

Email sent to the Campus Community by President Tilghman
Subject: Letter from President Shirley M. Tilghman

September 29, 2009

To members of the Princeton University community:

I am writing to update you on the impact of the continuing economic crisis on the University. In my April 6 letter to the University community, I thanked the many students, faculty, staff and alumni who had rallied around, offering their good ideas for cost-cutting, their hard work to put those ideas into practice, and their commitment to protecting the core teaching and research mission of the University. Five months later, I redouble my thanks for the spirit of collegiality that has pervaded the campus response and the rapid adoption of strategies to reduce spending. My thanks go out to our alumni, parents and friends, whose contributions to this year's heroic Annual Giving campaign were the third largest in our history, at a time when everyone was feeling the effects of the recession. Rajiv Vinnakota '93, the national Chair of Annual Giving, and Director of Annual Giving Bill Hardt '63, together with their army of volunteers and staff, worked tirelessly to achieve such a remarkable outcome. On campus our faculty have collaborated with the central administration to direct their departmentally managed endowment income to core needs such as undergraduate financial aid, graduate fellowships and faculty salaries, and managers began to realize budgetary and vacancy savings prior to the end of the academic year, yielding an \$11 million operating budget surplus on June 30, 2009 that could be applied immediately toward the challenging saving goals for this year.

Because of the dedication of so many, Princeton is now and will continue to be a resilient and strong university, protected by our tradition of prudent management over many decades, a common understanding of our focused research and teaching mission, and a culture that breeds intense loyalty and devotion. Furthermore, it is a university that exuberantly celebrates its traditions while keeping its eye firmly on the forefront of scholarship and learning. Last year was no exception. The University successfully renewed its contract with the Department of Energy to manage the Princeton Plasma Physics Laboratory and recruited a very able new director, Dr. Stewart Prager, to lead the effort. The implementation of the four-year college plan and the expansion of the undergraduate student body, nine years in the making, are now complete, with the opening of the lovely new dormitories at Butler College, named in honor of John C. Bogle '51, Mark Wilf '84 and the Class of 1967. The exciting Bridge Year Program was successfully launched over the summer, with 20 members of the Class of 2014 now engaged in public service in Serbia, India, Ghana and Peru. The place of the arts continues to expand on campus, inspired by the Lewis Center for the Arts, and the Andlinger Center for Energy and the Environment is now a reality, fostering innovative teaching and research across the University, and propelled by a commitment to a more sustainable future for the world.

Reductions in the Budget

In April, facing the prospect that the value of the endowment would decrease by as much as 30% by June 30, the University embarked on a two-year plan to reduce its operating budget by a total of \$170 million. Our goal in paring down the budget was to preserve the quality of the educational experience of our undergraduate and graduate students, so that no one 25 years from now would say that he or she attended Princeton at a time when opportunities were limited. Second, we aimed to mobilize every available dollar toward that goal. The plan included freezes of all salaries this year, with the exception of modest increases for the lowest paid faculty and staff; halts to all capital projects that were not already underway; slowing down the recruitment of new faculty and staff; and instituting two years of successive 8% reductions in spending of endowment income. Our budgetary challenges were heightened by decisions to set this year's increase in tuition and fees at the lowest level since 1966 and to increase the budget for undergraduate financial aid by 13% so that we could continue to meet the full need of every undergraduate who qualifies for aid without requiring loans. We also increased the budget for graduate student stipends. Through the hard work of many individuals, led by Provost Christopher Eisgruber '83, Executive Vice President Mark Burstein, Vice President for Finance and Treasurer Carolyn Ainslie, Dean of the Faculty David Dobkin, and Vice President for Human Resources Lianne Sullivan-Crowley, we have achieved our savings target of \$88 million for the current academic year (FY10), and we are well on our way to identifying the additional \$82 million we must eliminate from the FY11 budget.

Toward that end, this summer we offered a Voluntary Incentivized Retirement Program (VIRP) to 460 members of the staff who were eligible for retirement, and 145 of them took this opportunity to retire from the University. Much credit goes to Vice President Sullivan-Crowley and her staff for designing and administering this generous offer with skill and thoughtfulness. While the outcome allowed a significant number of staff to retire at a time of tight financial conditions, it will not fully eliminate the need for additional layoffs this fall. The number will be less than it would have been without the successful VIRP and the vacancy savings achieved by our managers over the last six months, and significantly less than the number of layoffs that have been necessary at some of our peer institutions. While some of the VIRP retirements result in savings as positions are left vacant or redeployed, others create vacancies that we will be filling, and to the extent possible we will try to fill at least some of these positions with staff members who will be affected by the layoffs.

On the plus side, the exercise of reviewing virtually everything we do for cost-savings and efficiencies has strengthened us as a University. There were things we were doing not because we *should*, but because we *could*. There were duplications in services that were historical accidents. There were staff positions that could be consolidated or redirected toward higher priorities. There were services that had become obsolete, such as television hookups in every classroom and postage meters in many departments. By eliminating or cutting back on such services, we achieved significant savings without affecting the operation of the University.

