AMHERST AND THE ECONOMY

A Report From the College

Dear Friends,

One thing I have seen time and again at Amherst is that this is a community—those of us here on the Hill and the many thousands of graduates in the wider world—that rallies together in moments of challenge. We are at such a moment now.

Against the backdrop of an economic downturn unprecedented in most of our lifetimes, putting new pressure on a diminished endowment, Amherst College has just completed an intensive, collaborative and at times difficult budgetary self-assessment. Despite the uncertainties ahead, we have begun to set our course in the right direction. Amherst will maintain its leadership position in higher education while at the same time preserving an academic environment that is unparalleled in its excellence and in its accessibility to a wide range of the most talented students in America and beyond.

In the report that follows you can read about this recent budget process, and about its historical context, in more detail. The broad brushstrokes are as follows: Earlier this year, a group called the Advisory Budget Committee was formed to help develop plans to adjust the College's budget, with the goal of reducing the rate of growth in order to keep the spend rate from the Amherst endowment at a sustainable level. The ABC took into consideration the views of the College's several standing faculty committees, as well as the views of trustees, administrators, students, staff, alumni and other members of the College community. The advisory committee eventually reached consensus on a series of recommendations to be considered by the Board of Trustees.

Throughout this process we have been guided by a commitment to the primacy of Amherst's educational mission and by the conviction that any steps we take must be informed by our fundamental values, including a recognition of our obligation both to the Amherst community of today and to those who will teach, learn and work here in the years to come. There is more to be done, but I am confident that we have been, and will continue to be, true to this charge.

Yours,
Anthony W. Marx

During the past year the worldwide financial crisis has prompted painful readjustments in every aspect of American life. Higher education has been profoundly affected. The collapse of the stock market, the onset of recession, the surge in joblessness, the strain on public resources—all of this has had an immediate impact on the nation's colleges and universities, on the students who attend them and on the families who stand behind those students.

Amherst College is hardly immune to the challenges that face the nation. The value of the endowment—on which the College depends for more than a third of its expenses—has eroded significantly over a very short period of time, as has also been the case at the College's peer institutions. The College must take significant steps to deal with this new reality, and has begun to do so. All parts of the Amherst community have been engaged in the process. The response has often been inspiring—as when, last spring, the student body voted to transfer $100,000 from a reserve student-activities fund in order to bolster financial aid, offer assistance to the lowest-paid employees and maintain certain programs. This report will explain the measures the College has taken in the face of evolving and difficult circumstances. With respect to the budget and the financial picture as a whole, it will describe where the College has been, where it stands at the present moment and how it is moving forward.

