Background: The Dartmouth Budget

Accompanying Text to President James Wright's
Report to the General Faculty
Dartmouth College
October 28, 2002

Colleges and universities have enormously complex budgets and are increasingly managed like a business. This is not to say that Dartmouth is a business — quite the contrary — but it is to acknowledge that economic forces and business realities affect the work we do. Good financial markets provide us with greater resources to expand our purposes. Poor financial markets, in turn, challenge us to prioritize our activities. In the past few years we have witnessed a movement from the dizzying heights of a bull market to the worrisome reality of a bear market.

The following is an outline of Dartmouth's budget and the budget challenges that the College faces today, with a primary focus on that part of the budget that excludes the professional schools (Dartmouth Medical School, the Thayer School of Engineering and the Tuck School of Business). The total annual Dartmouth budget for 2002 is approximately $550 million including auxiliaries. This is divided into the budgets for the three professional schools, which account for approximately $200 million, and the College-only budget of $347 million.

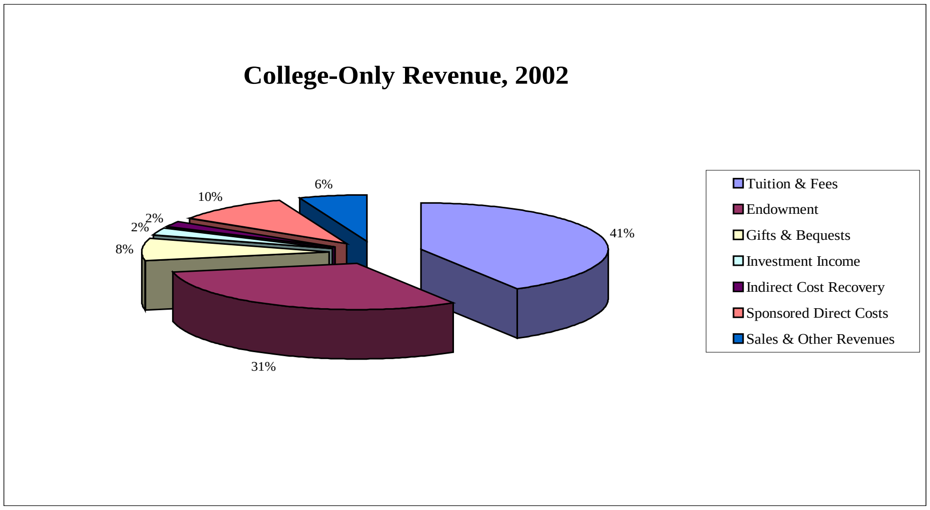
1. Sources of Revenue

Sources of revenue include

A. Tuition and Fees — 41 percent
B. Endowment Distribution — 31 percent
C. Investment Income — 2 percent
D. Gifts and Bequests — 8 percent
E. Sponsored Direct Research — 10 percent
F. Indirect Cost Recovery — 2 percent
G. Other income (fees) — 6 percent

FY 2002 Revenue Summary

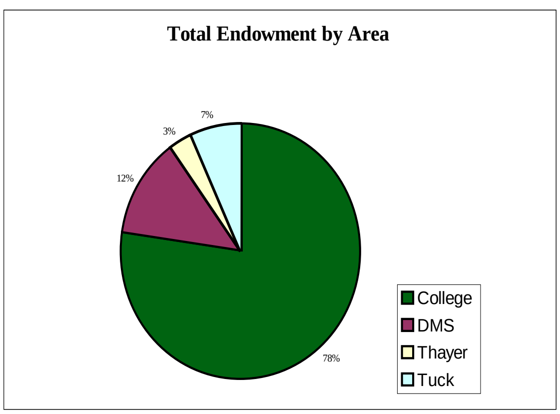
REVENUE	Actual
Tuition & Fees	123,255.6
Endowment Income	95,570.5
Other Gifts & Bequests	26,118.5
Other Investment Income	5,824.6
Sponsored Direct Costs	20,154.3
Indirect Cost Recoveries	10,090.1
Sales and Other Revenues	17,065.2
Sub-total - Education & General	298,078.7
Auxiliary Enterprises	45,909.6
TOTAL REVENUE	343,988.3



