Financial Overview

From the Vice President for Finance and the Treasurer

The University had solid operating results for fiscal year 2016 and achieved our goal of managing operating expenses at a level equal to or less than revenues. The operating surplus for the year was $77 million or 1.6% of revenue, slightly higher than last year's operating surplus of $62 million or 1.4% of revenue. Overall operating revenues increased 5.6% to $4.78 billion, and expenses were up 5.3% to $4.70 billion.

The positive operating results for the University reflect the consolidated effort of careful resource management at each of Harvard's schools, affiliates, and allied institutions. Every year, each of Harvard's operating units undertakes extensive planning with rolling five-year "multi-year financial plans," as well as annual operating and capital budgets, including liquidity and facilities renewal targets. These plans are monitored and tested throughout the year to maintain the financial health that ultimately supports Harvard's mission in teaching, learning, and research.

The balance sheet reflects mixed results for the year. Liquidity remains sufficient for operating needs as well as unexpected requirements, and debt levels were reduced during the year by 7% to a manageable $5.2 billion. Our most fundamental measure of financial resources, however, net assets (the equivalent of a net worth), shrank 5% during the year from $44.6 billion to $42.4 billion. Given the challenging investment climate, this was not a surprise, with the decrease due to the withdrawal of the annual distribution from the endowment for operations of $1,706 million, as well as endowment investment losses of $626 million. In most years, and over time, investment gains from the endowment generally outweigh distributions with the purposeful aim of maintaining the necessary inflation-adjusted purchasing power of the endowment in order to balance current needs with future requirements. The investment losses in 2016 reflect a 2% negative investment return during the year as discussed in the Harvard Management Company letter included in this report. It was a very difficult investment year for all endowments and pensions, the worst since the 2008-09 financial crisis. Nonetheless, Harvard's financial condition continues to earn a AAA-rating by the leading rating agencies, due in large part to the overall strength and size of our endowment, manageable debt profile and operating surpluses.

It is hard to overstate the importance of philanthropy to the University. Tuition alone does not cover the costs of educating our students and research grants do not cover the full cost of the research enterprise. Thanks to the generosity of past donors, endowment distributions this year made up our largest source of operating revenues at 36% of the total, and thanks to the generosity of current donors, current-use gifts represented an additional 9% of revenues. The combined force of these two philanthropic sources represented 45% of the year's operating revenues and made possible the realization of Harvard's aspirations: an exceptional and affordable education for our students, access to incomparable collections in our museums and libraries, and continuing leadership in scholarship and research by our faculty. Harvard is fortunate to have so many generous donors and friends who enable us both to preserve the key elements of our world-class teaching and research, and invest in the future.

The Harvard Campaign is making an enormous difference to the health and vitality of the University. Since the start of the Campaign, current-use giving has increased by 46% from $289 million in fiscal year 2012, prior to the launch of the Campaign, to $421 million in fiscal year 2016, and now comprises 9% of our revenues (as compared with 7% in fiscal year 2012). Gifts to the endowment, split interest agreements, and gifts to capital projects of $628 million in fiscal year 2016 are up 130% since fiscal year 2012, and are fortifying our ability to fulfill the University's core mission while also creating a campus for the 21st century. These large numbers should not obscure the truth that small gifts make a meaningful difference for individual students and faculty. In the current year, for example, a $1,000 donation can fund half of a start-up grant for a freshman from a low-income family or fund a subscription to a leading academic journal at the Harvard Library, available to everyone on campus as well as those beyond.

At a time when the costs of higher education are understandably under scrutiny, some point to endowments as repositories of underutilized and excess wealth. This thinking is misguided. Harvard's endowment is actively deployed every year as the University's largest source of revenue for operations, and it is distributed in amounts that propel current programs while preserving capacity for the long term. The endowment should be understood and celebrated as the very mechanism that reduces the cost of education for Harvard students at both the undergraduate and graduate levels through financial aid programs that are among the nation's most generous. For example, one in five undergraduate families are not required to contribute toward the cost of their child's Harvard College education, as they have annual incomes of less than $65,000. More than half of undergraduates receive financial aid and pay on average $12,000 a year. Harvard only awards grants and never requires undergraduates to take out loans to cover the cost of their education. As a result, more than 75% of Harvard College's Class of 2016 graduated debt-free.

The outlook for the traditional sources of revenue for higher education in the United States in the next few years, as well as for Harvard, are likely to be constrained: Tuition revenue growth will continue to be limited by affordability pressures, federal research funding faces an increasingly uncertain political climate, and most financial market experts agree that investment results for endowments will be modest due to low interest rates, low risk premiums and muted worldwide economic growth.

Harvard is responding to these economic realities. First, on the expense side, each of the schools and operating units is adjusting their spending plans to the new environment. If, as some expect, higher education revenue growth rates are in the 2-3% range in the next few years, down from 4-5% in the recent past, it will significantly constrain the University's ability to increase budgets. In order to maintain balance between our annual revenues and expenses—and continue to support and invest in our mission—we must carefully analyze our expense ledger for any opportunities for improvement. Subsequent to year end, given the historically low interest rate environment, Harvard refinanced $2.5 billion of existing bond indebtedness, achieving annual interest cost savings of $35 million that will be reinvested in University priorities. On the revenue side, many schools are rapidly expanding their offerings to lifelong learners through continuing and executive education programs. This is an area of pedagogical excitement as students of all ages and geographic locations have access to Harvard faculty through new in-person programs as well as blended and on-line programs. In the face of waning federal research funding, Harvard faculty members and principal investigators have broadened their relationships with foundations, individual donors and corporations, and are working with the Harvard Office of Technology Development with increasing success in venture creation and licensing royalties.

In closing, we want to acknowledge that a review of the highlights of the financial statements of the University does not begin to tell the underlying real story of Harvard's transforming impact on students or its essential contributions to the world's challenges and opportunities. We want to thank our faculty, staff, administrators and students for making Harvard vital and alive every day.

Thomas J. Hollister
VICE PRESIDENT FOR FINANCE

Paul J. Finnegan
TREASURER

November 1, 2016