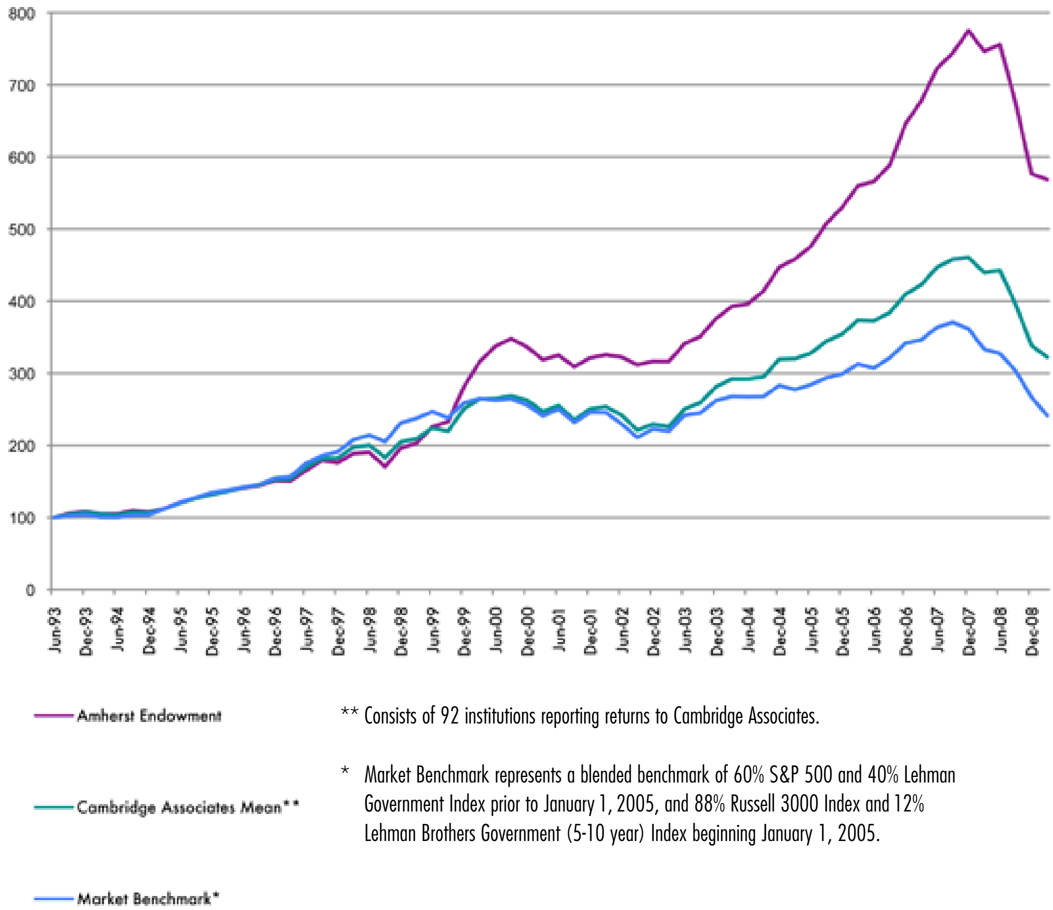
The challenges ahead will be met. Amherst came to life during the nation's first great financial crisis; undaunted by home foreclosures, bank failures and widespread panic, the founders launched a new college and solicited donations for a Charity Fund—the original endowment—to support it. We live today in uncertain times, but Amherst remains an institution with considerable resources. Those resources are not merely, or even mainly, financial. The commitment and creativity of the faculty, the student body, the administration, the staff and the alumni are the College's greatest assets. They have sustained the College in harsher times than we face now, and they have always enabled the College to emerge on a sound footing and with a clear vision. The contribution to our society and the larger world, as measured in the lives of Amherst graduates, can never be captured in ledger books. Amherst's "multiplier effect" has been, and will remain, incalculable.

THE BACKGROUND

It was apparent by the middle of 2007 that the United States was heading into rough economic waters, even if there was no agreement on how rough the waters would become. It is important to present a baseline picture of the College's financial condition at that time.

Recent news reports about the impact of the economic crisis have taken note of precarious circumstances at some of Amherst's peer institutions. As serious as its challenges are, Amherst confronts them with a track record of prudent management, which continues to hold us in good stead. Two decades ago, the College faced up to the fact that, for a variety of reasons, its spending rate was outstripping its financial capacity. A Priorities Planning Committee was created to take stock of the situation. The committee's report, issued in 1993, laid down a series of basic principles. Among them: Operating budgets must be balanced, and must be projected to stay in balance; the trend line of income and expenses must be closely monitored. Any budget must ensure that the present and future quality of students and faculty is maintained. Investment in the physical plant must be adequate to protect its value; failure to renew or replace facilities is no bargain over time. Finally, and crucially, the purchasing power of the endowment must be maintained—the needs of the present must not come at the expense of responsibility to the future. In practice, this has meant an annual "draw," or spend rate, of no more than 5 percent, the rate at which income can be tapped (taking inflation into account) without diminishing the endowment, given assumptions about performance based on long history.

Figure 1. Long-Term Endowment Outperformance for Period 1993–2009



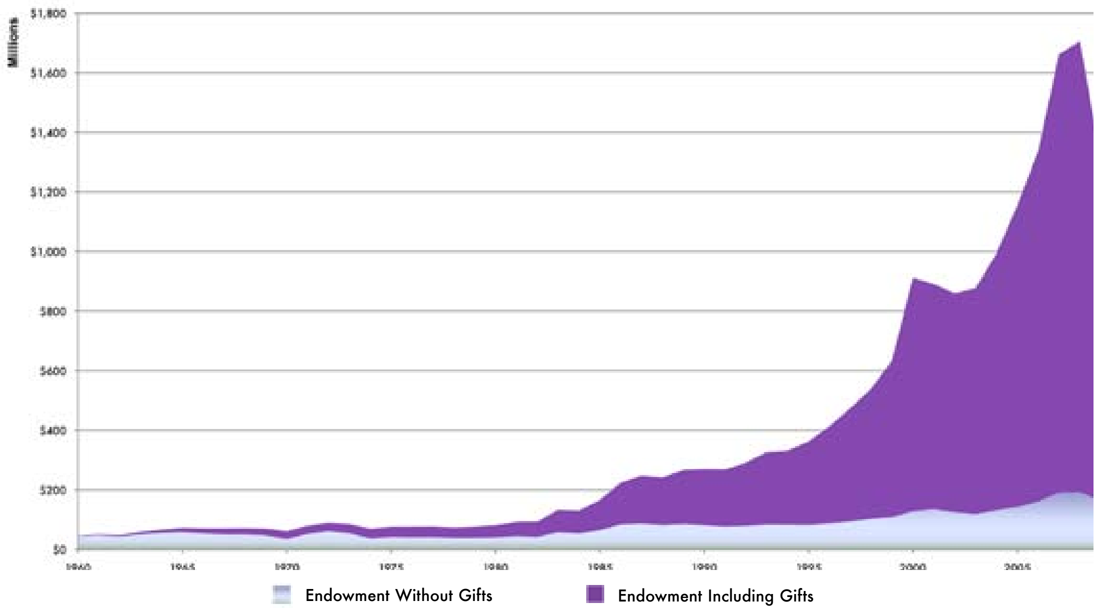
** Consists of 92 institutions reporting returns to Cambridge Associates.