A. Tuition and Fees — 41 percent

The current charge for tuition, room, and board at Dartmouth for this year is $35,988. Knowing the difficulties some families have in affording this, particularly middle-income families who do not meet the financial aid requirements, the Board of Trustees and the administration have as a priority goal keeping down the cost of a Dartmouth education. In the last several years the rate of increase in tuition has been the lowest in three decades and is below the average for private four-year colleges.

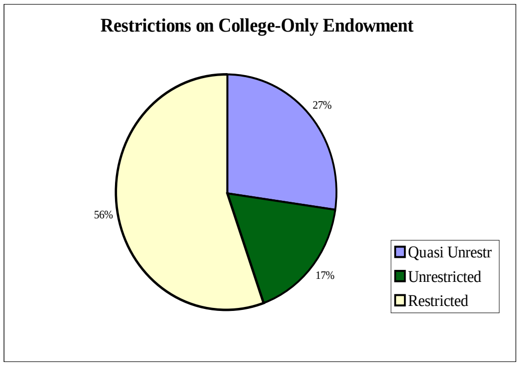
B. The Endowment and Investment Income — 33 percent



The endowment has accumulated over the past 230-plus years through the contributions primarily of generous alumni/ae and friends, and now amounts to approximately $2.2 billion. The endowment is held in trust by the Trustees of the College for both current and future generations of students and faculty and is invested in a range of different funds. The income generated by those investments is, in turn, distributed across the institution to a multitude of different programs and provides a critical source of revenue.

Of the endowment, 12 percent is restricted to the Dartmouth Medical School, 7 percent to the Tuck School, and 3 percent to the Thayer School. The remaining 78 percent is College-only. The endowment is made up of thousands of individual funds that we can divide into three essential components: fully restricted funds, unrestricted funds, and quasi endowment funds.

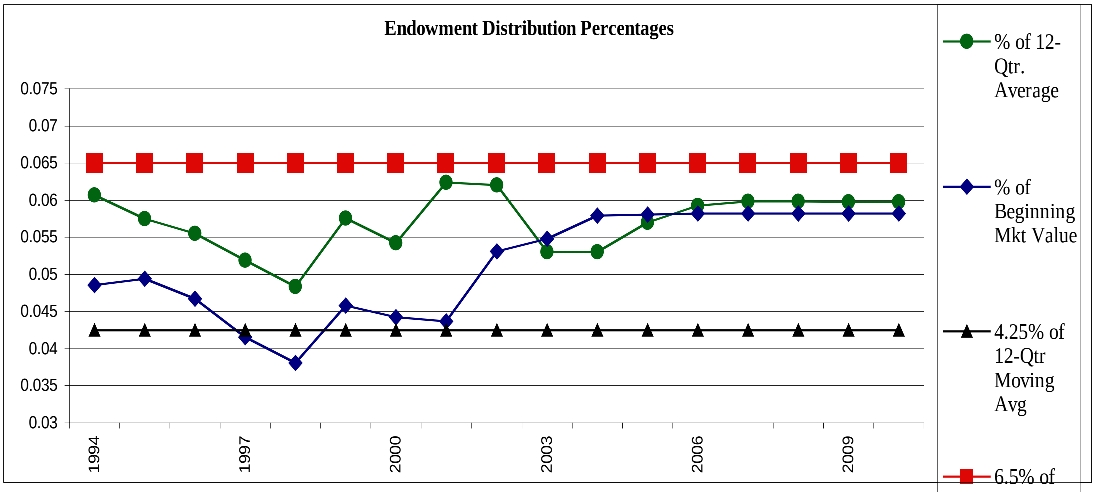
* **Restricted funds** are those funds that are fully restricted for a particular purpose determined by the donor. These can include a wide variety of monies such as financial aid funds, funds for professorships, or for particular collections of books. The income from these funds must be spent for the purpose for which the money was donated.



