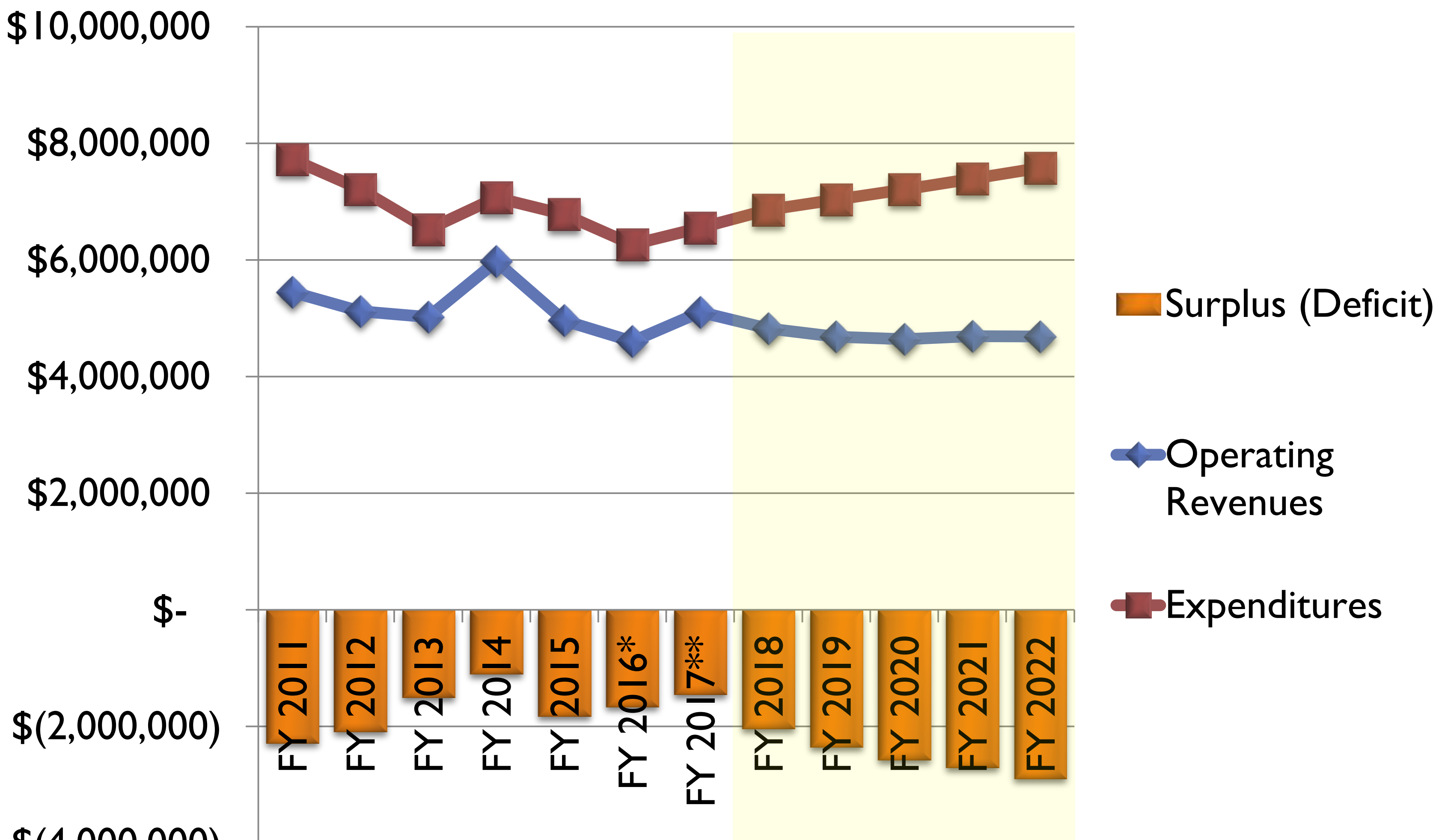