* Market Benchmark represents a blended benchmark of 60% S&P 500 and 40% Lehman Government Index prior to January 1, 2005, and 88% Russell 3000 Index and 12% Lehman Brothers Government (5-10 year) Index beginning January 1, 2005.

Amherst has adhered to these principles ever since. Meanwhile, over the same period, the College was greatly lifted by the generosity of its alumni and by the strong performance of its endowment. The comprehensive campaign of 1996-2001 exceeded its goal of raising $220 million. Meanwhile, the investment returns posted by Amherst's endowment—an average of 11.8 percent a year between 1993 and 2008—outpaced not only market indexes but also the record of most peer institutions. [**See Figure 1.**] The endowment even weathered the high-tech implosion of 2000-2001 without significant loss. During these years the College's investment strategy, overseen by the investment committee of the Board of Trustees, has been to broadly diversify the endowment while making meaningful investments in alternative, often illiquid, assets, such as hedge funds, private equity, real estate and natural resources. By any measure this strategy has paid off handsomely, far outweighing recent setbacks. All told, the College's endowment grew from $327 million in 1993 to $1.7 billion by the beginning of 2008. And remember that, in the course of this period, even as the endowment grew, it was providing nearly $400 million toward the College's operating budget.

In these years Amherst was able to upgrade much of its physical plant, from academic buildings and residences to athletic facilities and basic infrastructure. A Residential Master Plan brought all first-year students together on the Quad. New buildings arose to house biology and geology. More recently, financial aid became more generous as loans were replaced with grants and Amherst's historic commitment to need-blind admissions was extended to international students.

