

August, 2009

TO: Faculty, Staff, and Student Leaders

CC: Trustees and Trustees *Emeriti*

FROM: Dennis Berkey

SUBJECT: President's 2009 Budget Memorandum and Outlook

With this memorandum I begin a practice of reporting annually to the campus community, just prior to the opening of the new academic year, on our financial performance for the fiscal year recently ended, the operating budget that has been developed for the year just begun, and my outlook for the next several years.

This report is intended neither as a replacement for the important discussions that will be held on these subjects in the months ahead in various quarters (faculty meetings, the Committee on Administrative and Financial Policies, department heads meetings, the University Council, meetings of the Board of Trustees, etc.) nor as an official, complete, or final commentary on these subjects. Rather, it is offered to increase further the transparency and good communication that we all work to achieve. I hope you find it helpful and of interest, and I will welcome any feedback you might wish to provide.

### A Word of Thanks

Before addressing the three main topics described above I wish to express my sincere appreciation for this community's stellar response to the national and international economic calamity of the past year. We have navigated this first phase of challenge with impressive continuing strength:

- academic program quality has been sustained;
- all 26 authorized faculty searches were continued, resulting in the appointment of 22 new fulltime faculty, one internal appointment of a department head, and the continuation of three searches;
- layoffs were avoided;
- wages and salaries were increased;
- core fringe benefits (retirement contributions, health insurance) were maintained;
- the tuition increase was limited to a historically low (2.9%);
- giving to the Annual Fund remained at the prior year's level;
- several major renovations to academic facilities were funded, including projects in Gordon Library, Goddard Hall, and Perrault auditorium; and
- the fiscal year 2009 ended with a record operating surplus.

Of course, not all outcomes were positive, as our endowment declined by approximately 30% in total value (from \$405 million to approximately \$290 million), and construction on the new sports and recreation center was deferred. But few colleges and universities can claim such strong results. They are a testimony both to WPI's strong value proposition and to the effective responses each of you made to the unforeseen challenges. Thank you!

### FY 2009, the Year Just Ended

While final results for the fiscal year ending June 30 will not be available for another few weeks, and need to be reviewed by our auditors and the Trustees' Audit Committee before being made public, it is already clear that WPI's FY 2009 operating result will be a record surplus, something in the range of \$7.5 million to \$8 million, or about 5.5%. Significantly better than anticipated, this outcome resulted from performance exceeding expectations in a broad range of areas, including the following:

- In response to the economic free-fall, faculty and staff reduced expenditures in a broad variety of ways, including reduced or forgone travel, leaving open staff positions unfilled as part of the hiring "frost," and generally taking responsibility to reduce operating costs at the department and program level with an impressive degree of success.
- Again this year, we made very minimal use of the institutional contingency (\$1.8M in FY 2009) that is part of the operating budget.
- Revenues strongly exceeded projections in almost every area, from Corporate and Professional Education (CPE), to (net) undergraduate and graduate tuition, to the Advanced Distance Learning Network (ADLN).
- Certain operating costs, especially those for utilities, were lower than anticipated, due to easing commodity cost inflation.
- Debt service costs were below budget, reflecting lower interest rates coinciding with attempts to ease the credit crunch.

While this administration readily admits to following a prudent practice of budgeting conservatively, and we are proud of the substantial operating surpluses that have been achieved in recent years, the stunning FY 2009 result should not be understood to suggest that we have been overly conservative in these practices. There are several important observations to keep in mind. First, this year almost every budget variation (of which there are usually many, both positive and negative) broke in the favorable direction, a most unusual phenomenon. Second, as noted above, was the strength with which the community tightened its belt mid-year, refraining from many expenditures that really should be made in the course of normal operations. Third, we are seeing increasingly strong results from the excellent work that has been done by faculty and staff to improve student retention and to build revenue streams both in the traditional undergraduate and graduate tuition and in non-traditional areas, especially the CPE and the ADLN. While we do not want to become dependent on these latter, non-traditional

sources of revenue to fund our basic operating costs, due to the contingent nature of these businesses, they are major contributors to our recently increased operating margins, almost all of which have been transferred to plant to fund capital projects for further campus development. (This year's surplus will provide a substantial boost to both the sports and recreation center fund and academic facilities development.)

