MINUTES OF THE APRIL 23, 2012, FINANCE COMMITTEE MEETING

The Finance Committee ("the Committee") of the Board of Regents of the Smithsonian Institution held a meeting on April 23, 2012, beginning at 2 p.m. Participating were Committee Chair David Rubenstein and Committee members France A. Córdova, Representative Steven LaTourette, Roger W. Sant, and David Silfen. Senator Thad Cochran was unable to participate. Staff attending included Secretary Wayne Clough; Treasurer Sudeep Anand; Chief of Staff to the Secretary Patricia Bartlett; Smithsonian Enterprises Chief Financial Officer Gregory Bokman; Acting Deputy Under Secretary for Finance and Administration Bruce Dauer; Under Secretary for Finance and Administration/Chief Financial Officer Albert Horvath; Acting Director of the Office of Planning, Management and Budget Ken Johnson; Chief of Staff to the Regents John K. Lapiana; General Counsel Judith Leonard; Smithsonian Enterprises President Chris Liedel; and Director of Government Relations Nell Payne.

Because he was participating by telephone from a remote location and was concerned that he might lack good transmission, Mr. Rubenstein asked that Mr. Sant chair the meeting. Mr. Sant agreed and called the meeting to order.

APPROVAL OF MINUTES

Mr. Sant asked for comments on the draft minutes of the January 17, 2012, Committee meeting. There were none and the minutes were approved.

FISCAL YEAR (FY) 2014 FEDERAL BUDGET PRIORITIES

Mr. Sant noted that consideration of the FY 2014 budget priorities was probably one of the most important issues the Committee will consider. Mr. Horvath agreed, noting that "tremendous" uncertainty regarding the FY 2013 Federal budget existed in Congress. Nonetheless, he said, agencies are expected to continue preparing their FY 2014 Federal budget requests for submission to the Office of Management and Budget (OMB) in September 2013. He added that the OMB has not yet issued official guidance on preparing requests. Mr. Johnson observed that the Smithsonian will likely be permitted to submit both a "requirements budget" and a budget anticipating a 5 percent government-wide funding cut.

Mr. Horvath then outlined the principles recommended by staff to guide the FY 2014 Federal budget submission:

- Fund fixed costs/non-discretionary increases (e.g., rent and utilities);
- Fully fund the construction of, and ramp up operations for, the National Museum of African American History and Culture;
- Optimize the leveraging effects of Federal funds on fundraising for continuing public-private projects; and
- Sustain facilities.

In a requirements submission, Mr. Horvath said that the Smithsonian would also seek "limited, targeted increases" for activities for which private fundraising is unlikely (collections care, IT infrastructure, and facilities maintenance and revitalization), and would redirect resources to high-impact activities such as the SI Redesign effort.

Mr. Sant asked how the priorities change from a requirements budget to a 5 percent reduction budget. Mr. Horvath noted that detailed discussions have commenced with individual units to devise implementation plans should the reduction be mandated. He expects those plans to be completed within the next month and added that the Smithsonian has been planning for such a contingency (as well as a 7 percent cut) in recent past budget cycles. However, Mr. Dauer warned the Committee that the Budget Control Act is in effect and that sequestration would be triggered in FY 2013 if certain overall Federal budget targets are not achieved. The sequestration would be government-wide.

After some discussion on the factors included in the contingencies planning process, the Committee approved the following motion:

> **VOTED** that the Finance Committee recommends that the Board of Regents approve the annual Federal budget priorities proposed by the Secretary.

FY 2013 ENDOWMENT PAYOUT

Mr. Horvath outlined the Secretary's proposal for an Endowment payout of 5 percent of the Endowment's market value for programs and expenses and up to an additional 1 percent for the national campaign. This would result in a payout of $53.33 million for programs and operations and up to $6 million for the campaign. He noted that the proposed payout was consistent with the Smithsonian's policy to pay out 5 percent of the five-year moving market value of the Endowment annually, as well as the Regents' previous endorsement of an extraordinary payout of up to 1 percent of the eligible Endowment's market value for campaign expenses.

Mr. Silfen described some of the pressures that university endowments are under as a result of the recession, and Mr. Sant asked that the Finance and Investment committees consider revisiting the payout policy at future meetings of the respective committees. With that, the Committee approved the following motion:

> **VOTED** that the Finance Committee recommends that the Board of Regents approve a payout rate of up to $46.36 per share for all Endowment funds for fiscal year 2013. This represents $38.63 per share for programs and operating costs and up to $7.73 per share for the national campaign.

FINANCIAL REPORT: FY 2013 FEDERAL BUDGET STATUS AND FY 2012 Q2 DATA

At Mr. Sant's request, Mr. LaTourette provided an overview of the FY 2013 Federal budget process. Mr. LaTourette began by complimenting the Secretary and his team for making a "masterful" case on the Smithsonian's behalf before the House Interior Appropriations Subcommittee. Mr. LaTourette noted that the House recently passed the "Ryan Budget," which calls for a series of reductions affecting discretionary domestic spending (including the Smithsonian). He then described a series of possible scenarios, as well as the potential impact of the possible sequestration mandated for January 2013. In light of the November 2012 elections, Mr. LaTourette said that a continuing resolution at "near flat funding" for FY 2013 to at least January 2013 was probable.