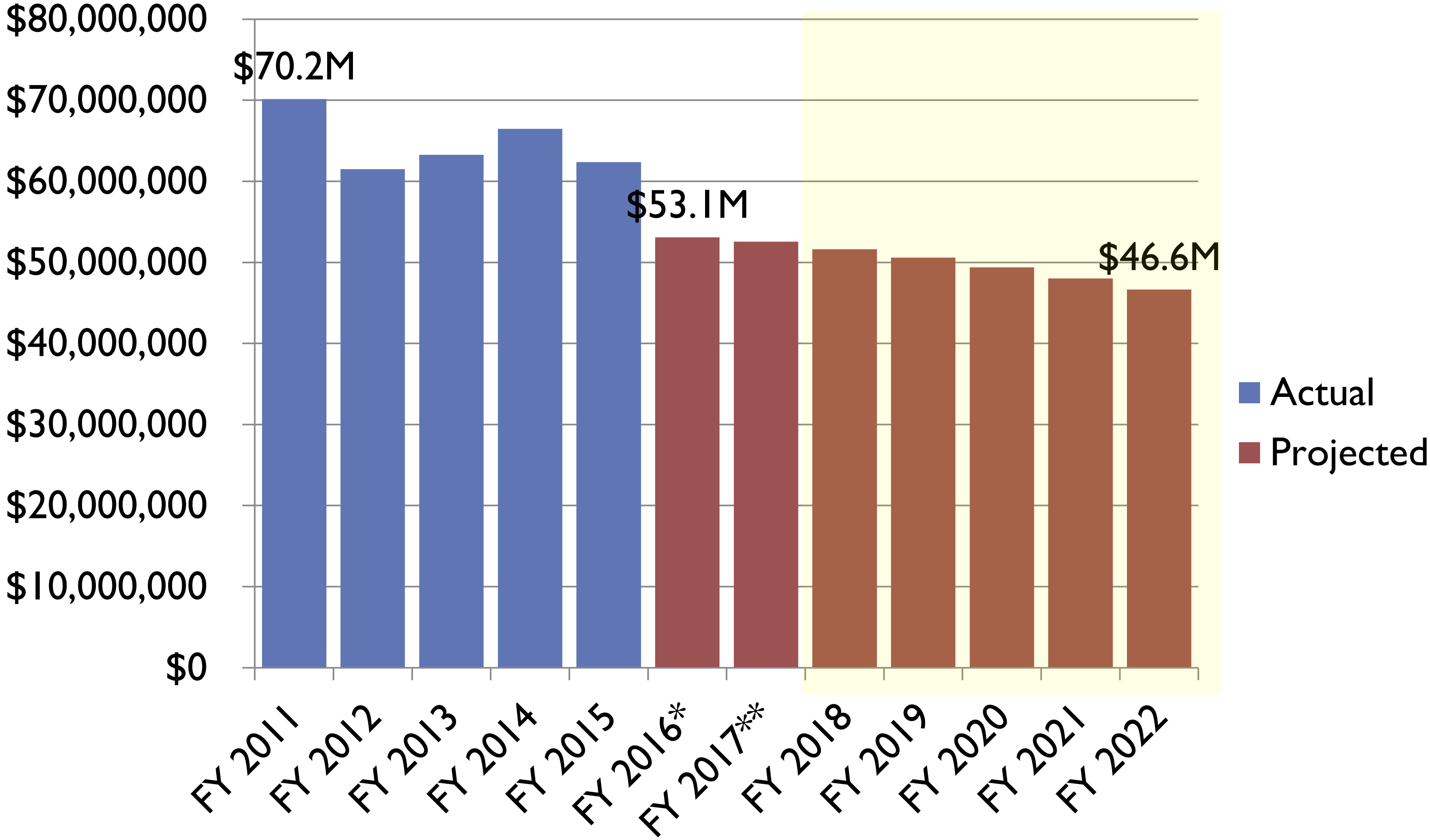


