Financial Overview

From the Vice President for Finance and the Treasurer

The financial effects on Harvard from the onset of the pandemic in March of this year were significant and sudden. Following the University's early decision to send most students home and move all teaching and research to a remote basis, revenues were immediately impacted. Refunds of room and board charges, the closing of research labs funded by sponsored support, the cancellation of continuing and executive education programs, and the virtual cessation of services such as events and reunions, parking, and rent resulted in a \$138 million drop in revenue, 3% less than 2019, with the decline all concentrated in the last three months of the fiscal year. When we think of total "lost revenue," however, the number is closer to \$270 million, or 5% less from revenue projections made just prior to the pandemic.

At the bottom line, the University showed a loss for the year of \$10 million from operations, compared to last year's operating surplus of \$308 million. The sharp year-to-year decline was directly the result of the reduction in revenues, as well as a one-time voluntary early retirement benefit program for eligible staff, and the write-down of select assets. The loss would have been far greater without the implementation of immediate cost control efforts including cuts in discretionary spending, a freeze in new hires and raises, no bonuses or overtime work, voluntary salary cuts by senior leadership, and reduced capital spending.

Despite these losses, Harvard's underlying financial position remains strong. Years of careful stewardship by schools and units had replenished reserves from the losses of the Great Recession of 2008-09 and recent coordinated steps positioned the University and Harvard Management Company (HMC) with ample liquidity (i.e. cash and near-cash investments) and substantial unused committed borrowing capacity. Through a refinancing of existing indebtedness, the University has secured long term, low borrowing rates, and downside budget planning was already in place, the result of the "Recession Playbook," an internal financial planning resource introduced over a year ago. This sound financial management allowed the University to be in a position to cover sudden losses from operations, while also investing in the mission, for example, by granting \$645 million in financial aid and scholarships to students, an increase of \$31 million or 5%. We thank all of Harvard's financial stewards and budget managers for the hard work over the last ten years in creating financial capacity and flexibility. We will no doubt need to call on it again in coming months.

As we close the books on 2020, a few observations on the unexpected:

- Harvard pivoted with breathtaking speed in March to remote learning. The logistics of helping students safely depart campus and standing up all undergraduate and graduate courses on an on-line basis was exceptional. Administrators, faculty and staff reacted far more like seasoned crisis managers or start-up entrepreneurs than staid guardians of tradition in a nearly 400-year-old institution.

- Guided by the framework articulated in April 2020 by President Larry Bacow, Provost Alan Garber and Executive Vice President Katie Lapp—prioritize the health and safety of the community; do everything possible to maintain the excellence of the mission; and recognize that Harvard is its people—the University turned to planning for the summer and fall. Thanks to this intensive work, Harvard has successfully reopened its research labs, broadened and strengthened its remote learning offerings, established hybrid classrooms, and returned a limited number of students, faculty, and staff to campus with a rigorous testing regimen for everyone living and/or working on campus as well as robust contact tracing practices in coordination with local and state public health authorities.

- It has been an extraordinary exercise in imagination, teamwork, academic and administrative planning, and old-fashioned hard work across Harvard's schools and in central administration. We are grateful to everyone who has been involved in these important efforts.

Unfortunately, we cannot rest. The hardest part likely lies ahead with ongoing challenges related to the pandemic and the related economic upheaval, as well as turmoil in our politics, societal inequities, racial injustice and underlying pressures on higher education. Each of these forces will affect the University in varying degrees and influence our financial outlook for years to come. With respect to FY21, our most recent forecasts indicate that revenues will likely be down a second year in a row, something Harvard has not experienced since the 1930's. At the same time, we have incurred significant new investments and increased spending on COVID-19 testing and tracing, the reconfigurations of laboratories, classrooms and dormitories, the procurement of personal protective equipment, and investments in technology and training for faculty and students for remote and hybrid learning. Testing and tracing costs alone are expected to be in the tens of millions of dollars.

Declining revenues and increasing costs is not a sustainable equation, but it is our near-term reality. Harvard's decentralization, however, provides a key advantage—resources are often managed locally by those most knowledgeable and responsible for academic and other activities. It is a time when each and every member of our community can focus on resource stewardship and assume a vigilant responsibility to ensure that our declining resources continue to be best used to support our primary commitment to teaching and research.