Mr. Horvath stressed that the Smithsonian was trying to anticipate every contingency regarding its FY 2013 budget. Of primary concern is the possibility that a sequestration in January would likely require furloughs as a central response strategy. He reiterated some of the priorities that would be in danger should the Smithsonian's Federal budget be significantly reduced, including the construction of the National Museum of African American History and Culture facility and earthquake damage repairs.

Turning to his FY 2012 financial update, Mr. Horvath characterizes the status as "relatively calm and in relatively good shape." Philanthropic giving and grants and contracts were "trending well." The net gain from Smithsonian Enterprises activities also was higher.

SMITHSONIAN ENTERPRISES (SE) UPDATE

Mr. Liedel began his presentation with a financial recap for the first six months of FY 2012. As of March 31, 2012, overall revenue from SE activities was near flat at $64.5 million, with a $9.7 million net gain after Unrelated Business Income Tax (UBIT). The most significant decline was due to a planned reduction of the number of holiday catalogs and the cancellation of the winter sale catalog. Two publications, in contrast, have "done very well": *Jefferson's Bible* and *The Nation's Hanger.* He said some additional expenses have been incurred as SE invests more in its online activities. Regarding the whole of FY 2012, Mr. Liedel said that SE expects revenues of $144.8 million and a net gain after UBIT of $29.2 million. He briefed the Committee on some of the drivers causing deviations in the April 2012 end-of-year outlook with that presented in January 2012.

Mr. Liedel next presented his early observations about the SE organization after serving his first few weeks as SE President. Before detailing his observations, he noted that the transition between former President Tom Ott and himself "has been going very well." Mr. Liedel categorized his observations in three areas: initial budget analysis; internal partnership focus; and staffing. With regard to the initial budget analysis, he said that management will focus on year-over-year net gain growth and improving second-half revenues.

SE will increase its efforts to partner more closely with museums on business initiatives, particularly in the area of educational products, he said. Mr. Liedel noted that 40 percent of SE senior management joined in the last nine months, and said that they are aggressively learning about the organization's strengths and weaknesses as well as assessing staffing needs for new revenue opportunities.

Mr. Liedel described strategic opportunities in the advertising competitive landscape, particularly ways to capitalize on Smithsonian cross-platform assets, that would bolster the performance of *Smithsonian* magazine. With regard to the *Smithsonian Channel,* Mr. Liedel described the growth in royalty license payments and the increase in the Smithsonian's equity investment income. Subscriber households have grown from 7.9 million in February 2011 to 14.1 million in January 2012. He noted that the Smithsonian has a significant opportunity to increase revenues from its right to sell up to 20 percent of the advertising time on the Channel. With a current subscriber base of over 15 million, Mr. Liedel said that the Channel should prove to be a "very attractive" vehicle for advertisers.

EXTERNAL DEBT UPDATE

Mr. Anand presented the annual Committee update on Smithsonian external debt. He noted that the Smithsonian had $109.5 million of existing external debt as of September 30, 2011. Of that, $77.5 million is in variable rate debt that matures in 2033. That debt is serviced by National Air and Space Museum's Udvar-Hazy Center pledge payments and banking and business income. Fixed rate debt stands at $31.8 million and consists of serial and term bonds with final maturity in 2028. The annual service on that debt is funded through $2.5 million in income from trust activities at the National Museum of Natural History.

Mr. Anand noted that the interest rates on the variable rate bonds reset every week and can be tendered back to the Smithsonian on any reset date. To guard against illiquidity caused by unexpected tenders, the Smithsonian has a stand-by bond purchase agreement with the Bank of America. The agreement with Bank of America expires on December 31, 2012. Mr. Anand noted that Moody's has placed Bank of America on a negative credit watch for a possible short-term rating downgrade, which, if it occurs, will likely lead to a downgrade of Smithsonian variable rate debt and increased interest costs.

The Committee discussed and evaluated a series of options that could be taken should Moody's downgrade Bank of America, ranging from paying off the debt to doing nothing until the agreement expires at year end. Mr. Anand said his office will continue to monitor Moody's possible actions and will develop a recommendation for the next Finance Committee meeting on August 27, 2012. Mr. Sant also suggested that the Investment Committee be briefed on the matter, particularly as some suggested options would impact the Smithsonian's working capital account. Mr. Horvath noted that management is conducting a significant cash flow analysis that will help craft a strong recommendation for the Committee's consideration.

ADJOURNMENT

The meeting was adjourned at 3:15 p.m.

Respectfully submitted,

David Rubenstein
Chair