*** including capital expenses financed by withdrawals from invested assets.

Endowment and Other Long Term Invested Assets. Actual and Projected Market Value at Year End. Spending includes 5% draw, additional operating draw, and capital renewal draws. Investment return of 7.5%



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Observations from Financial History and an Initial Projection.

- Ongoing operating deficits in the range of $1.66 to $1.45 million (FY 2016 and FY 2017, and increasing thereafter) suppress growth in financial assets (a.k.a. the endowment.)The endowment thereby loses purchasing power.
- The endowment shrinks, and thereby provides fewer operating revenues. The target operating gap is $1.45 million, or 22 percent of expenditures in FY 2017.
- Closing the gap solely through increases in operating revenue would require that tuition, gift, and other non-endowment revenues to increase by 74 percent.
- Closing the gap with an infusion of financial capital to investments would, at five percent spending, require $29 million in 2016.

Sensitivity Analysis – Positive Financial Impacts

Variable	Change of Variable	Positive (Negative) Effect on the Operating Results in 2021/22.	Positive (Negative) Effect on the Financial Assets in 2021/22
Enrollment	10% growth each year	$ 125,927	$ 414,514
Tuition Pricing	10% increase in rate	$ 140,023	$ 467,262
Discount Rate (Grants)	Decrease to 55% of tuition	$ 155,655	$ 782,926
"Normal" Endowment Donations	Increase by $40,000 per year.	$ 8,064	$ 681,857
Current Use Donations	Growth of 6% annually	$ 157,519	$ 938,894
Capital Campaign	$1.4MM received by 2020/21	$ 27,984	$ 1,664,867
Capital Campaign	$5.5MM received by 2020/21	$ 109,936	$ 6,540,550
Investment Returns	10% for five years	$ 222,683	$ 6,926,139
Expenditure increase (decrease)	(7%) decrease each year	$ 2,936,975	$ 9,865,268
Sale of Property	Sell all property for $20 million in 2017/18.	$ 759,848	$ 25,534,202

Sensitivity Analysis – Negative Financial Impacts

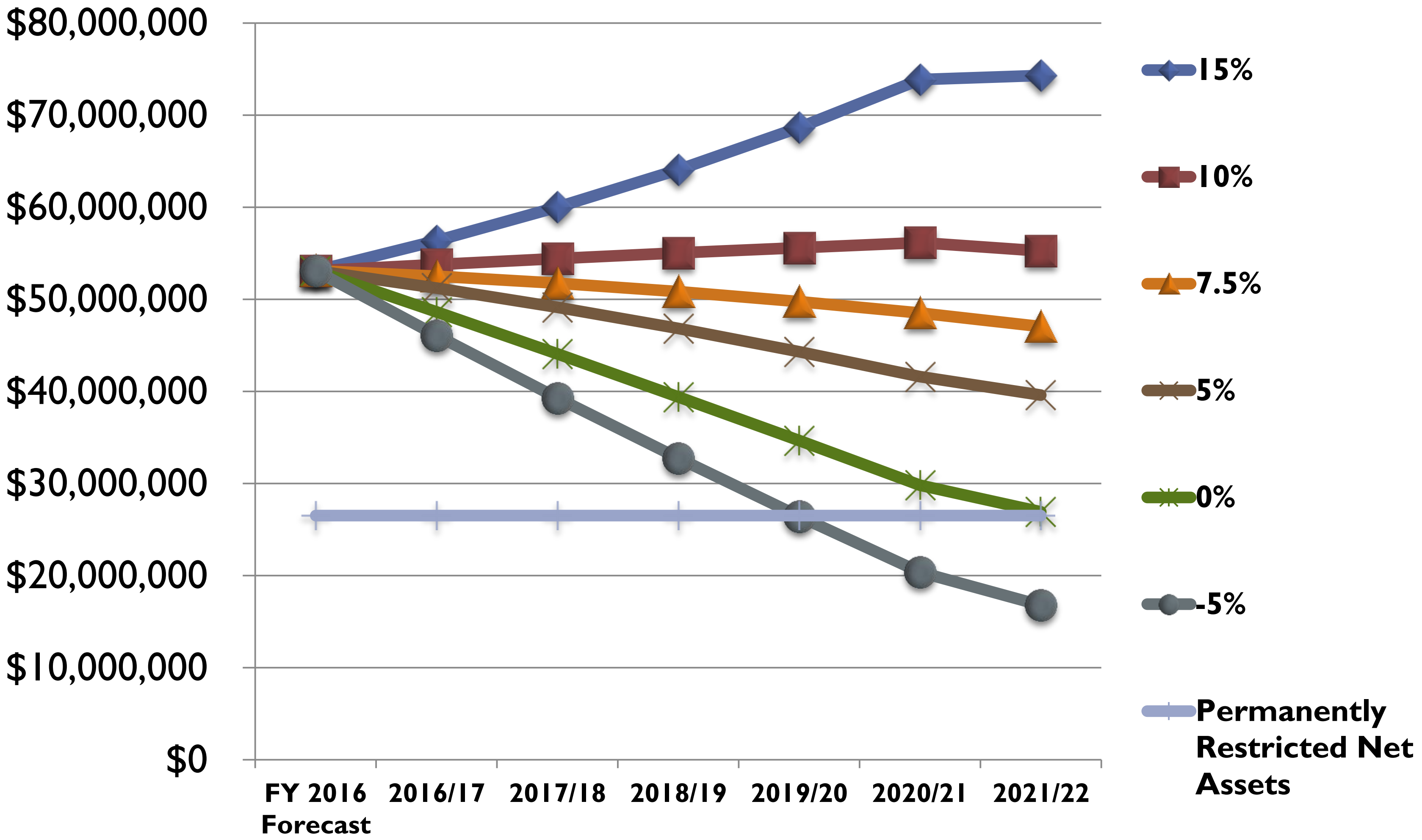
Variable	Change of Variable	Positive (Negative) Effect on the Operating Results in 2021/22.	Positive (Negative) Effect on the Financial Assets in 2021/22
Enrollment	4% annual decline in volume	$ (35,797)	$ (130,419)
Discount Rate (Grants)	Increase to 95% of tuition	$ (180,363)	$ (907,200)
Current Use Donations	Decline by 3% each year	$ (265,743)	$ (418,409)
"Normal" Endowment Donations	Decrease by $10,000 each year.	$ (2,016)	$ (170,464)
Investment Returns	5% for five years	$ (209,813)	$ (6,132,710)
Expenditure increase (decrease)	8% increase each year	$ (1,949,380)	$ (5,954,657)