Given the levels of uncertainty, we will need to be as flexible and adroit as possible. The reality is, we simply do not know what is going to unfold, even as we engage in planning for the spring semester. Working with the Corporation Committee on Finance, Harvard has established three overriding financial principles to maintain during the pandemic: to stay 'liquid' (meaning to have sufficient operating cash available), to endeavor to reduce spending in line with declining revenues, and to be on the lookout for investment opportunities that will strengthen the mission for the future. This compass will guide our decision making and the management of resources in the weeks and months to come.

The University is blessed with alumni and other philanthropic supporters who rose to the occasion this past spring, amidst the onset of the pandemic and the stock market collapse, with a record-breaking amount of gifts for current use for the year—more current use dollars received than in any other year in Harvard's history. We thank our loyal donors for this extraordinary support. As we have repeatedly emphasized before, endowment distributions and current giving constitute 46% of annual revenues and enable Harvard's pursuit of academic excellence. We offer a note of caution, however, as many of the donations in the Spring were in the form of early collections on past pledges. Consequently, pledge receivables on the balance sheet are now down 13% from a year ago and they will likely continue to decrease as donors pay pledges from the campaign. In the current environment, with the backdrop of a fragile economy, we should anticipate less philanthropy in the coming year.

The endowment earned a 7.3% return for the year, which is an excellent outcome in the midst of market volatility and places HMC's results for the second year in a row at the higher end of large peer universities. Narv Narvekar, the President of HMC, is the first to say that results should not be measured on a year-to-year basis, but we have confidence that Narv and his able team are making steady progress and demonstrating proficiency in a variety of ways. Please see Narv's letter in this report for further information on the endowment.

Stepping back from Harvard, we have cautioned in these letters in recent years that higher education in the United States is facing increasing pressures across all its traditional sources of revenue. Unfortunately, the pandemic and the economic contraction has exacerbated these issues, and we expect significant difficulty for the sector, with existential issues for some institutions. This looms as one of the many challenges facing our nation due to the pandemic and its consequences. While higher education as we know it will be changed, we hope that it will continue its vital role as the engine of opportunity for students, as well as an ongoing source of new discoveries of knowledge, ideas, and future leaders for a better tomorrow.

In the midst of the current difficulties, we are heartened to watch with appreciation as our faculty, staff, students, and alumni actively contribute to the country and the world in providing epidemiological counsel, leading research on COVID-19 cures, taking legal action on behalf of foreign students, breaking pedagogical new ground in remote and hybrid classrooms, contributing resources and talent to our local communities, and finally, publishing articles, papers and research in every field on the effects of the pandemic, and the possible best paths forward.

In closing, we want to once again thank each and every donor to the University—past and present—for understanding that Harvard's excellence in teaching and research is made possible through philanthropy. We also want to thank faculty and staff for their inspiring contributions, on a daily basis, in carrying on in the midst of this pandemic and making Harvard one of the world's preeminent institutions.

Thomas J. Hollister
VICE PRESIDENT FOR FINANCE

Paul J. Finnegan
TREASURER

October 22, 2020

FINANCIAL OVERVIEW

The University ended fiscal year 2020 with an operating deficit of $10 million compared to a $308[1] million surplus in fiscal year 2019. This financial loss was driven by COVID-19 pandemic related declines in revenue, as board and lodging payments were refunded and executive education programs cancelled, while the University continued to fully support salaries and benefits for all workers. At the same time, the University acted quickly to manage discretionary spending in response, reducing those categories of spend by $155 million. Despite volatile financial markets, the University's net assets increased by $893 million to $50.2 billion at June 30, 2020 due to strong performance from Harvard Management Company.

OPERATING REVENUE

In fiscal year 2020, total operating revenue decreased 3% or $138 million to $5.4 billion. As a result of the COVID-19 pandemic, Harvard experienced significant revenue declines, including the cancellation of executive education programs, board and lodging refunds, as well as slowdowns in other campus activities including research.