As we catch our breath from this strong performance and prepare for the next phase of our challenges, we should keep in mind our goal of achieving *a sustainable adaptation to the new economic realities, whatever they prove to be*. It is too early, in my opinion, to draw conclusions about which of the factors, in both our challenges and our responses to them, will or should persist as the economic landscape stabilizes. Sorting this out and making the corresponding decisions will require much careful analysis and thoughtful collaboration. For now, I express the administration's appreciation for the excellent results to date, as well as our excitement for the opportunities before us.

### FY 2010, the Year Just Begun

With strong support from the academic department heads we have built a budget for the new year that continues both to build on our academic strengths and to respond to the continuing economic uncertainties. This budget has the following features:

- Anticipation of 850 entering freshmen with an average discount factor (financial aid need) of 40% of gross tuition revenue (increased from 39% budgeted in FY 2009);
- Funding for 20 new tenure-track faculty appointments (plus one to start next year) and two new fulltime, non-tenure track faculty members, including newly recruited academic department heads in the departments of Biomedical Engineering and Humanities and Arts. (Three additional tenure-track faculty searches, which did not result in appointments for this year, will remain active.);
- Full funding for the inaugural Dean of Engineering position;
- Continuation of the search for a Vice Provost for Research;
- Supplemental funding of \$100,000 allocated to academic departments and programs to support enrollment growth and unavoidable cost increases;
- Salary and wage (merit) increases of 2% on up to \$50,000 of gross wages;
- Special faculty equity pool of \$150,000 for full professors (year 2 of a 5-year program);
- Full merit/equity increases for faculty awarded tenure and/or promotion;
- Increase in health insurance funding (WPI portion) of 1.9%;
- Supplemental funding of \$880,000 in the Divisions of Information Technology, Finance and Operations, Enrollment Management, and Student Affairs to cover inflationary factors, structural deficits, and increased program costs;
- Reductions in various non-core fringe benefits by approximately \$300,000;
- Elimination of certain staff positions, including two in the president's office, and the anticipation of various other staff positions remaining unfilled: and

- An expanded institutional contingency, from \$1.8 million to \$3.0 million (primarily to fund unanticipated financial aid needs).

Under these assumptions we believe the budget is solidly in balance, although we have already begun to see variations, most notably in the size of the entering freshman class and its financial aid need. Rather than 850 students, we now anticipate an entering freshman class of approximately 930, but with an average discount factor (financial aid need) of 45% of gross tuition rather than the anticipated 40%. We are of course pleased that the “yield” on our offers of admissions spiked up, a sign of our increasing attractiveness in the marketplace. And, unlike many of our competitors, we did not need to make use of our wait list. The increased financial aid need of this class, however, will absorb much of the additional tuition revenue, as will the accommodations being made to teach, support, and house the additional students. (The latter includes converting all double rooms in Morgan Hall permanently to triples by investing in new, more compact furniture; adding new furniture to the Wedge to increase its social functionality; converting the access grid to a fitness facility; and developing additional residential capacity in Institute Hall.)

The FY 2010 capital budget is similarly well funded to support continuing improvements to campus facilities. These include:

- Completing the conversion of Perreault Hall into two smaller, more useable lecture halls;
- Adding a new classroom to Salisbury Labs;
- Renovations to Fuller Labs and Gordon Library to provide additional space for the Department of Computer Science and better user service facilities in the library;
- Continuing the (quite expensive) decommissioning of the nuclear reactor facility;
- Completing the renovations to Goddard Hall lab facilities;
- Providing \$1 million in new faculty startup equipment funding (in addition to \$390,000 of startup funding provided in the operating budget); and
- Continuing planning for the sports and recreation center.

