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Minutes of the Academic Council
Thursday, April 21, 2022

Erika Weinthal (Chair, Academic Council / Nicholas School of the Environment): Thank you for hanging in there as we worked through those technical difficulties and welcome to our meeting, both on Zoom and in the room. I hope everyone is doing well today as we approach the end of the academic year. I'm sure everybody saw that it was LDOC yesterday, if you were on campus. We will have one more meeting of Academic Council next month on May 5th and we will continue in this hybrid manner. Hopefully, we will not have any more technical difficulties. Before we begin, I have a few announcements. The first one is to share some delight and good news for one of our colleagues. I would like to recognize Cynthia Rudin, from the Pratt School of Engineering, who was recently awarded a Guggenheim. Our warmest congratulations on this prestigious honor and recognition of her research and scholarly endeavors. *(Applause)*

It's good to start with something pleasant. The second thing is the election of members to the Executive Committee of Academic Council is currently in progress. Those who are eligible to vote for the next set of members to ECAC are our Academic Council members for academic year 2022-23. So, if your term ends this May you would not have received an email to vote. Standing for election for the 4 open spots are: Betty Tong from Clinical Sciences and School of Medicine; Joe Izatt from Pratt School of Engineering; Tom Rankin from Art, Art History and Visual Studies and that is the Humanities division; Karin Reuter-Rice, from School of Nursing; Barak Richman from the Law School; Deondra Rose from Sanford School of Public Policy; David MacAlpine from Pharmacology and Cancer Biology and that is the Basic Sciences and School of Medicine; and last is Mine Centinkaya-Rundel from Natural Sciences and the Mathematics division. We are grateful for all eight for their willingness to not only stand for election, but to commit to the time required to serve should they be elected. I will announce at our next Academic Council meeting, on May 5th, the results of the election.

Lastly, before we turn to the main item today, there should be attendance sheets circulating, so please sign those. For those of you on Zoom, attendance will be taken from the screen.

APPROVAL OF THE MINUTES OF THE MARCH 17 ACADEMIC COUNCIL MEETING

Weinthal: We're going to start with the approval of the March 17 meeting minutes, they were posted with today's agenda. Are there any corrections or edits to the minutes? May I have a motion to approve? Thank you. A second? Thank you, the minutes are approved.

We have one main agenda item, that's in regular session today, and this is going to be a financial presentation. It's been a little over a year since the Academic Council has had a presentation on Duke finances. ECAC and I thought it would be a good idea to have an update as we close out this academic year. We are, hopefully, no longer in that mindset of pandemic finances, so we can take stock of a bigger picture of Duke finances over the last year, where we are now, and hopefully thinking about where we are going. We will have Executive Vice President Daniel Ennis and Vice President for Finance Rachel Satterfield provide us with this update and then they will take questions after they are done.

FINANCIAL UPDATE PRESENTATION

Slides used in presentation

Daniel Ennis (Executive Vice President): It's great to be with you. Thanks for giving us time on the agenda. I have the privilege of introducing Rachel, Vice President of Finance, who just does a terrific job in these presentations and I know you'll feel the same once we go through this. I also wanted to say up front we've had great help from ECAC in preparing these materials. We value the faculty input we get in the University Priorities Committee, ECAC, and from the faculty members who are on the BOT Resources Committee. It is just invaluable, the advice and thought partnership we get in those forums. We are fully aware of the fact that we will use lingo or terms that may not be fully legible or accessible to you and we're working hard to do better in that regard. But, please ask questions and, you know, everything's fair game in terms of whatever's on your mind or whatever questions you have even if it's in the definitional space. So, with that I'll turn it over to Rachel.

Rachel Satterfield (Vice President for Finance): Good afternoon and thanks for having us. Hopefully I will navigate this but, after having the technical difficulties already…I'm hoping that's behind us. *(laughter)*

I just want to start out with a scale of the university so you can understand from Duke's perspective that the operating revenues for FY21 were $8.4 billion. Of that, about a third of that relates to the university. As you can see, the rest of it relates to the clinical mission, 64%. The PDC is not currently part of the university, but it obviously has overlap with the university, such that you can see how much dependence is on the clinical enterprise.