U.S. 60/40 Historical 5 Year Returns

Annual Returns	% Of 5 Year Periods
Greater than 15%	11%
10% to 15%	28%
5% to 10%	33%
0% to 5%	24%
-5% to 0%	4%
Less than -5%	1%
http://awealthofcommonsense.com/2015/10/6040-return-expectations/	

Wealth Effect of Annual Investment Return Over the Five Year Interval FY2017-FY2021.

Return at 7.5 % FY2022.



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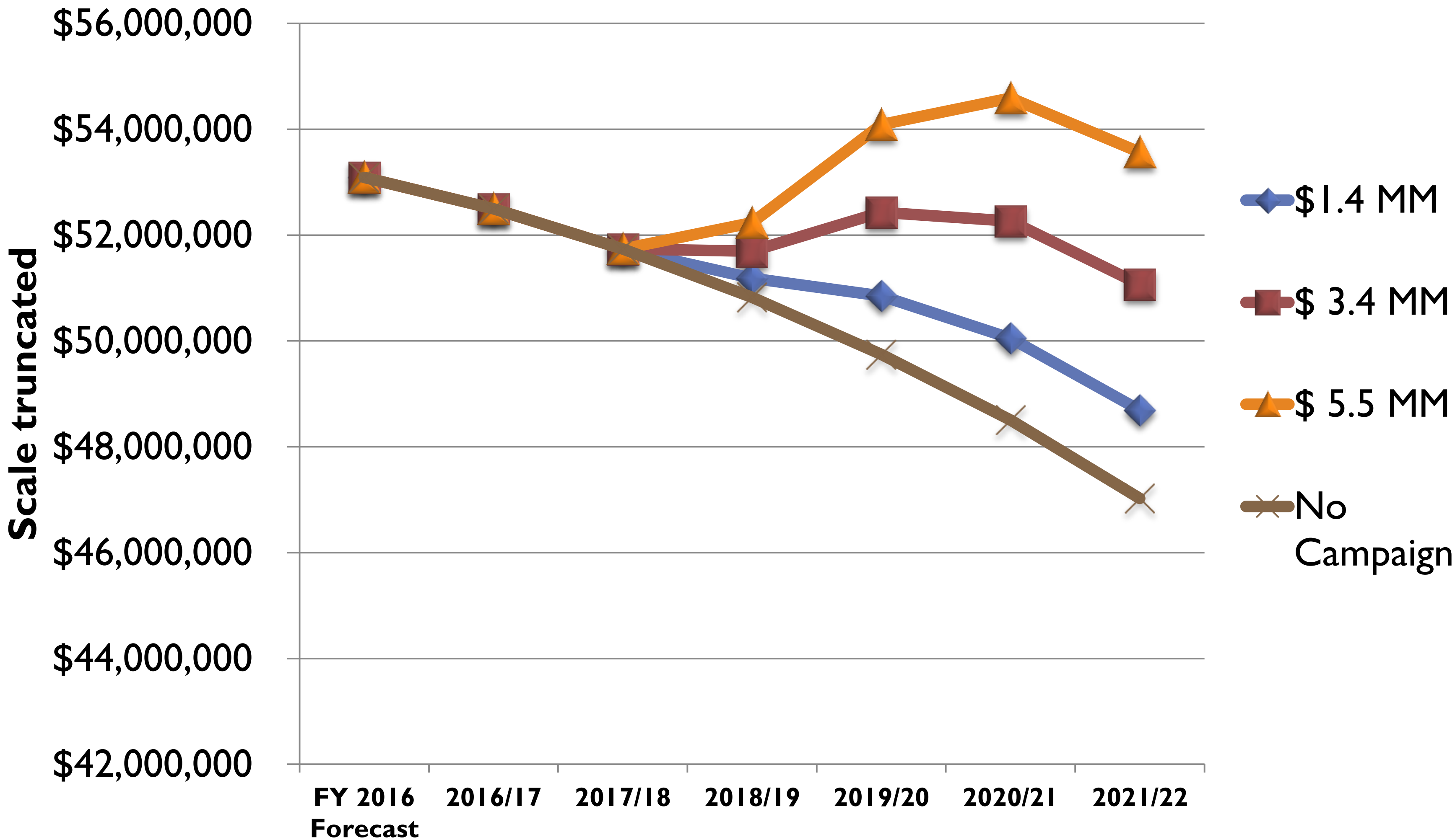
Investments

- EDS' dependence on its financial assets also generates a significant vulnerability to adverse investment markets.
- Future planning should aim for significantly lower draws on endowment, so that the school retains the ability to respond to financial emergencies and unforeseen circumstances, and shows reasonable expectations of future financial viability and overall institutional improvement.