* **Unrestricted funds** are the most flexible. These are monies that were given to the College with no particular designation in mind. They must remain in the endowment but their distribution may be allocated to different activities.

* **Quasi endowment** is money from an unrestricted source that was put in the endowment by the Trustees. Because it is unrestricted and not true endowment, the Trustees can approve spending the capital as well as the income. But if the decision were to do this, the amount of endowment income each year would be reduced, which, in turn, would negatively affect the operating budget. This endowment is an important source of unrestricted funds.

The Dartmouth Trustees have established the policies that govern the distribution of monies from the endowment. They have approved a formula that sets a floor (4.25 percent) and a ceiling (6.50 percent) of the beginning market value of the12-quarter rolling average within which the distribution must stay. This policy essentially helps to smooth out the variations of the market so that the flow of revenue will be more predictable. Typically about 5 percent of the beginning market value is distributed across the institution each year according to the terms of endowment fund.



Each year, budget projections for future years include an assessment of likely endowment performance.

Return Assumptions	
FY '01	0.0%
FY '02	**-5.7%**
FY '03	**0.0%**
FY '04	**8.0%**
FY '05	8.0%
FY '06	8.0%

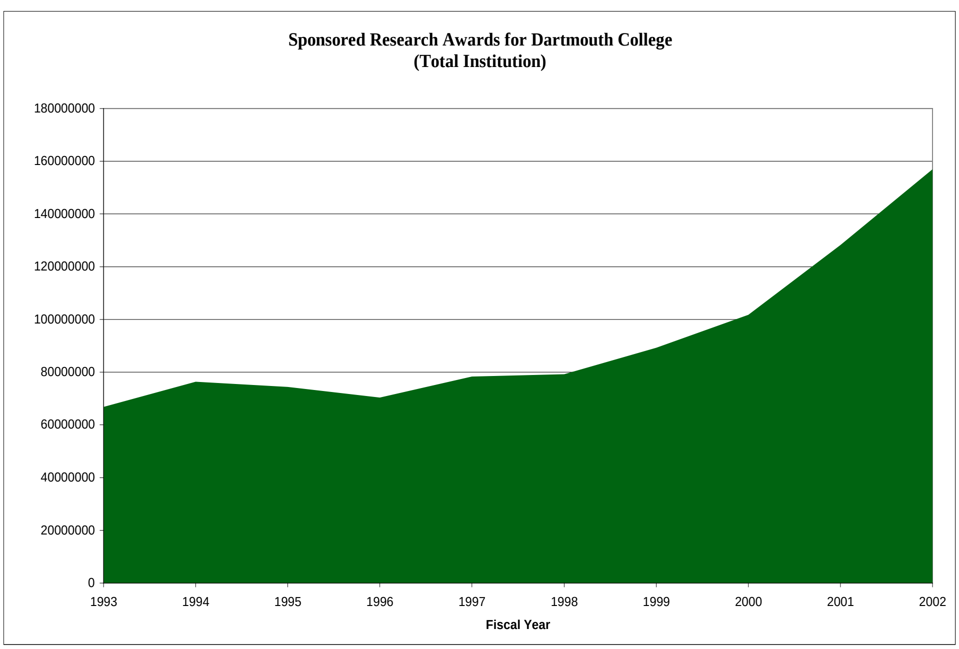
Distribution Rate	% of 12 qtr avg
FY '01	6.24%
FY '02	6.20%
FY '03	5.30%
FY '04	5.30%
FY '05	5.70%
FY '06	5.93%

C. <u>Alumni Fund and Other gifts — 8 percent</u>

Each year the Alumni Fund and other gifts that come in provide Dartmouth with approximately $20 million. Much of this money is restricted for financial aid.

D. <u>Sponsored Research (direct and indirect) — 12 percent</u>

This source provides 12 percent of the College-only budget revenue and 25 percent of the institution-wide budget. The past few years have seen a tremendous increase in sponsored activity. The Medical School alone raised $111 million in sponsored activity last year, including some projects jointly funded with principal investigators in the Arts and Sciences.