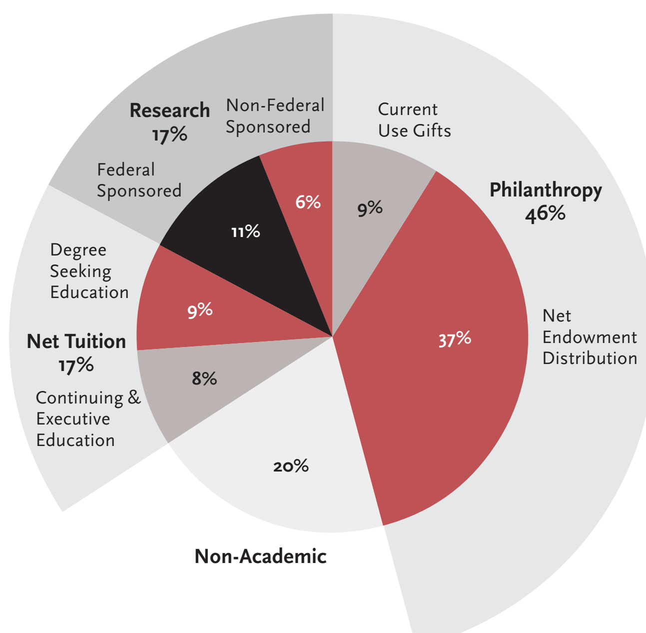
Total student revenue decreased 11% to $1.1 billion in fiscal year 2020. Modest decreases in net revenue from traditional student programs (undergraduate and graduate) were planned and driven by increases in financial aid. Board and lodging revenue of $164 million declined 16% mainly driven by $32 million in refunds issued to students and families for half of the spring semester. Net executive and continuing education totaled $410 million and was substantially impacted by the COVID-19 pandemic, declining $90 million or 18% driven by related program cancellations and enrollment declines.

Sponsored support was only modestly impacted by the pandemic, as the University was able to quickly adapt research activity to continue remotely. As a result, revenue from federal and non-federal sponsored sources decreased just 2% to $918 million. Federal funding, which accounted for approximately 67% of total sponsored revenue in fiscal year 2020, decreased 2% to $616 million. Non-federal sponsored revenue, attributable to funding from corporations, foundations, and other non-federal sponsors, decreased 2% to $301 million and includes newly awarded research awards focused on COVID-19.

We are grateful to all donors who have continued to support the University's mission during this unprecedented time, with current use giving continuing at record levels. Current use gifts, received from alumni, foundations and others, totaled $478 million, representing approximately 9% of operating revenues in fiscal year 2020. Combining gifts for current use and Harvard's endowment distribution, philanthropy accounts for 46% of fiscal year 2020 revenue.