Impact of Capital Campaigns on Projected Financial Assets



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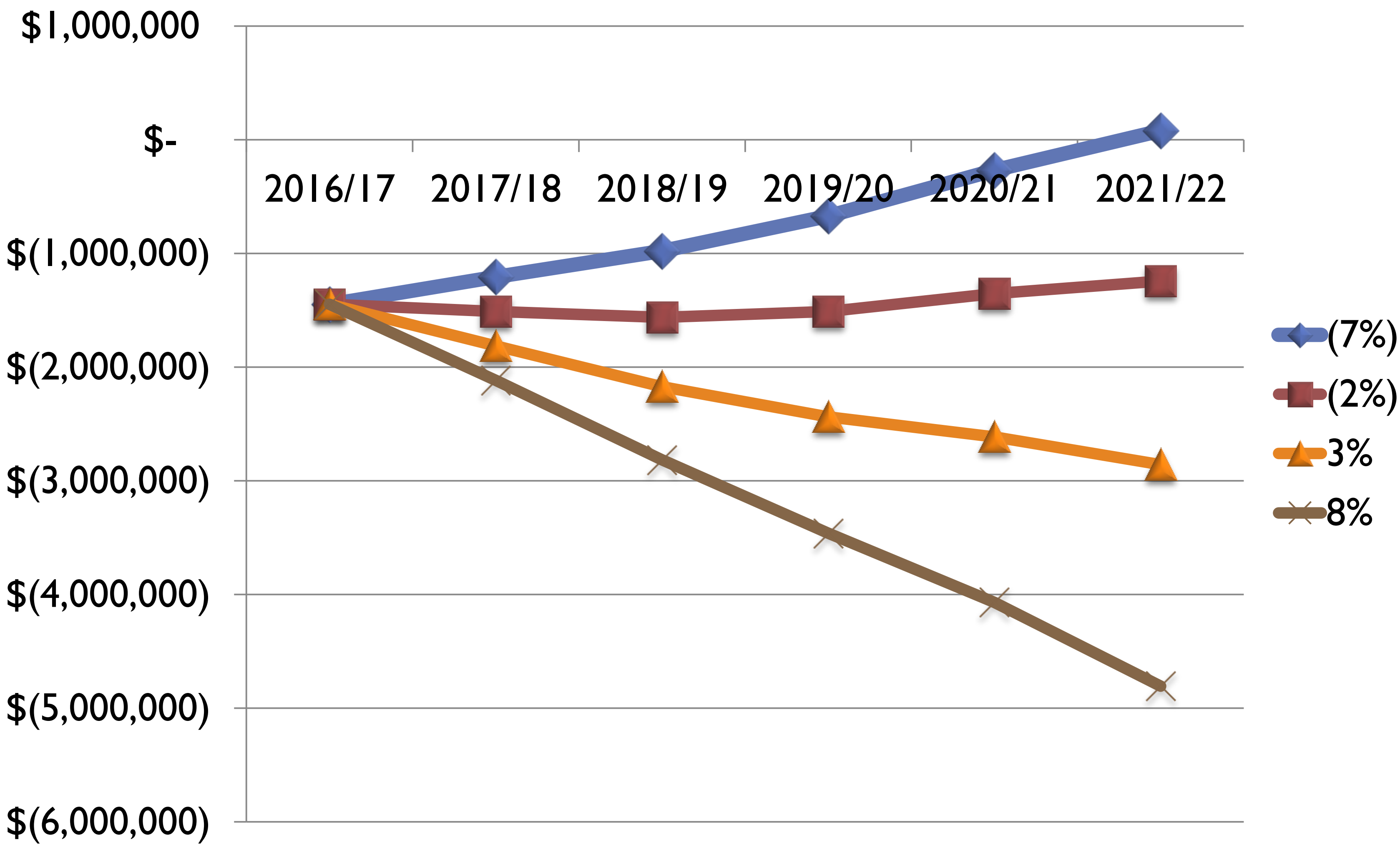
Institutional Advancement/Development