Research activity is divided into two sources of revenue: Direct is the money that goes to the Principal Investigator and the PI's team to conduct the research contracted for. Any money that is not needed to complete the project is returned to the sponsoring organization. Indirect cost recovery is the money that comes to the institution to pay for facilities and other necessary infrastructure costs to support the research program. The indirect recovery rate is currently 58 percent. This money directly supports the research efforts of the faculty.

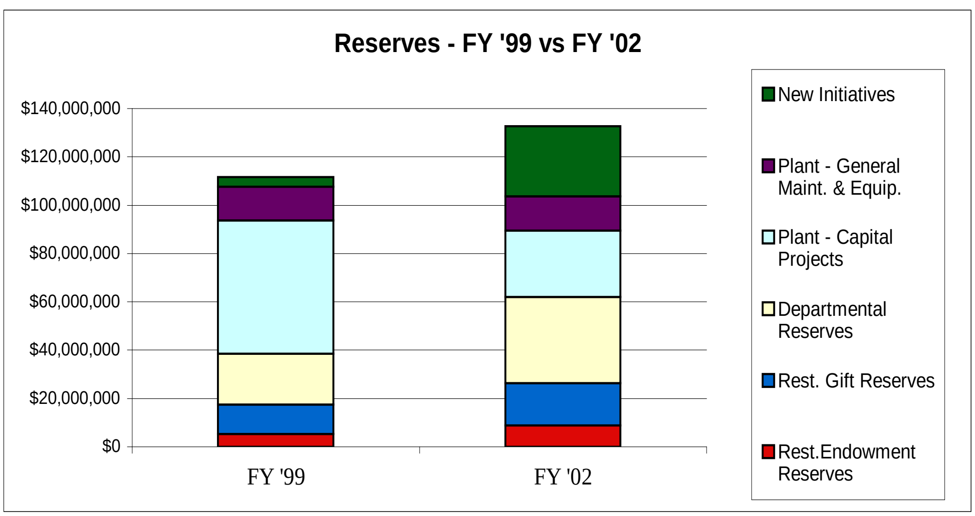
Within the arts and sciences, 23 percent of indirect cost recoveries goes to the Central Budget to cover costs such as overhead, and 77 percent goes to the Dean of Faculty Office. About 4 percent of the Dean of the Faculty share is allocated to departments and 8 percent to principal investigators.

E. <u>Other income (fees) — 6 percent</u>

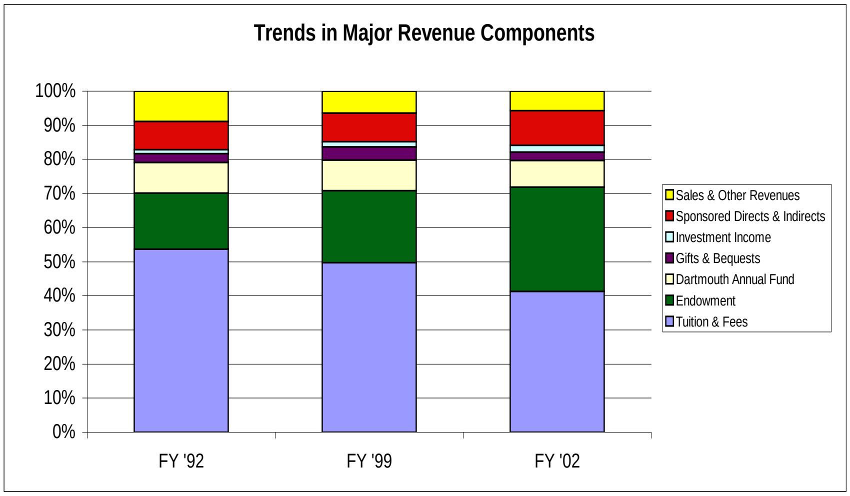
This includes revenues from athletic events and the Hopkins Center as well as student health fees and admissions applications fees.