Investment Results

Last weekend at a meeting of the Board of Trustees, Andrew Golden, the president of Princeton University Investment Company (PRINCO), reported that the return on the endowment during the 2008-9 academic year was -23.7%. While hardly an occasion for celebration, this is considerably better than last spring's prediction of -30%. As of June 30, 2009, the value of the endowment was \$12.6 billion, a decline of \$3.7 billion from the June 30, 2008 value of \$16.3 billion. This value reflects the year's returns and the addition of new gifts, but unlike most years it does not reflect cash withdrawals for spending from the endowment. To preserve the long-term purchasing power of the endowment, we chose not to transfer funds from the endowment to the operating budget last spring. Instead, working capital for operating expenses was provided by a combination of other resources, including proceeds from a taxable bond offering last January. That has proved to be a wise and prudent decision, given the recent recovery in the markets.

Some members of the community have responded to the reports of endowment losses with a concern that PRINCO's investment strategy exposed the University to unacceptable levels of risk, especially in light of the fact that 48% of our operating budget depends upon endowment payout. Let me try to respond to this concern. Since the inception of PRINCO in 1987, our investment strategy has been to prudently balance the two important goals of managing risk and maximizing returns, which are inextricably linked to one another. With regard to the issue of risk, our policy of broad diversification of asset classes, including relatively illiquid asset classes such as private equity, independent return and real assets, has, until last year, provided effective hedges against risk, as the values of asset classes tended to rise and fall independently of one another. Last year when the sub-prime mortgage crisis sparked the near collapse of the world's financial markets and we came face-to-face with a once-in-70-year recession, that lack of correlation disappeared, and all investment classes except fixed income experienced significant losses. From this we were reminded that there is no investment approach that could fully protect an endowment against the severest of global downturns, and at the same time provide high enough returns over the long term to enable us to preserve the purchasing power for future generations.

PRINCO's success at maximizing returns led to approximately 11.8% annualized returns on its investments over a 22-year period. Even after factoring in the steep decline last year, our 10-year annualized rate of return of approximately 9.7% (compared to the MSCI All Country Index at 0.2%) puts us in the top 3 or 4 of the 40 largest endowments in terms of long-term performance. The linkage between risk and returns is made crystal clear by the fact that universities that employed a more conservative approach to investing may have had losses that were significantly lower than ours last year, but they also had much lower annualized returns over the last ten years. Had we adopted a more traditional approach, our endowment would be about half its current size and we would not have been able to lead the country in eliminating loans for students on financial aid;

we would not have been able to expand the size of our student body to make a Princeton education available for more students; nor would we be able to make the critical investments we currently make in the research and teaching missions of the University.

In other words, our pre-eminence has depended upon the risk/reward profile that PRINCO has adopted. It is important to remember that even after successive 8% reductions in endowment spending this year and next, the payout per unit of endowment in FY11 will still be more than 37% above the FY06 payout.

The economic crisis has brought into sharp relief the importance of maintaining sufficient liquidity within PRINCO to supply the budget with operating funds on a quarterly basis.

The pressure on liquidity was exacerbated by having a significant percentage of PRINCO's resources in illiquid investments, and the looming (but largely unrealized to date) prospect of significant capital calls from its external managers that we would be legally obligated to meet. The endowment has had more than ample liquidity to support the operating budget and meet its contractual obligations, even in the current circumstances, but as I noted above, providing that liquidity would have required selling equities at unattractive prices. In light of this past year's experience, the directors of the PRINCO Board, together with the members of the Finance Committee of the Board of Trustees, are reviewing our overall investment strategy and considering ways to further buffer the University from future severe downturns. The early stages of the review suggest that marginal, not radical, changes may be warranted.

Looking Ahead

Even with the endowment's better-than-expected returns last year and \$170 million in savings over this year and next, we will still be spending more than is prudent for the long-term wellbeing of the University. Several years ago the trustees adopted a policy of spending between 4 and 5.75% of the total value of the endowment each year, a band that would guarantee that current and future Princetonians benefit equally from the endowment's resources. This year our spending rate is 6.04%, which is outside the band. A return to the middle of the band will require some combination of two factors: more positive investment returns than we have projected and/or an annual increase in endowment spending beyond FY11 that is lower than the 5% annual increases that are anticipated under our established policy.

To give you some sense of the magnitude of the challenge to restore a sustainable spending rate for the endowment, we are constructing the FY11 budget with the assumption that endowment returns will be flat this year, based on ongoing uncertainty about the extent and timing of the recovery in the markets, and that they will return in FY12 to the long-term projections of ~10%. Should these predictions hold, we would only return to the very top of the spending band in FY12 if we enacted no increase in endowment spending over FY11. We thus have no choice but to continue implementing the two-year budget plan that we announced last spring, and it remains possible that we will have to ask for more cuts in FY12. This is clearly not a time to relax, but rather to sustain the budgetary discipline that will protect the University's core programs now and in the future.

Let me close where I began. We still face significant challenges, but we have made excellent progress this past year and we are doing everything we can to emerge from this period with renewed strength and vitality. The University is weathering this economic storm with its commitment to excellence in teaching and research intact, thanks to the dedication and hard work of the entire campus and alumni community. For that I am deeply grateful.

Sincerely,

Shirley M. Tilghman