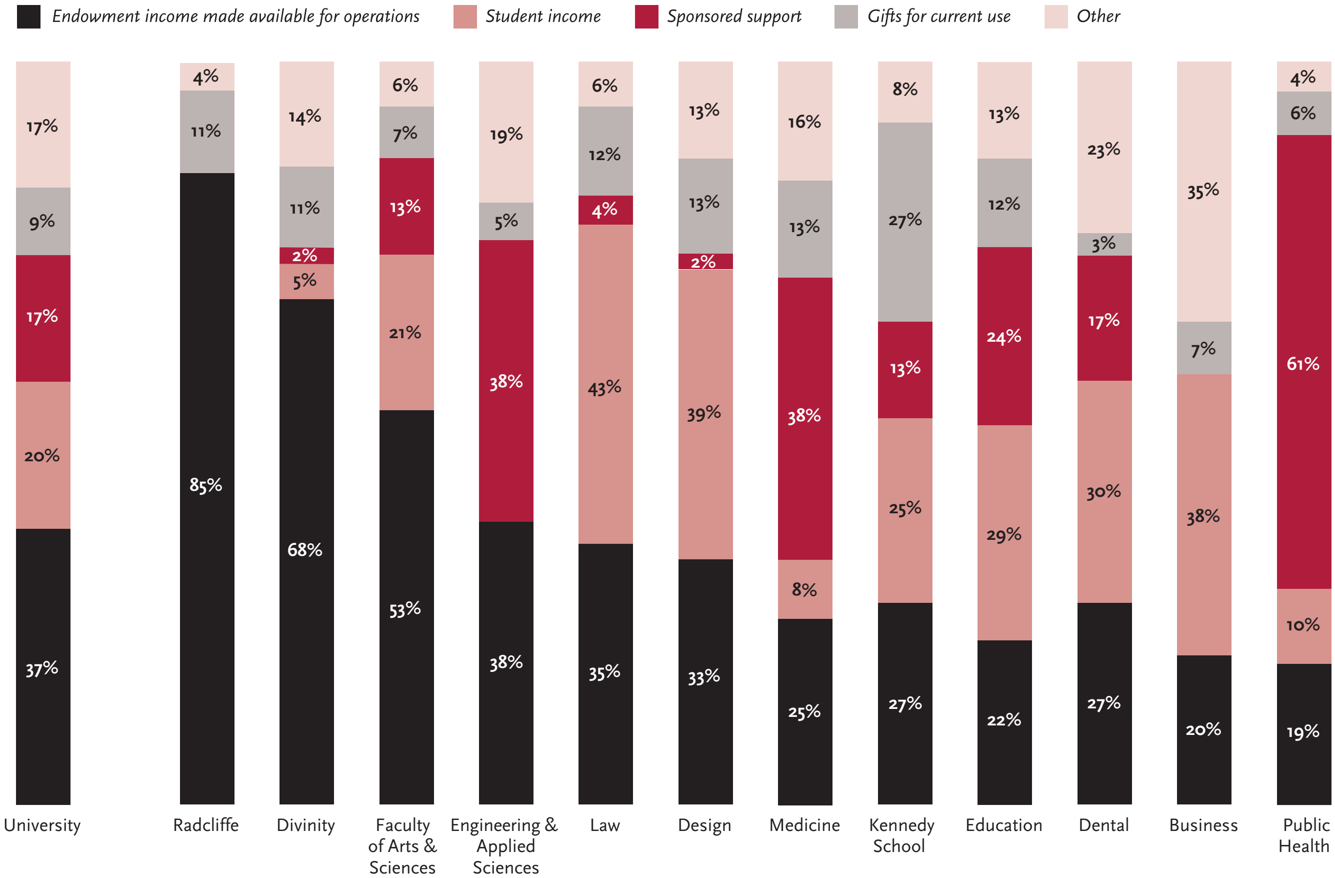
In fiscal year 2020, the endowment distribution increased by 5% to $2.0 billion. This growth was the combined impact of new gifts, as well as the Corporation-approved distribution rate increase of 2.5%. In the aggregate, Harvard's endowment payout rate (i.e., the dollars withdrawn annually for operations as a percentage of the endowment's prior year-end market value) was 5.2% compared to 5.1% in the prior fiscal year, and in line with the University's targeted payout rate range of 5.0%–5.5%. The University continues to be keenly focused on managing the endowment's payout rate in order to maintain an appropriate balance between supporting the University's near-term programmatic needs and aspirations and safeguarding the endowment's long-term purchasing power.

FISCAL YEAR 2020 UNIVERSITY REVENUE SOURCES



[1] *The 2019 "Net Operating Surplus" has been adjusted by $9.7 million to conform with current year presentation from the adoption of ASU 2017-07 (see* Note 2*).*