F. <u>Reserves</u>

Reserves are not technically a source of revenue, but many areas of the college use reserves at the end of the year to balance their budgets. Reserves are, like the endowment, held across the institution and include a wide array of monies. They include the surpluses that some departments have accumulated and money that has already been committed, although it has not yet been spent, such as startup funds for new faculty, faculty professional development funds, future capital projects, and for equipment. It is critical that we use restricted monies first so as to reduce pressure on the operating budget.



The College's dependence on any one of these revenue sources has of course varied over time. And it varies from the College-only budget to the professional schools. For example, Dartmouth Medical School is less reliant on endowment and more on sponsored research. Over the last 10 years the College-only budget reduced dependence upon tuition and increased endowment support. This shift allowed us to keep tuition down and to have more revenue available, but it has also increased our vulnerability to a downturn in the financial markets.



2. Managing Sources of Revenue

In times such as these, our first reaction is to look to our sources of revenue to see how and where we can increase them.

* Last year tuition went up by 4.5 percent. We are assessing, with the Trustees, the rate for next year.
* We have reviewed our endowment portfolio to ensure that it is carefully balanced.
* We have considered our distribution formula and the possibility of adopting a more aggressive stance. We are already at the high end compared with our peers in how much we distribute.
* We have considered decapitalizing some of the endowment, but this has implications for the ongoing operating budget. When we take money out of the endowment, the amount distributed each year will obviously also decline.
* We are working hard to increase contributions to the Dartmouth Fund and other gifts to the College.
* We hope to see further gains in sponsored research. Our investments in faculty and facilities are paying off in this regard.
* We seek to maximize use of debt — since there is currently a good market for borrowing money – but we need to do so prudently and in a way that does not have negative consequences for our other budget priorities. It has been our policy to borrow if incremental money is available in the operating service for debt service.

3. Expenditures (College-Only Budget)

EXPENSES - Line Item Breakdown	
Sponsored Salary & Fringes	10,121.7
Non-Sponsored Compensation (excl. Plant)	
Faculty/Instructional Salaries	33,942.7
Exempt Salaries	41,254.3
Non-Exempt and all other Salaries	27,379.7
Fringe Benefit Expense	28,123.7
Total Compensation	140,822.1
Scholarships & Awards	42,015.3
Plant Expense	
Operations, Maintenance & Renewal	18,321.0
Debt Service	9,810.5
Books and Publications	6,313.3
Equipment	6,463.4
Travel, Entertainment, Conferences	12,554.4
Sponsored Non-Comp Expense	10,032.5
All Other Expense	24,495.1
Sub-total - Education & General	270,827.7
Auxiliary Enterprises	44,690.8
TOTAL EXPENSES	315,518.5

A. Non-Discretionary Expenses

* Operation & Maintenance — As we add new facilities, the costs of maintaining facilities also increase.
* Taxes — Dartmouth pays approximately 15 percent of the taxes of the town of Hanover. Unlike any other state, New Hampshire does not exempt residence halls from property taxes. So although our academic buildings and those facilities that are directly tied into the academic mission of the College are exempt, the residence halls are not.
* Utilities and operations include utilities like electricity and heat.
* Statutory health benefits are those benefits like social security, FICA, and unemployment insurance that we are required to pay by federal law.
* Insurance covers a wide range of areas including liability for both people and facilities and insurance for off-campus programs.
* Existing debt service — We are currently carrying debt on some existing buildings, and we have recently issued another $101 million in debt to fund some future projects.
* Tenure-track faculty
* Financial aid

These are areas in which we cannot cut or make significant savings. We have no discretion regarding the payment of taxes, utilities, and insurance — these are quite simply expenses that have to be paid.

Existing tenure-track faculty are likewise a non-discretionary line of expense.

Financial aid is an area where we could back away from our commitments, but we are not prepared to do so. We are committed to a need-blind admissions process that guarantees that we will provide 100 percent of need once a student is admitted.