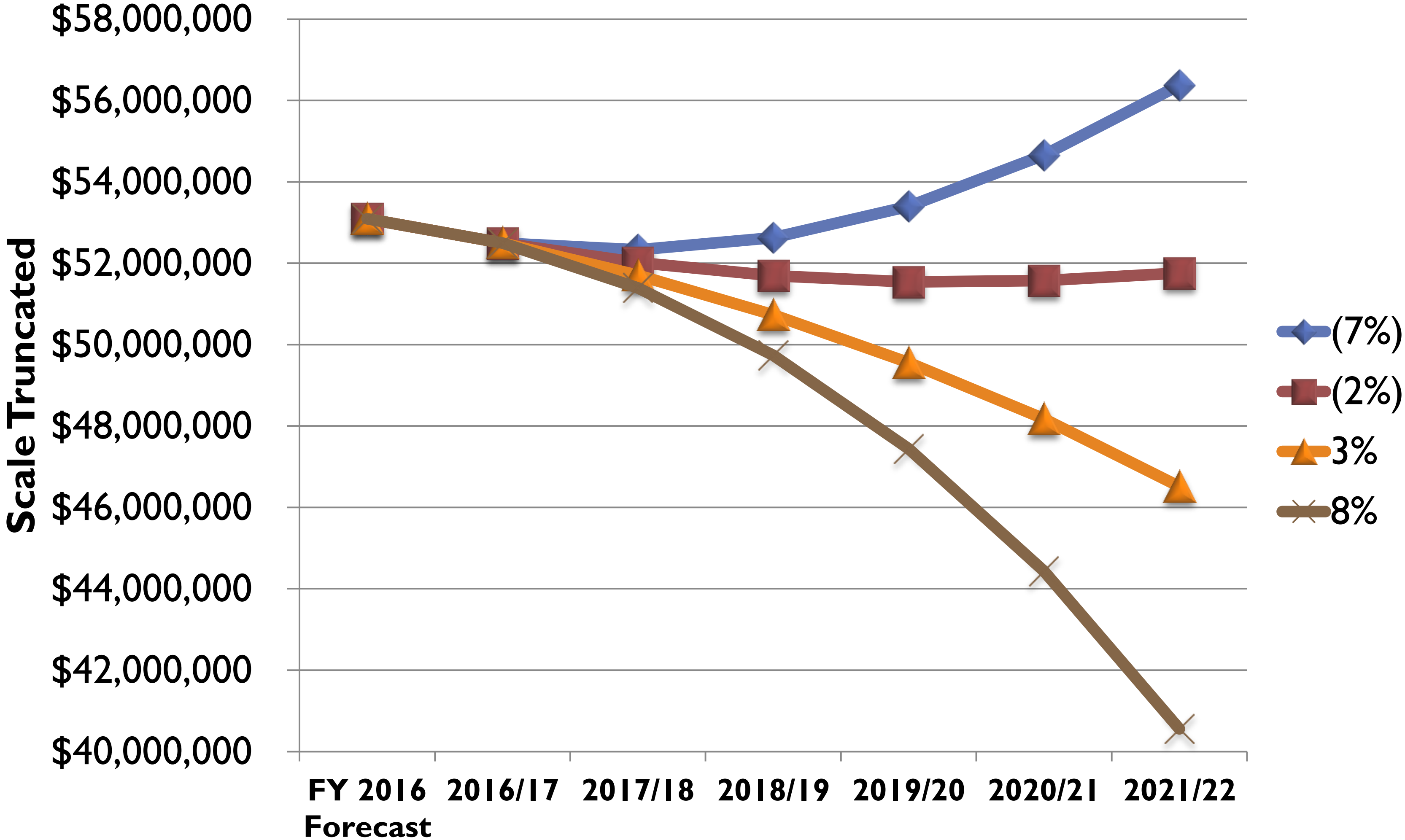
- Planning for EDS' future must include a thorough commitment to advancement. Little growth will be possible without new and renewed philanthropic partners. Expectations of advancement efforts by board members, the President and Dean, and advancement staff should be made clear.

Annual Increase or (Decrease) of Expense. Effect on the operating budget surplus (deficit).



Effect of Annual Increase or (Decrease) of Expense on Endowment/Financial Assets.