Takeaways, for today's discussion is, overall, we are in a very healthy place and we were very thankful for the returns from DUMAC [Duke University Management Co] that are really what drives this, you'll see on our balance sheet in just a minute. The university's operating performance, so that's the revenues minus our expenses, they've stabilized as you'll see. But, it's unclear as to whether or not that is short lived or fragile, and I'll explain why when we get to some of the trends that you're going to see. For the Health System, their operating performance continues to be a challenge. And I know in this environment we don't generally talk about the Health System's finances, but the reason we mention it is because there's a huge reliance from the School of Medicine on funding from the Health System. So, the challenges that the Health System face trickle down into how the School of Medicine will be funded.

So, focusing on improving the operating performance for both the Health System and for the University will be critical, especially in the face of the rising inflation and cost escalation. I'm sure each of you have seen that, especially in the labor market. I've heard across the board numerous concerns about what it costs for employees and their salaries, as well as retaining and in hiring new talent. We also see that in terms of our construction costs. So, what we saw two years ago, the cost of those things is sometimes 40% higher. It's very hard to manage operating performance when your expense base is going up at that particular level. We're also going to focus on facilities and reinvestment in existing facilities. You'll see in a minute, but there's been a lot of focus on growth and new facilities. We're going to slow the pace of the physical expansion and we're going to focus more on existing facilities and making sure that they're maintained.
Then last, this all goes to say that, we're trying to work towards transparency around university finances, such that you always feel like you understand where we are at any given point. And we've been preparing a one-page dashboard that has various financial metrics. I'll flash it up in a little bit, but all of this is to say that it's always available, it's routinely updated on a monthly basis, and it's shared with leadership all the time, so that people always understand where we stand at any given point in time.

This is the picture of the balance sheet that I mentioned. So, we are healthy. What I'll say is, the top line is the consolidated net assets, that's University and Health System. The blue line is the University by itself, and the Health System is the red line. When you think about net assets, what that really is is kind of an equity position that you have. So, you have assets and then you have liabilities. The difference between the two is your equity position. So, kind of like, how much money have you put into your home, how much have you paid in and how much equity do you have? I will point out the fact that, while this looks healthy and you might wonder, "why can't we do everything we want to do?" Part of it is because this is not the same as cash. In essence, what you have, and some of the net assets are tied up in donor restricted net assets. So, about $10 billion of it, donors have given us money and they've told us how we have to use it. So, we can't spend that for whatever we would like to. And then, a lot of the rest of the equity is tied up in facilities. So, it's again something that we can't just turn around and liquidate and be able to use this as cash, but the balance sheet is definitely strong in terms of its scale.

I want to talk a little bit about the debt level of the University. So, what you can see is the blue line, again, is the University and Health System is the red line and what you can see is that the University has $2.7 billion of debt outstanding. You can see that there was a big spike from 2019-2020. We took out additional debt of $600 million, and we did that at the beginning of the pandemic. We needed liquidity, cash. We needed to be able to make sure that if we had risk around our revenue streams, let's just say revenue didn't come in for a period of time we have fixed costs. So, in order for us to be able to manage the enterprise for a period of time we needed cash in hand. So, we turned around and we issued $600 million of incremental debt. That is a large level of debt. We are actually at our capacity levels where we can't borrow without what's considered to be a downgrade and that's not something that we're looking to do. But, I guess the point being, while $2.7 billion is a big number of debt, it does cost us roughly $96 million annually in principal and interest payments. So, that's part of the expense side of the equation, and it is scheduled to grow to $190 million by 2036 when some of our principal payments become due. We don't have the capacity to borrow any more debt and as we consider some of those capital renovations, that I talked about, that's normally how we would do that is by borrowing. We will have to take into account the fact that we have some challenges around additional debt for construction.

The operating performance, this is a trend of, like I said, this is our operating margin. So, revenues minus expenses. This is the Health System. I'm kind of bringing them in one by one, so you can see. This is what the Health System's operating margins look like, and obviously what you can see is a declining trend. This is the University as a standalone enterprise. This is what's published in our annual financial statements. And you can see that there was a pickup in 2021, and as many of you recall, while there were a lot of revenue losses in 2021, we took a number of steps to reduce our expense base. You know, we held our salaries flat, we took a hiatus on our 403 B plan for half of the year, and we had spending controls. We had all kinds of things that we did in response to what could have been a far larger revenue shortage. So that year, you can see, is a trending increase. But, before that you can see declining trends. The black line is the consolidated number. The point being that this takes into account eliminations of inner company transactions between the University and the Health System.