B. Discretionary Expenses

Discretionary expenses are those areas of the budget where we have the ability to make reductions or to reallocate expenditures, but they also include a range of items that have a direct impact on the quality of the education Dartmouth provides. These are only discretionary to the extent that we have more control over them, although even here "discretion" is constrained by restrictions on certain funds. If we want to remain competitive with our peers — which of course we do — we need to be extremely careful in how we make reductions in discretionary areas.

* Size of faculty and staff — Compensation makes up a significant portion of our underlying budget (over 55 percent) and one way to save money on an ongoing basis is to cut the number of employees. The sort of education that Dartmouth provides is people-intensive. So, we will need to look at our staffing levels and, as Provost Scherr has reported, we may need to cut as many as 80 positions. We hope to rely on attrition but may need to lay off as many as 30 people. This is an area where we need to proceed very cautiously, and as mentioned above, tenure-track faculty lines are non-discretionary expenses.
* Competitive compensation — We have recently had an aggressive strategy to improve both faculty and staff compensation. As we continue to recruit top-notch faculty and as we work to retain them, we need to offer compensation packages that are commensurate with the quality of work that they do and are competitive with our peer institutions. We do not want to lose ground in this important arena.
* Non-statutory benefits include those areas of health and retirement benefits where we have more discretion but which nonetheless once again have an impact on our ability to recruit and retain the best faculty and staff.
* Discretionary non-compensation expenses include the whole range of programs and activities that take place across this institution and that once again are integrally tied into the quality of the Dartmouth experience. These include just about everything else — books, computers, supplies, equipment etc.

4. Strategic Priorities

The increase in the endowment in the late 1990s allowed Dartmouth to move ahead on several strategic initiatives.

* Academic Initiatives including the beginning of the expansion of the faculty of the Arts and Sciences, funds for projects such as the South African telescope, conferences, start-up funds for faculty, retention funds, and senior faculty grants.
* Compensation strategy for both faculty and staff. Over the last three years, Dartmouth has allocated an additional $1.8 million to Arts and Sciences faculty compensation and a similar amount to staff compensation. This has allowed Dartmouth to bring faculty salaries closer to the mean of our peer institutions and to be more competitive with our staff salaries.
* The Student Life Initiative, including the addition of professional staff to the residence halls, the enhancement of orientation and student programming, enhancements to athletics and to recreational programs, and increases to the compensation for UGAs.
* We have strengthened our commitment to diversity in both the Office of Institutional Diversity and Equity and in the Dean of the College Area. Ozzie Harris assumed new responsibilities as Senior Assistant to the President for Institutional Diversity and Equity

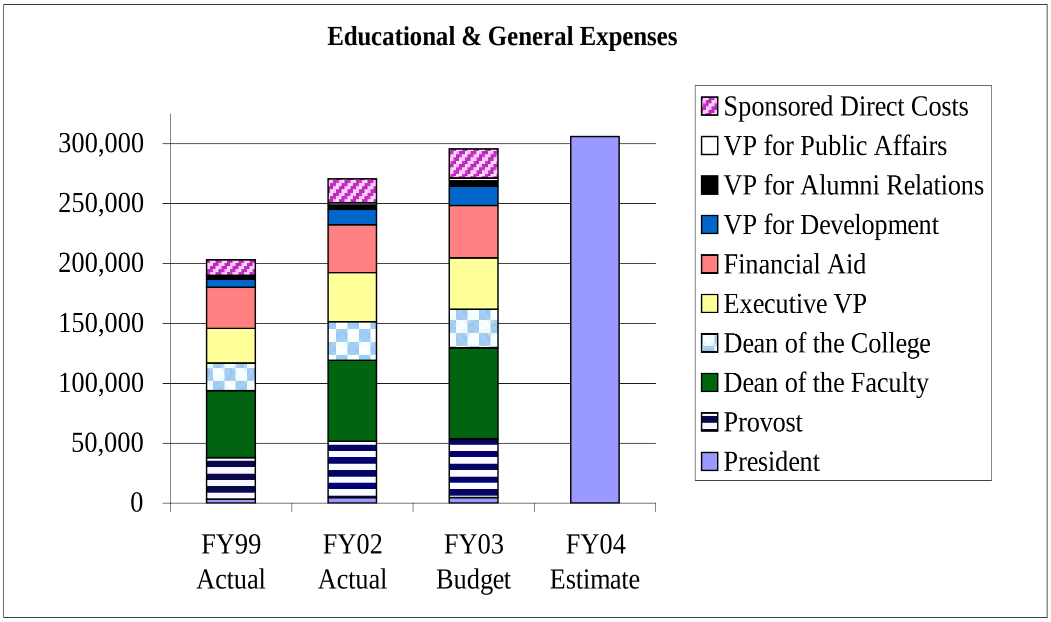
and has expanded his office, while Dean of the College James Larimore has made the diversity-support positions in his office full time and has added a new dean with responsibility for these matters.