These are very substantial commitments, both to the continuing significant expansion of our faculty ranks and academic leadership, and to important improvements in our campus facilities. At the same time, there are numerous ambitions that must remain unfulfilled, at least in the short term, due to the need to control payroll and fringe benefit expense. In particular, several of our administrative department heads have plans to reorganize and otherwise further develop their units to increase the quality of services. I appreciate the frustration that results from not being able to make the necessary investments, or even to keep administrative departments fully staffed during the staff hiring “frost.” But until the current uncertainty abates, the wiser course in my opinion is to refrain from making non-essential investments, especially those that do not impact critically the quality of teaching, learning, or campus life. The need to find ways to do more with less will no doubt be with us for some time, a part of the *sustainable adaptation* we will need to achieve.

## Outlook

While it may seem to some that the recession is closer to its end than to its beginning (which I myself believe), there are numerous signs that the recovery will be long and slow. Recent strong corporate earnings reports resulted largely from cost reductions, not revenue growth. Unemployment will likely remain high for some time to come. And the housing market, while seeming to have bottomed, has a steep climb and huge inventories to overcome.

We are fortunate that WPI's strong value proposition is widely understood, and that families remain committed to providing high quality educations for their children. Worrisome factors remain, nonetheless. Household income has remained essentially flat. As regards family assets, the dramatic drop in the stock market during this past year may become a more prominent factor in families' abilities to pay for higher education in the years ahead for the following reason. Those families whose children will be entering college this fall had likely already moved their college funds into relatively conservative instruments before last fall's market decline. Those with younger children, however, may have been more likely still to have been invested aggressively when the decline hit. We have no hard data on this potential problem, only good reason to worry. Since undergraduate tuition remains our largest source of revenue, family ability to afford a WPI education remains our largest concern. With this as backdrop, here are some of the issues we must manage thoughtfully in the years just ahead.

Endowment: Our endowment fell from its peak of \$405 million by about 30%, a figure that is in line with the broad general experience of colleges and universities. There has been some recovery in recent months, negated to some extent by the annual withdrawal to fund operations. Our "spending rule" prescribes an annual withdrawal of 5.5% of a trailing three-year average of the endowment's total value, one year removed. Thus, the market declines of the past year will result in declining amounts from the endowment for operations beginning next year. The problem is compounded by the fact that the current withdrawal rate under the spending rule is much higher than 5.5% of the endowment's *current* value, due to the use of the trailing average. We have addressed the latter concern by holding the endowment draw in the FY 2010 budget at last year's level (in dollars), even though the spending rule prescribes a higher amount. We are building a sliding three-year model with which to plan for the effects of the declining inflows from the endowment. This is a policy matter for thoughtful consideration, as well as a reason to continue building the endowment through fundraising and wise investment strategies.

Faculty Size: We need to match faculty size carefully to instructional and advising need, as well as to research aspirations. Top line revenue growth implies some necessary increases in expense, but also presents an opportunity to strengthen our financial position and build our asset base. As with all other aspects of our operations, finding ways to be as effective and efficient in delivering the academic programs and advancing our research programs as possible is an important goal.

Academic Leadership: We are now well positioned to add our three academic deans (engineering, business, and arts and sciences) and benefit from the increased leadership and support they will provide in program development, institutional visibility, research and scholarship, and fundraising. The imperative for the current year is to find three individuals well suited to WPI's culture, ambitions, and opportunities.