This is what's reported in aggregate for Duke University, as externally reported to our financial statement users. And the blue line is again the University in its absence, what we call unplanned investment support. So, in the past, where there were holes in different areas of the institution that were gaps, I would say, we would take additional investments support out to be able to help support those areas. So, they're really deficits, but they were somewhat being masked by the fact that we were matching it with investments. So, the blue line is to show you what was the true margin before we made those moves. Again, which you can see, is each of these lines shows a declining trend again with 2021 being the outlier.

Why is that? So, this is the University's revenue and expense growth over the last 5 years. The blue is the revenue, and the red is the expenses and what you can see is 3 out of the last 5 years where expenses are outpacing the revenue growth. So, that can only last so long unless you focus on improving your operating margin. I will say that early trends for us in terms of FY22, while we're showing we're projecting a slight surplus for the year, we are still seeing that we're back to a place where expenses are getting very close to outpacing the revenue growth again.

This is the Health System's rates of revenue and expense growth, and in fact they've shown expense growth that outpaces revenue over each of the last 5 years.

This is a picture of the Schools revenue budgets. So, which you can see here, and this is for FY22. I highlight a few of the primary revenue sources, but what you can see if you add up the bottom row is

$2.5 billion worth of revenue. The first column on the left, is the School of Medicine, it's $1.5 billion in total of the University's operating revenues. Then you get followed by Arts and Sciences, Pratt, Fuqua, you can read the names at the bottom. But, the point of this slide is to show the different revenue resources available to the Schools. For example, School of Medicine is highly research based, that's the blue bar here. The green represents tuition, contributions is white, and then the investment endowment support is yellow. And, the reason this is an important conversation is when we talk about managing or improving our operating performance, the different funding models here create certain challenges for the Schools. I mean, when your research based in a lot of cases it's not fully funded. It expects a bit of institutional support here. So, when you say you want to increase your operating revenues or decrease your operating expenses, you have to live within the model of revenue that you're being supported by.

This is to show the increased gross square footage over the last several decades, and as you can see we've actually put a lot of money in construction and grown the physical footprint over time. And as I said, this is an unsustainable path in terms of every time you add a building you add ongoing operating expenses as well. So, what we're going to do is we're going to slow the pace of growth in our physical plant and we're going to spend more on campus renewal.

This is, I know a lot to digest, but this is the dashboard that I mentioned at the beginning, in terms of us looking for transparency around Duke finances. This is the dashboard that we update every month, and that we provide to University leadership.

I'm always happy to walk you through or answer any questions with regard to this, but what it basically is in a snapshot it shows what our investment returns for the year, what the balance sheet looks like at that point in time, how are we doing here today on our operating performance, what are we projecting to be by the end of the year. Those types of metrics are what we're trying to get across in terms of the financial performance on a monthly basis.

So again, that was pretty quick, I hope I didn't use too much financial jargon and I'm happy to answer any questions that you may have.

Cam Harvey (Fuqua School of Business): Thank you very much for doing this presentation. It was very comprehensive, and I appreciate it. I also appreciate the back and forth email. I'm like the nightmare student. In October I asked the Provost a question when it looked like we were going into an inflation surge as to what proportion of employees were getting compensation that at least matched inflation? At the time, inflation was 5.4%, today it is 8.5%. I'm just wondering how you think about that risk. How is that affecting our finances and is there a contingency to potentially help out some employees? I'm sure you realize inflation is very regressive.

Ennis: To be honest, coming out of the pandemic, to the point of the front and some of our email exchange, it really should, in large part feel quite good, right? I think that balance sheet coming out the way it is, in terms of how Rachel's described it, and that revenue minus expenses picture. So, it's really frustrating that we face this incredibly hard problem. And I couldn't agree more with its regressive character and our concerns about that. The structural dimension of it, for us, is we do not pass on those costs. We're not about to turn around and raise tuition at the rate of inflation. Our funding sources will not match the pace of inflation. So, we will end up in a structural pressure point financially. We understand that, we've been talking to the Deans, we've been trying to prepare for it. We have made some moves. We did change Duke's minimum wage. We gave salary guidance that was well in excess of where we've been historically. But, we are in a situation where we will not close the gap as a sort of an all boats rising moment against that inflation. It's not structurally possible. Will we and are we digging deep to adjust salaries, to figure out where and how we can retain and support folks? That's absolutely the case. We're also in the context of negotiating all of our Labor Union contracts. This will be reflected and be a part of that conversation, as you would expect. So, there's a lot happening to try to respond to it, but I don't want to mislead anyone. As a university, given our funding sources that we will be in a position to address it unfortunately and frustratingly.