Dartmouth College Increases in Expenses FY '99 to FY '02 (Excluding Professional Schools and Auxiliaries) (000s omitted)			
Expenditures		**Change From FY '99 - FY '02**	**Percent of Total Growth**
Inflation, Compensation Increments & Continuing Operations			26%
Annual Compensation Increases: FY '99 Base FTE Only	$	13,300	
General Non-Comp Expense Growth @ 2%/Yr		960	
Fringe Benefit Incremental Cost Increases		1,665	
Student Health Services & Insurance		2,000	
Sponsored Research: Direct Costs		7,290	11%
New Initiatives			45%
Academic Initiatives		3,420	
Research and Academic Support (Library, G&C, Computing)		4,756	
Special Faculty Compensation Increment		1,820	
Staff Compensation Increment from Market Study		1,845	
Athletics		1,885	
Student Life & Diversity		2,575	
Financial Aid		5,800	
Development & Alumni Relations		7,925	
Communications and Public Affairs		735	
Facility Expansion and Renovations (debt svs, operating costs, infrastructure)		10,459	15%
Other		1,305	2%
Total Change from FY 1999	$	67,740	100%

* We have twice enhanced our financial aid packages for students and their families, which added $5.8 million to the budget since 1999.
* The library budget increased by an average of 11 percent a year since 1999. Because of the run-up in the endowment, we were able to increase our investment in books, periodicals and other materials by 10 percent annually. The budget for books and publications increased by $1.34 million while the overall library budget increased from $11 million to $14 million between 1999 and 2002 or 28 percent. With the opening of the Berry Library, we have added staff, and compensation has increased by 8 percent. Librarian Richard Lucier has also made enormous inroads into building the digital library. The offices of Grants and Contracts and Computing both added staff to help support the increased activity of the faculty.
* Development has expanded because this is an area where we need to make an investment as we build up for the next campaign.
* Finally, we have added new leadership in the area of Public Affairs to more strategically promote the College's priorities and reputation and to better communicate the work of this faculty.

In addition to these strategic priorities, every area of the College that has an endowment has seen an increase in its discretionary funds. Departments have spent these funds in a variety of ways including the funding of post-doctoral students, sending students to conferences, supporting undergraduate research, graduate fellowships, visiting speakers, and to supplement faculty professional development funds.

As a result of these increases, the overall budget has increased significantly.



5. College-Only Budget Cuts

Cuts in VP/Dean Areas to Balance FY2003 Operating Budget	
Implemented during Spring budget process.	
DOF	1,050.0
Provost	810.0
DOC	537.0
VP/Treas	646.0
President	74.0
Development	148.0
Alumni Relations	63.0
VP Public Affairs	10.0
Total Area Cuts	3,338.0