Figure 2. Actual Endowment Value v. Endowment Value Without New Gifts, 1960–2009

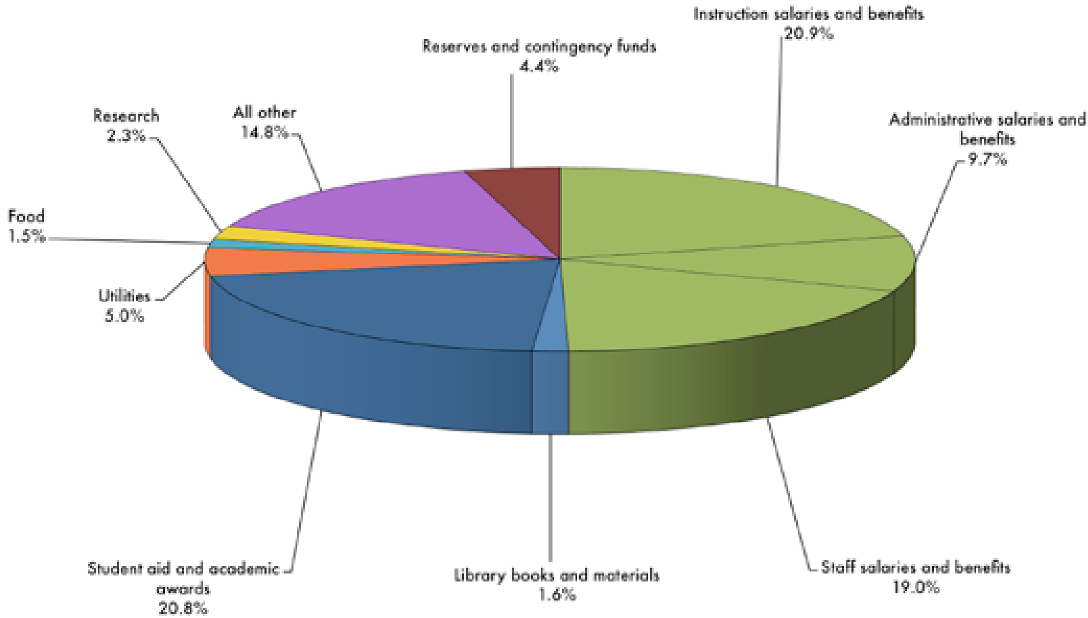


These investments are enduring. They were made possible by the combination of gifts to the College and the growth of the endowment. Indeed, it is worth emphasizing the extraordinary cumulative role that gifts have played with respect to endowment growth, a dynamic that may not be widely appreciated. [**See Figure 2.**] As noted, for many years Amherst has kept the spend rate from the endowment at a relatively modest level—it has varied between 3.5 and 4.8 percent. Even so, the remarkable annual increase in the value of the endowment meant that this conservative spend rate would generate significantly increasing income, from which the College has greatly benefited.

Amherst's annual revenues come from three main sources: income from the endowment, which covers some 35 percent of operating expenses; income from tuition and fees and a few other minor sources, which covers 53 percent; and gifts made by alumni and friends, chiefly to the Annual Fund, which cover 12 percent. This basic triad has supported the College throughout much of its history, though the relative contribution of each component has changed with time. In particular, reliance on endowment income has slowly grown over the years. Overall, the College's budget in the 2008-09 fiscal year was originally projected to be $155 million. An early round of cuts, in reponse to the economic situation, reduced that budget by approximately $3 million.

How is this money spent? Amherst College is by its nature a labor-intensive enterprise. The budget is built around people. In the mind's eye one may picture Amherst as classrooms and dorms, libraries and labs, lecture halls and playing fields, but the biggest slice of the budget pie consists of compensation for the College's faculty, administration and staff, who together create the extraordinary educational community that students experience and alumni remember. [**See Figure 3.**] The second largest portion of the budget consists of financial aid. In truth, every student receives financial aid, for the simple reason that the actual cost to the College per student of a year at Amherst exceeds the annual fee by more than 50 percent. That said, more than half of the student body receives some amount of financial aid as conventionally defined—in other words, aid to make up the difference between the annual fee and what the student and the student's family can afford to contribute. This is Amherst's

Figure 3. Operating Budget Expenditures, Fiscal Year 2008–09



investment in a student body chosen according to the College's own criteria—a wide array of the most promising applicants selected regardless of ability to pay. The commitment to financial aid is historic, is consistent with the College's mission and has helped make Amherst at once the most diverse and the most selective liberal arts college in the country. The remaining slices of the budget consist of items such as academic support, student services, plant maintenance and administration. But to step back: all told, about three quarters of Amherst's budget goes to compensation or to financial aid. It is spent, that is, on investments in people—investments that yield dividends over lifetimes of achievement. This budget structure is typical of liberal arts colleges. But should the need for budget-cutting arise, it also has the potential to make the process especially wrenching.

And, last year, the need arose with urgency. The general outline of the economic story is by now familiar. Economic storm clouds had been gathering for some time, but the events of last autumn—the fallout from the subprime-mortgage crisis, the failure of Lehman Brothers, the bailout of AIG, the broader credit crunch—reverberated throughout global financial markets and heralded a downturn whose severity had not been experienced in generations. The College responded quickly and deliberately. President Marx asked all administrative and academic departments to seek immediate non-personnel cost reductions, paring the College's budget, as noted, by $3 million in the academic year already under way. The president also sought additional savings for the year to follow, thereby reducing the projected budget in the 2009-10 academic year by $11 million. Salary pools were frozen. So was most new hiring. Planning for some capital projects was put on hold. Enrollment was again increased slightly; it has grown modestly in recent years for a variety of non-financial reasons, but at the margins enrollment growth can also augment revenue. In order to further strengthen liquidity, the College borrowed $100 million of taxable 30-year debt in early 2009.

Meanwhile, the Board of Trustees made the final decision to launch a $425 million comprehensive campaign. This campaign, *Lives of Consequence*, has been long in the planning and is intended to support a variety of initiatives, including curricular renewal, the hiring of new faculty, and financial aid. As many noted at the time, the darkening economic forecast made the environment for a comprehensive campaign less than ideal—but it also made a comprehensive campaign more important than ever for sustaining and advancing the mission of Amherst College.