I would just note, we're feeling it strongly on our side of the enterprise. What the Health System is experiencing with regards to labor shortages and incredible pressures on salary, in terms of the clinical mission, is really concerning and a big part of the story for what's happening there financially.

Kerry Haynie (Political Science and African and African-American Studies): Thank you Rachel and Daniel. One question I have, so you have a long-term trend, and if you go back even farther on the net revenue expense line, what's the answer for getting out of that or changing those trend lines? We won't be able to frack for oil in the back of Allen Building, and all of a sudden have revenue, although maybe we might. *(laughter)* How do you get out of that? Because it's been that way for as long as I've been at Duke, it seems where those lines look that way.

Ennis: One thing this presentation doesn't do that we need it to do is to have within these conversations is talking about the extraordinary programmatic and mission outcomes that are occurring underneath the hood of this financial performance. That's what we're here for, we're a nonprofit and we're going to invest in mission excellence. And we will be chronically challenged. This is part of Cam's [Harvey] email. Basically, finding the balance point with mission excellence and financial sustainability. It's not a science entirely, it's a lot of art and careful judgment and consideration. Having said that, I think our view and what our argument would be that it is in our best interest to try to incorporate that, if not ultimately be in a more sustainable and ideally surplus position. That's what creates the free cash to reinvest in our facilities, our talent, on regressive issues that we're worried about with inflation. So, it's a question of discipline and when I say discipline, it's to be honest, it starts on the administrative side of the operation. We're trying to do a lot of things in that regard. So, we've been shrinking the administrative footprint for the central departments dramatically, with flexible work, with changes in staffing levels, and subletting space. So that's the kind of thing that is complex but it's creative as a financial matter. What else is less painful, less mission distracting? You know procurement is a classic one. It's never straightforward. We are offending the Provost on a regular basis on the supply chain issue. But, it's the kind of things you've got to do. So, the challenge to the administrative side is to be as smart and aggressive in pursuing opportunities until we have resources to invest academically. We need consistency and buy in across our academic programs and ask that academic leadership be as thoughtful and careful as stewards as possible. The thing that gives me hope is we're talking about rates. It's slow. This enterprise will grow, expenses will grow. It's just, can we be careful to navigate that rate at a slightly lower pace and can we be more creative, entrepreneurial, and risk taking to get that revenue line moving slightly differently? But that's what we want to be a hopeful and more attractive tractable framing of the opportunity. If we get it right, it will be meaningful for its advancing mission excellence.

Lee Baker (Cultural Anthropology and African and African American Studies): My question is, again, a little bit on the inflation side. In terms of the strategy for the Schools, I mean if central administration and inflation is going up, are you going to hold attributed and allocated costs the same or do you squeeze the Schools a little bit more to make up? What's the strategy vis a vis the Schools and inflation and unallocated costs?

Ennis: Jennifer [Francis] and Sally [Kornbluth] are here but we've tried to live within a planned set of guidance and to not surprise the Schools to the greatest extent possible with pops in that rate. So, that will mean that we've got to find it from within and not pass it along or at least bridge it until when the Schools might be in a better position. But listen, you know, this is the constant tension point in terms of the burden of the center, whether it be the administrative center or the academic center on our Schools and where the mission gets delivered. We are constantly trying to evaluate the burden we're creating for Schools. It's not an easy time. Whether we're talking about capital projects with departments that have been waiting a long time for certain projects and people who raised a lot of money and we're talking about talent issues and the pressure points there. So, I would say we're in a place where we're taking a deep breath together and navigating through a complex environment is important. And we've been here before we've done the hard things when necessary, and I'm sure we will again as we absorb the inflation of the moment. The hope, of course, is that it will not be a chronic persistent inflation. That we're going through a really challenging moment, but that we will come out the other side with regards to a more normalized experience of inflation and escalation.

