NOTES OF THE APRIL 24, 2013, FINANCE COMMITTEE MEETING

The Finance Committee ("the Committee") of the Board of Regents of the Smithsonian Institution held a meeting on April 24, 2013. Participating were Committee Chair David Rubenstein and Committee members France A. Córdova and Roger W. Sant. Committee members Representative Xavier Becerra, Senator Thad Cochran, and David Silfen were unable to participate. Accordingly, a quorum was not achieved to conduct the official business of the Committee.

Staff participating for all or part of the meeting included Secretary G. Wayne Clough; Treasurer Sudeep Anand; Chief of Staff to the Secretary Patricia Bartlett; Chief Investment Office Amy Chen; Inspector General Scott Dahl; Smithsonian Enterprises (SE) Vice President for Finance and Administration Bruce Dauer; Under Secretary for Finance and Administration and Chief Financial Officer Albert Horvath; Chief of Staff to the Regents John K. Lapiana; General Counsel Judith Leonard; SE President Chris Liedel; Liaison for Representative Becerra Grisella Martinez; Director of Government Relations Nell Payne; and Office of Planning, Management and Budget Director David Voyles.

CALL TO ORDER

The Chair called the meeting to order at 10:05 a.m.

ENDOWMENT PAYOUT

Mr. Rubenstein noted that historically the Smithsonian Endowment payout has been 5 percent of the five-year average of the Endowment's market value. He noted that management recommends continuing that practice for fiscal year 2014, with an additional "special draw" on certain endowments to support expenses related to the national campaign (up to 1 percent).

Mr. Horvath noted first that the recommendation from management reflected deliberations with the Investment Committee on long-term return assumptions and their implications on a reduction of the payout rate. He added that the five-year market value has been decreasing due to down years coinciding with the recession. As a result, by maintaining the current payout rate with a declining market average, the projected payout will decrease $1.35 million from fiscal year (FY) 2013 to $53.8 million. He noted, however, that the effective payout rates against the projected FY 2014 Endowment market value ($1.203 million) would be 4.98 percent (including the projected national campaign payout).

Mr. Horvath then described the programmatic and central administrative activities supported by the payout. Approximately 33 percent of the payout ($18.1 million) is earmarked for Central Trust activities, while the remainder ($36 million) is directed toward mission-based units (e.g., museums and research units).

Mr. Sant noted that the Investment Committee's deliberations included discussion of a continuing payout rate of 5 percent and the challenges of securing the returns necessary to sustain that rate. Mr. Horvath said that his staff will continue to work closely with the Finance and Investment committees to monitor changes and new developments in the market and their potential impact on the Endowment's market value.

After further discussion, the participating Committee members conditionally approved the following motion:

> **VOTED** that the Finance Committee recommends that the Board of Regents approve a 5 percent payout from the Smithsonian Endowment in fiscal year 2014 to support programmatic activity. The Committee further recommends that the Board authorize up to an additional 1 percent payout from the Smithsonian Endowment in fiscal year 2014 to fund certain expenses associated with the national fundraising campaign. The payout shall be calculated against the current five-year average market value of the Smithsonian Endowment.

The motion was subsequently approved by the Committee through electronic balloting.

DEBT PLANNING

Mr. Rubenstein explained that management is seeking authority to issue debt to provide financing for specific, continuing Trust-funded capital projects, particularly the National Museum of African American History and Culture (NMAAHC), of up to $100 million. Mr. Horvath noted that internal Smithsonian funds are not adequate to meet the capital needs of current and anticipated Trust-funded projects. Although the Smithsonian's short-term portfolio can provide some bridge funding, more extensive use of internal funds would unacceptably reduce the Institution's financial flexibility. The current fiscal environment allows the Smithsonian to issue external debt at historically low rates, he said.