THE ADVISORY BUDGET COMMITTEE

By the beginning of 2009 the full dimensions of the economic crisis had come into sharper focus. Of central importance, it was now possible to estimate that the likely loss to the endowment between the summer of 2008 and the summer of 2009 would amount to roughly a quarter of its value—a loss modestly less severe than at many peer institutions, but one with obvious consequences for annual revenues. The Board of Trustees welcomed the creation of an Advisory Budget Committee to begin the process of identifying further measures the College might adopt to bring the budget into equilibrium within a reasonable period of time—specifically, by 2019, a decade hence. The committee was made up of the president of the College and representatives of the faculty, the student body, the administration, the staff, the alumni and the Board of Trustees.

Although the Board bears ultimate fiduciary responsibility—it approves the annual budget and exercises close scrutiny over it—the creation of an advisory committee reflected a recognition that Amherst is a close-knit community where diverse voices can be heard, and that this is a fundamental source of strength. Proposals put forward by the committee would be subject to consideration by the board, which would in the end make its own decisions in close consultation with the president.

The Advisory Budget Committee did its work in late winter and throughout the spring, meeting with the various standing faculty committees and with other community groups. The level of on-campus interest and participation was high. In June, the advisory committee convened for three days to discuss a range of options, and by the end of the month it produced a detailed report.

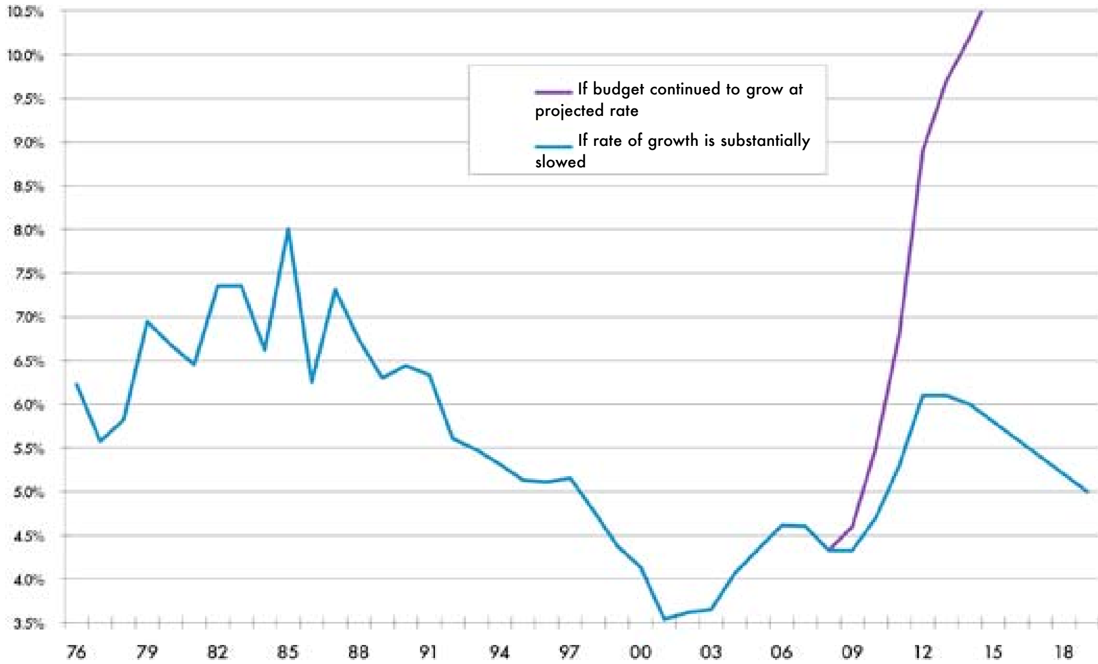
The charge given to the advisory committee was straightforward. Its underpinnings, however, may be less self-evident to those at a distance, and are essential to understand.

In the short term, the College has the capacity to increase the spend rate of its endowment above a sustainable level to cushion the impact of a deep economic downturn—this, after all, is one of the purposes of an endowment. There would be no need for the extreme or hastily considered adjustments that some institutions have been forced to make, notably institutions whose spend rates were already high when the crisis hit. But an increased spend rate could only be temporary. If the College's budget continued to grow in the future as it had in the recent past, the spend rate would within a few years balloon to 8 percent and then ultimately even higher. Therefore, the task ahead for the committee, as laid out by the board, was to find ways to curtail the future rate of budget growth so that within the decade the spend rate from the endowment would return to a level at or below 5 percent. [**See Figure 4.**]

Furthermore, the committee undertook its work mindful that improvements in the economy, even if they were to come robustly and fast, would by no means remove the need for immediate and enduring action. The loss to the endowment—the core of the budget problem—will not be made up anytime soon, no matter how quickly the economy improves.