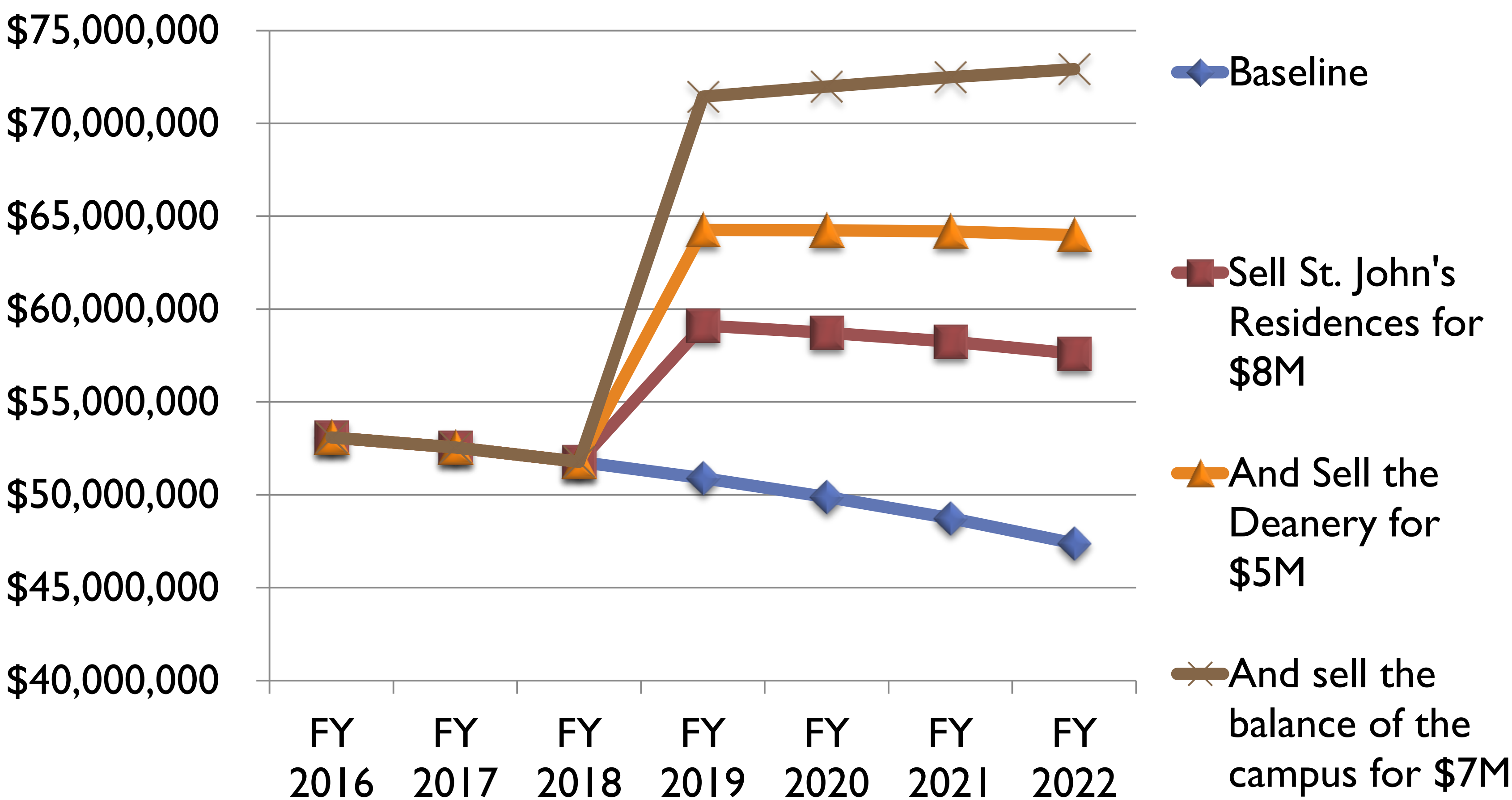
Baseline model assumes approximately 2.5% increase per year.