FISCAL YEAR 2020 SOURCES OF OPERATING REVENUE

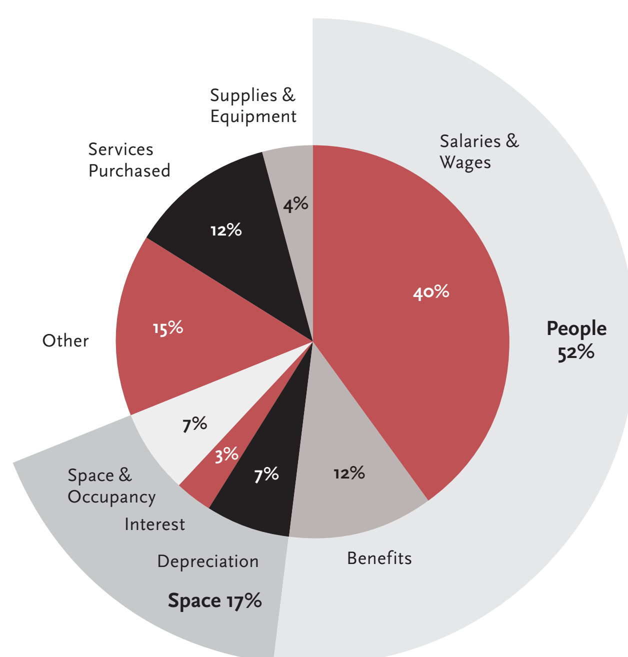


OPERATING EXPENSES

The University's operating expenses increased by $180 million or 3%, to $5.4 billion as of June 30, 2020. Compensation expense (i.e. salaries, wages and benefits) increased $158 million or 6% from the prior fiscal year which is inclusive of a $71 million estimated accrual related to the Voluntary Early Retirement Incentive program offered to 1,599 staff members in June 2020.

Additionally, while total non-compensation related expenses increased year-over-year, fiscal year 2020 includes one-time costs related to asset impairment and environmental remediation. The University acted quickly to manage discretionary spending in response to COVID-related revenue pressures and these efforts resulted in a 6% decrease over prior year for non-compensation related expenses, after removing the impact of one-time charges. For example, travel expenditures—supporting student and faculty research and other programmatic activities—were reduced by $33 million, as world-wide travel shutdown in mid-March.

FISCAL YEAR 2020 OPERATING EXPENSES



BALANCE SHEET

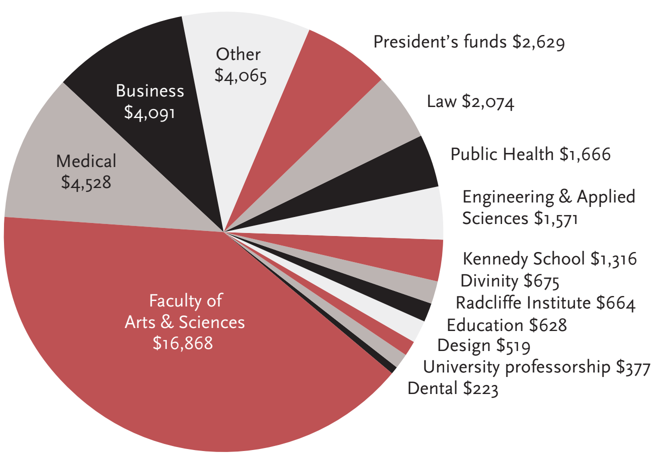
Investments and Endowment

In fiscal year 2020, the return on the endowment was 7.3% and its value (after the net impact of distributions from the endowment for operations, and the addition of new gifts to the endowment during the year) increased from $40.9 billion at the end of fiscal year 2019 to $41.9 billion at the end of fiscal year 2020. More information can be found in the Message from the CEO of Harvard Management Company, found on page 9 of this report.

The University has a policy of maintaining liquidity outside of the General Investment Account (GIA) through a combination of cash, cash equivalents and short-term investments. These investments totaled $1.6 billion at June 30, 2020 compared to $1.0 billion at June 30, 2019 (see *Note 2*).

MARKET VALUE OF THE ENDOWMENT AS OF JUNE 30, 2020

In millions of dollars



TOTAL MARKET VALUE $41,894

Debt

Bonds and notes payable increased from $5.2 billion at June 30, 2019 to $5.7 billion at June 30, 2020, resulting from the April 2020 refinancing of $450 million in tax-exempt commercial paper and issuance of $500 million in taxable debt. The University maintained its AAA rating by S&P Global Ratings and Aaa by Moody's Investor Services.

Fixed assets

The University curtailed spending on capital projects and acquisitions as a result of the COVID-19 pandemic and for fiscal year 2020 it invested $627 million compared to $903 million in fiscal year 2019. Significant capital projects, including the Science and Engineering Complex, were delayed due to pandemic construction shutdowns. Over the past several years, the University has invested in renewal projects across the University that will allow us to prudently manage capital projects during this upcoming period of financial uncertainty.