Financial Overview

From the Vice President for Finance and the Treasurer

The operating results of the University for fiscal year 2017 showed a positive surplus of $114 million, or 2% of total revenue of $5 billion. This year's surplus was $37 million more than fiscal year 2016 as a result of Harvard's individual Schools and units carefully managing their spending in line with revenue gains, and also due to a reduction in interest expense of $33 million, stemming from a debt refinancing in October. This year's operating surplus of $114 million may represent a high water mark for the foreseeable future, however, due to the broad and ongoing revenue pressures in higher education, as discussed below.

Total revenues increased 5% or a solid $222 million versus the prior year, with many of the University's traditional sources of revenue—endowment distributions, sponsored research funding, and net tuition—all performing at pace. Additionally, with thanks to our entrepreneurial faculty and staff, the University was able to invest in mission-related activities with non-federal research funding up 8%, and revenue from continuing and executive education also up 8%. Although smaller in size, these represent important revenue sources for the future.

The balance sheet was strengthened this past year as net assets increased by $1.7 billion, or 4%, to $44.1 billion. The increase in net assets was driven by endowment returns in excess of distributions, as well as new gifts to the endowment and to capital projects. Moody's and Standard & Poor's both reconfirmed Harvard's AAA rating this past year, and in October we refinanced $2.5 billion of our existing bond portfolio. In testimony to Harvard's standing in the investment community, our underwriters tell us that Harvard set records on the new debt issuance—the $500 million tranches of 30-year and 40-year taxable debt in the Series 2016A offering achieved the lowest interest rates ever recorded for those maturities in the history of taxable bond markets.

Although investment returns on the endowment this past year exceeded distributions, HMC's 8% return for the year was generally less than peers'. Narv Narvekar's letter reviewing this result, as well as his discussion on the repositioning of Harvard Management Company, is included later in this financial report. After decades of market leadership, HMC's investment results in recent years have been comparatively disappointing. We believe that the key underlying issues are being squarely addressed, and that the repositioning of portfolio and staff, as well as the changes in investment approach, are necessary and correct. Narv's leadership is also most encouraging. We caution, however, that it will likely take time to see the benefit of these important changes.

Harvard is at the forefront of many of the exciting changes in academia and higher education including new approaches to online and blended learning; cross-disciplinary scholarship; and the emergence of new science, technologies, and data science. In the background, however, the business model of higher education is under enormous pressure.

Since the 1950's, higher education in the United States has been a growth industry, and has enjoyed demographic increases in student populations, generally steady economic expansion, increases in federal research funding, and robust investment markets. This picture has changed. Higher education has matured as an industry and revenues are under pressure as student numbers have plateaued, tuition costs reach limits of affordability, federal research support is threatened, and expectations for returns in the investment markets are muted. The industry is showing financial strain, even in these comparatively healthy economic times, with the recent closures, shrinkages, and mergers of smaller, less well-positioned schools. Large research universities have been to date somewhat less affected, but they are not immune. While Harvard is fortified by its resources in people, as well as physical and financial capital, and in more recent years by the extraordinary success of The Capital Campaign, we are mindful in our long-term planning for a less favorable future revenue environment.

Harvard's Schools and units are keenly aware of the changing economic landscape. Our Deans and administrative staff are first focused on mission excellence, but they are also increasingly focused on cost containment and newer sources of mission-related revenues. Harvard is comparatively agile in that every school and unit is managed locally under the centuries-old discipline of "every tub on its bottom." In addition, budgeting, financial planning, and management processes are well developed, and "guard rails" for performance and accounting practices have been established and embraced. In the years ahead, however, it will be increasingly difficult to balance budgets in a new era of constrained revenue growth, and also, inevitably, when the current economic expansion wanes. We raise this 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.

Any discussion of Harvard's finances is incomplete without emphasizing the significance of philanthropy. Fully 45% of University's revenues are thanks to the generosity of past donors in the form of distributions from the endowment (36% of revenues), as well as current donors through gifts received this past year (9% of revenues). Excellence in academics and research is highly correlated with philanthropy, and Harvard is blessed by its many supporters. The Harvard Campaign has recently surpassed $8 billion in pledges and receipts, and the funding has made possible, for example: supporting a need-blind affordable education for every Harvard undergraduate, sustaining nearly 120 chairs for faculty, dozens of new research discoveries, and an invigorated campus, including the recently renewed Winthrop House, the Science Center's new Pritzker Commons and modernized Cabot Library, the new Ruth Mulan Chu Chao Center at Harvard Business School, and an entirely transformed Harvard Kennedy School campus. From a financial standpoint, every dollar donated to Harvard is needed and appreciated as the full costs of teaching and research are not respectively covered by tuition and research sponsorship.

In closing, we want to 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 your philanthropy, and we want to thank each and every member of Harvard's faculty and staff for their contributions, on a daily basis, in making Harvard one of the world's preeminent institutions.

Thomas J. Hollister
VICE PRESIDENT FOR FINANCE

Paul J. Finnegan
TREASURER

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