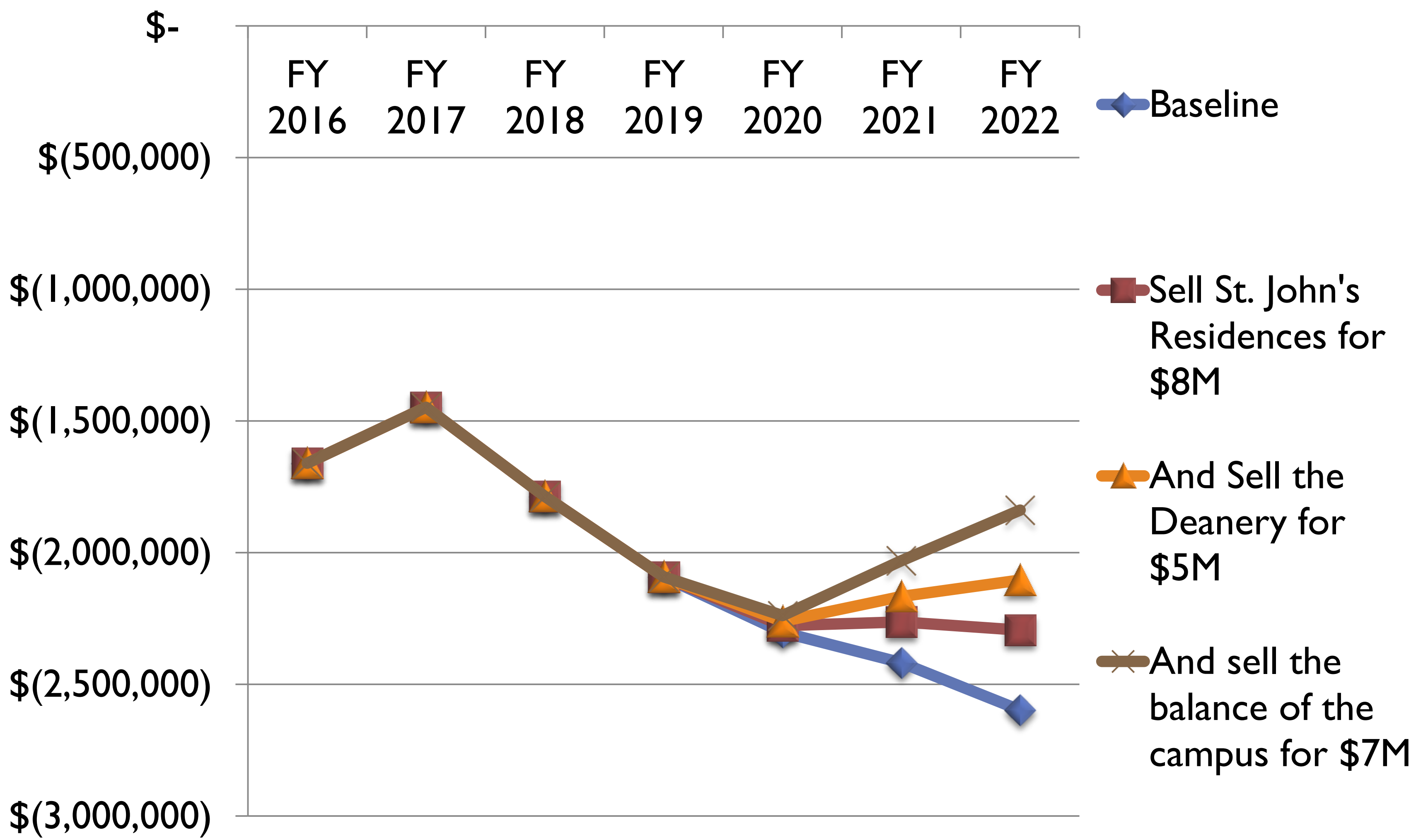
Expenditure Reduction

- The Futures recommendations include ideas whose implications could significantly reduce operational costs:
  - The clear call for an educational partner implies that substantial educational expenses will be shared. These could include instruction, academic administration, library, and educational technology expenses.
  - The recommendations also point to shared administrative services, student services, and space. Contracting for services from others may help EDS only pay for what it uses.

Campus Real Estate Sales Thought Experiment in 2017/18. Effect on Wealth.



Campus Real Estate Sales Thought Experiment in 2017/18. Effect on Operating Deficit.



Notes on Campus Real Estate Sales Thought Experiment.

- The last slide shows increasing revenue due to the inclusion, by formula, of the sale proceeds in the three year endowment average. The sale proceeds will have been fully incorporated by FY 2022. Thus endowment draw revenue increases from the sales would not continue after that point.

Summary

- Projections are not plans.
- The overall direction is toward continued weakening of financial strength and stability if no change occurs.
- The most powerful factors are investment return (over which EDS has little control), expenditures, major gifts/capital campaign, and monetization of real estate.
- Growth will require first-rate advancement performance.
- Financial assessment of planning proposals will probably need to include consideration of operating modifications and real estate reconfiguration.

Significant Potential Financial Decisions

1. The type of mission EDS wishes to pursue. Should we seek a future as an active education and formation provider? Or should we seek a new and distinct expression of mission, such as functioning as a foundation providing financial aid grants?
2. If we choose to pursue an active educational/formative role, the selection of a partner will have significant financial impact. The selection would require due diligence research on the major educational and institutional issues impacted by the partner.
3. Attendant on these choices, the potential use and/or monetization of property should be evaluated.
4. The overall mission feasibility and financial sustainability of the plans should then be assessed and decided upon.