	FY03	**As a % of 03 Budget**	**FY04**	**As a % of 03 Budget**
Add'l Cuts in each VP/Dean Area in FY03 & FY04:				
Dean of Faculty	525.0	0.7%	1,095.0	1.4%
Provost	312.5	0.6%	1,620.0	3.3%
Dean of the College	268.5	0.8%	885.0	2.7%
VP/Treas	323.0	1.0%	1,295.0	4.0%
President	37.0	0.8%	188.0	4.0%
Development	74.0	0.4%	350.0	2.1%
Alumni Relations	31.5	0.8%	157.0	4.0%
VP Public Affairs	5.0	0.2%	87.0	4.0%
Sub-total: Area Cuts	1,576.5	0.7%	5,677.0	2.6%
Savings from prior-year area cuts			1,623.8	
Use of Unbudgeted Endow. Distrib. And/or Reserves:				
Dean of Faculty			525.0	
Provost			350.0	
Dean of the College			25.0	
President			1,262.0	
One-time Use of Reserves	919.7		61.0	

When we made the preliminary round of cuts in the spring of 2002, we made them across the board. The amount to be cut was relatively small and the budget committee — made up of the Provost, the Dean of the Faculty, the Dean of the College, the Vice President for Finance and

Administration, the Associate Vice President for Finance and their respective executive officers — decided that this was the best way of handling that cut.

When we decided over the summer that we needed to make more cuts to bring both the FY ’03 and the FY ’04 budgets into line, we started the process by deciding on a set of principles that would guide us. These included protecting need-blind admissions and financial aid, faculty lines and compensation, the core academic programs, and our new initiatives in student life and diversity.

We then established the level of cuts needed to meet our targets. With the exception of financial aid, no part of the College was untouched, but those areas of highest priority received the lowest cuts. We do not yet know the full impact of the cuts. The various areas are still working through exactly how they can meet their targets — and none of the suggestions have yet been approved by the budget committee or the senior officers.

6. Capital Budget

We have an ambitious building agenda before us — we have identified needs in the arts, the life sciences, for math and computer science, for the academic centers, for residential life, and for social and dining facilities. These projects are part of our strategic plan going forward and are integral to the academic quality of Dartmouth.

The capital budget is for the most part separate from the underlying budget. We use gifts that are donated for a specific building project as in the case of the Berry Library, the Baker renovation, and Carson Hall, which we will dedicate in November. We also use debt — as in the case of recent renovations to Silsby Hall — and we will use debt if we need to build a garage.

Major Capital Projects & Initiatives

Projects Now Underway and/or Substantially Planned

Project	Area	Funding Sources
Alumni Gym Squash Courts	Athletics	Gift
Phi Tau move	Academic	Reserves
Sudikoff Addition	Academic	Reserves
Kemeny & Academic Centers Bldg	Academic	Gifts, Debt
Demolish Bradley/Gerry	Academic	Reserves
Thayer School Addition	Academic	Gifts

Projects Dependent Upon Full Funding

Project	Area	Funding Sources
Projects Furthest Along in Planning		
N. Maynard Residence Halls	SLI	Gifts
53 Commons Dining/Social	SLI	Gifts
Thayer Hall Renovation	SLI	Gifts
Projects in Preliminary Planning		
Life Sciences Building	Academic	Gifts, some debt
Arts Center Phase I	Academic	Gifts
New Boiler	Infrastructure	Debt
Tuck School Residence Hall	Prof. School	Gifts

The capital budget has an impact in two ways on the underlying operating budget. If we use debt to help pay for construction, we then need to service that debt from the operating budget. We currently have about $240 million in debt from the ’80s and early ’90s and last year we took out an additional $101 million to help defray the cost of several on-going projects.

And, once a building is constructed, its operation and maintenance become an annual operating expense. We have implemented a review of all construction projects and have decided that we will only move forward with those projects where we have identified full funding for construction and the operation and maintenance of the building.

7. Fund-Raising

In the summer of 2002 we completed the strategic plan, which set out our priorities for the next ten years. It is an ambitious agenda, and despite the current economic climate, we cannot afford to back away from it.

We are looking at all of our options for funding these priorities. Clearly one of these options is a dramatically enhanced fund-raising program and we have begun the cultivation process that will help make our efforts successful.