The Advisory Budget Committee's report is available in full on the Amherst College Web site. [It can be found at www.amherst.edu/aboutamherst/economy.] By design, its first round of deliberations was focused on the three-year period 2010-12. The committee identified a combination of budget cuts and revenue increases totaling some $37 million over this period, in addition to the $11 million already removed from the 2010 budget. The cost-saving proposals include, but are not limited to, the following: holding salary-pool increases to the rate of inflation, or somewhat less, for the next two years; reducing the number of staff and administrative positions, if possible through voluntary retirements and attrition; reducing the number of visiting faculty; and further reducing non-personnel budgets across the board. The report took as an assumption that the proportion of students on financial aid, now 54 percent, would grow no further. However, it recommended no change in basic financial aid policies. It did determine that cost-saving financial aid adjustments could be made in various ways, for instance by raising the summer-earnings expectation for students. The report also recommended increasing the annual fee by 5 percent in each of the next two years. Taking note of the responsibility to maintain the high quality of the physical plant, the report recognized the importance of continuing to plan for a major capital investment in new science facilities. For

Figure 4. Endowment Spend Rates, Actual through Fiscal Year 2008–09, Projected Thereafter



similar reasons—maintaining both the high quality and the intensity of teaching over the long term—the report recommended increasing the number of searches for tenure-track professors, to bring the faculty up to its full complement.

The Advisory Budget Committee noted that, "as a community, we set high expectations for ourselves, and rightly take pride in the quality of the work we do." The recommendations, "should they be implemented, have implications for every corner of the campus." And the report continued, "Achieving additional savings on the order of $37 million from previously projected budgets, however it is done, will mean that some administrative services and programs to which we have become accustomed must be reduced or eliminated."

The committee also emphasized that while its proposals would certainly reduce the rate of growth in the College's spending, with particular impact on the years 2010-12, further action will be required if projected budgets are to achieve a sustainable level. As the report states: "More must be accomplished in order to reach the goal set by the trustees of reducing the spend rate on the endowment to five percent. Sustained efforts will be needed over the coming decade to return the College to financial equilibrium. All constituencies of the College will be asked, therefore, to think about next steps—that is, to continue exploring creative ways in which Amherst can control costs while providing the highest possible standard of instruction in the liberal arts."

THE PATH AHEAD

In mid-July, the Board of Trustees, with President Marx, reviewed the report of the Advisory Budget Committee. While noting, as the report points out, that the proposed measures do not fully achieve the mandated goal, the Board affirmed the importance of the work done thus far and made it clear that the process of campus engagement in the issues at hand must continue. The president, the Board and the administration, together with faculty committees and other campus groups, will soon resume this task.

In a statement to the Amherst community, President Marx elaborated on the advisory committee's proposals, noting that although adjusting to the new economic realities has not been easy, and will continue to present challenges, the steps taken thus far recognize the College's commitment to preserve an extraordinary faculty of teacher-scholars; to ensure access to the College for the most talented and most broadly experienced students regardless of ability to pay; and to maintain staff community and quality. He reported that, with the concurrence of the Board of Trustees, the administration would move ahead to implement the recommendations. [President Marx's letter to the community, and a statement from Jide Zeitlin, chairman of the Board of Trustees, can be found in full on the Amherst College Web site at www.amherst.edu/aboutamherst/economy.]

The challenges facing Amherst are part of a national challenge within higher education. Ideas about the creative approaches that liberal arts colleges may pursue in response are likewise part of an emerging national conversation. Amherst has for many years been a leader among liberal arts colleges—and beyond—on many fronts, and it will continue to be a leader in shaping that conversation about the future. Economic circumstances may not improve rapidly, and the College's plans cannot be based on wishful thinking. But neither can they be based simply on incremental retrenchment. As in difficult times past, opportunities abound for fresh thinking, renewed engagement and refocused ambitions.

Some things have not changed, and will not change. One point in particular should be repeated. Amherst's most important endowment is a living one: it is the people who teach, labor and learn at the College, and the many thousands who have gone out from Amherst and into the wider world "to lead principled lives of consequence." Even in hard times—perhaps especially at such times—this is an endowment whose value only grows.