Mr. Horvath noted that current outstanding Smithsonian debt stands at $104 million, of which $77.5 million (variable rate) was used to fund construction of the Steven F. Udvar-Hazy Center and $26.5 million (fixed rate) was used for the National Museum of Natural History's Discovery Center. He added that the Smithsonian's credit rating is rated as AAA by both major credit rating agencies, but with a "negative outlook" due to its reliance on Federal funding. Mr. Anand added that Smithsonian debt had been as high as $210 million after the purchase of the Victor Building. Mr. Horvath provided an overview of the current debt market and options for both tax-exempt and taxable bonds, as well as the impact of an additional $100 million of proposed debt to the Smithsonian's debt capacity.

After discussion, the participating Committee members conditionally approved the following motion:

> **VOTED** that the Finance Committee recommends that the Board of Regents authorize the Secretary to analyze financing needs for Trust funded capital projects and to research potential debt structures should it be determined that a borrowing is necessary. Further, the Committee recommends that Board direct the Secretary to

present any proposed issuance to the Committee for a recommendation to the full Board for approval.

The motion was subsequently approved by the Committee through electronic balloting.

FEDERAL BUDGET UPDATE: FISCAL YEARS 2013 AND 2014

FY 2013 Federal Appropriation and Sequestration. Mr. Horvath explained that the Smithsonian was operating on a full-year continuing resolution, at the FY 2012 level ($810 million), less a sequestration of $42 million. In addition, the Smithsonian received special appropriations for "ramping up" staffing for the NMAAHC. He noted that the Smithsonian has managed its resources since the start of FY 2013 "very conservatively." Among the actions that have been taken since sequestration went into effect, he noted, were a hiring freeze, partial museum gallery closures, reduced discretionary expenses (travel and training), and delayed maintenance and revitalization projects.

Mr. Horvath said that management is conducting a Smithsonian-wide 7 percent reduction assessment to determine actions required if the sequestration reductions become permanent in FY 2014. A directors' retreat to consider strategic responses to potential long-term reductions is being planned for July 2013.

FY 2014 Federal Budget. Mr. Horvath provided an update on the status of the FY 2014 Federal budget submission to the Office of Management and Budget. The submission requests overall appropriations of $869 million, which includes a one-time appropriation of $55 million for the construction of the NMAAHC. The submission also includes a proposed reallocation of $25 million from other Federal agencies to support STEM engagement by the Smithsonian and $21 million for NMAAHC increased staffing.

REVISED FINANCIAL DASHBOARDS

Mr. Horvath reviewed a revised format of finance and administration indicators and quarterly financial reports that would be distributed to the full Board for its April 29, 2013, meeting.

SMITHSONIAN ENTERPRISES UPDATE

Mr. Dauer provided an overview of the year-to-date financial performance of SE. He said that compared to FY 2012, year-to-date revenues were up $2.3 million with all three of SE's major business groups positing gains. Net gain against FY 2012 was also up $1.3 million. Net gain was adversely impacted by Hurricane Sandy, which caused the cancellation of the Smithsonian Winter Sale catalog.

The full FY 2013 outlook, he said, projects a $4 million increase in revenues and an increase of $0.8 million for net gain against FY 2012. Overall, Mr. Liedel added, FY 2013 promises to be "good year" for SE.

Mr. Liedel discussed strategies to reposition advertising for *Smithsonian* magazine against other major magazine opinion leaders. Although he expects *Smithsonian* to face “major headwinds” from a declining market, Mr. Liedel noted that advertising was up 9 percent from the previous period in FY 2012. He noted that, compared to their competitors, both the magazine and Smithsonian Channel rank first among C-suite executives.

Mr. Liedel described efforts to reach a wider, more global audience. Over the last year, he said, advertising representation has expanded to Mexico, Europe, and Southeast Asia. In addition, SE is negotiating with potential partners to license editorial content in 12 international markets.

Finally, Mr. Liedel described efforts to strengthen existing relationship with Smithsonian concessionaires, as well as to identify new technology platforms to deliver Smithsonian content. He cited, among other things, Internet2’s advanced network infrastructure; Global Cloud+, which will support outreach to almost 15 million students in approximately 600 universities; and Cengage Gale’s digitization of *Smithsonian* and *Air & Space* magazines.

ADJOURNMENT

The meeting adjourned at 11:30 a.m.

Respectfully submitted,

David Rubenstein, Chair