Campus Facilities: We need to revise the timeline for completion of the sports and recreation center, a facility that is critically important to maintaining and advancing our position in the undergraduate student market as well as supporting our outstanding athletics programs and the general health and well being of our faculty, staff, and students. Our increased undergraduate enrollments bring increased urgency to update our residence facilities, both by replacing or upgrading dated structures and by new construction. Several possibilities present themselves but we need an updated, comprehensive plan. Instructional and research space needs similarly to be carefully monitored and developed. There is an urgent need for a research laboratory for the highly successful Fire Protection Engineering Program, additional classrooms and project team spaces, faculty offices and research spaces, and improved performance spaces for the drama and music programs. We have developed a seven-year capital projects schedule, showing both sources and uses of funds, an important tool which requires continual review and updating.

Student Body Size and Profile: One of the most urgent considerations is for the intended size and composition of the entering undergraduate classes. I continue to believe that 3400 is a reasonable target for undergraduate enrollment, and our recent successes are moving us rapidly toward that mark. We have also made excellent progress in expanding the number of female, international, and underrepresented minority undergraduates. Academic qualifications have been similarly strong, especially as regards high school GPA's, advanced placement credits, and rank in class. Where we have lost ground, not surprisingly, is in the discount factor, or the need for financial aid. As one of the many institutions that use financial aid to achieve a differential pricing strategy reflecting our various enrollment goals, we will need to review regularly the relative priorities in order to bring the discount factor closer to what is required for sustained financial stability. While we might not be able to move fully to the 36% target that I proposed four years ago, the current factor of 45% is considerably higher than what we can reasonably sustain. Of course, any progress that we can make to increase endowed scholarship support will aid in the resolution of this challenge.

The Campaign: We have now entered the third year of our seven-year campaign to raise \$200 million. Still in the "quiet period," we have raised nearly \$50 million in pledges and contributions. While we finished our first year well ahead of schedule, the economic strife of this past year put us considerably behind where we wanted to be at this point. Accordingly, we are deferring the originally scheduled fall, 2010, public announcement of the campaign, but not, at least as of yet, extending the campaign's length. We will intensify our efforts moving forward and broaden the participation in the fundraising to include more members of the administration and faculty. I am especially grateful to those

members of the faculty and staff who have made significant financial commitments to this campaign, for its success will make a huge difference in WPI's abilities to seize fully upon the remarkable opportunities lying before us.

Academic Program Development: We cannot afford to lose momentum. Academic program development in robotics, aerospace engineering, environmental engineering, fire protection engineering, interactive media and game development, management engineering, systems engineering, entrepreneurship, learning technologies, the performing arts, the global perspective program, the Great Problems Seminars, and numerous others have been critically important to WPI's enrollment success and generally rich and exciting campus community. This great work must continue, and we will strive to support it mightily.

Branding and Positioning: Our recent remarkable success is all the more reason to redouble our efforts to make WPI better recognized and understood for its leadership in so many important areas of higher education, research, innovation, and entrepreneurship, and for its generally outstanding qualities. This "branding and positioning" effort, rooted in the academic excellence of our faculty, students, and programs, will be the focus of much of my own work together with our other campus leaders and our professionals in the Division of Marketing and Communications.

Salary, Wage, and Tuition Increases: We will remain committed to keeping our salaries and wages at competitive levels, with the amounts of any increases depending on data for comparable positions and other relevant information such as the Consumer Price Index. (The recent increases for FY 2010, while modest by historical comparisons, are actually well above the change in the CPI for the past 12 months, which was a decline of approximately two percent.) Similarly, the resolution of the current inflation/deflation quandary and data on CPI and family income will have significant implications for the pricing of tuition and other charges, as well as financial aid requirements of our students. The new economic realities to which we will need to adjust are not yet clear, although I am confident that WPI will remain well-positioned for continuing success as these matters become clarified.

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In conclusion, I again thank all members of the WPI Community for the incredibly positive and effective response you have made to our many challenges, as well as for the ways in which you have maintained our great momentum by your optimism and commitment to WPI's ideals. I hope that this report has left you somewhat better informed and even more eager to help determine our fate by fueling our achievements. I look forward to our discussions and collaborations on these and other important matters in the year ahead.