Sally Kornbluth (Provost): I can just comment on that. So, we've tried almost as long as I've been Provost to leverage our allocated costs to allow more than like 5.5% or so. But, the truth of the matter is the costs that come back down to us are always above that. So, we're having to find money elsewhere, and obviously that's different from school to school and not distributed completely. But, in general we've tried to hold it down. Now, if you think about the things that that funds - we get pressures on why we can't give more to libraries acquisition fund, etc. Because when we think about all the things that all the Schools pay for, there's a limit to how far we can stretch that if we're not increasing the allocated costs at all as a percent growth from year to year.

Deborah Jensen (Romance Studies): I've heard that when the Health System sneezes the University gets the flu. *(laughter)* One might say that it had COVID, but it really went you know, for several years prior to that. I just wondered if you could say anything about the forecast for the Health System and their relationship to the University.

Ennis: It's a really important question and I would just note that we've been the great beneficiaries of the Health System's financial performance over time and it's been incredibly meaningful to the missions of the School of Medicine and School of Nursing and meaningful to the university in a number of ways. When you have a partner and you're part of a family, you want to make sure we always recognize really good things have happened as a result of the performance and careful management with the Health System.

It is a really challenging time in healthcare and academic medical centers are in a really tough spot. If you think about what's happened in our country right now, the share of the GDP getting consumed by healthcare is dramatic. The rates of growth in patients' healthcare expenditures are non-sustainable. So, the funders of healthcare are just basically saying, "We can't. This is unacceptable. We need lower rates of growth from our providers." And academic medical centers have much broader missions. The care they're providing with regards to their quintenary services and expectations, specialized services. So, we will always be a higher cost provider and we're a higher cost provider working to get to lower cost, but in the healthcare environment where the patients and the willingness to accept and support that broader mission is more challenge, more threat. So, we have, I would say, as a lead academic medical center a structural dilemma and challenge. And then you layer on COVID, an extraordinary expense and impact to the normal productivity of healthcare services. And you have a three-part whammy, where the third part is this incredible change in the workforce and healthcare delivery, and the level of engagement, morale around the willingness to do the job the way it's been done. This is really a hard moment for the university, all of us, that our healthcare mission is challenged the way it is. So, I would say we put the focus here, because we're sober about it. We have smart leadership and they'll chart a path through this, but it is a particularly interesting and complicated time in healthcare.

Don Taylor (Sanford School of Public Policy): I was wondering, with the Health System, have there been any discussions about selling equity stakes in the Health System?

Ennis: I would say no, first in terms of my exposure, but I would just flag, kind of more broadly, as a moment of education for folks. Over time universities have looked at their healthcare delivery systems or hospitals and said that's a series of activities at risk that aren't necessarily fully aligned with mission or as a governance and risk management matter it's not what we want to have as part of our university. So, they've created more arm's length relationships and, in some cases, had people come in and buy their hospitals and educational partnerships, etc. That question is often asked in the context of academic medical centers and has been answered in a variety of forms. That's not part of the conversation that I'm a part of, and I don't think, Vince, you would say anything differently on this?

Vince Price (President): No, I don't think so. The challenge is to broaden our mutual ___________. (recording cuts out for several seconds)

Taylor: Just to add, I happened to be looking at Emory's financial statements and I was really surprised their Health System's double the size of ours in terms of the number of patients. It's a big difference and it's really their primary care footprint throughout the entirety of Georgia. I guess this state is rich with Health Systems -- it sort of seems like we are.

Price: There are very large differences regarding how the Health Systems operate. It's a little hard to extrapolate and say, "Well this worked over California, let's do it here."

Ennis: I would say that about healthcare, broadly, and academic medicine, is scale matters. I think, there wouldn't be a leader in Duke Health, who wouldn't say we need more geographic and population coverage to deliver on our mission, and to find opportunities to reduce costs, improve patient service, clinical experience. And this has long been discussed and worked through at Duke Health and much more to come in that regard.

Thanks all.

(Applause)

Weinthal: Okay, we are now going to move into executive session regarding the last agenda item. Members of the Press and anyone who is not a member of Duke's faculty, I need to ask you to leave the meeting or Zoom.

[Remainder of the meeting conducted in executive session in order to discuss the Honorary Degrees for Commencement 2023]