

Drake University
 FY11 Annual Report to the Board of Trustees
 From the Vice President for Business and Finance
 September 2011

Executive Summary

Total assets at May 31, 2011 were \$386,039,289 (\$361,647,833 in FY10); while liabilities totaled \$111,007,236 (\$118,252,370 in FY10). Overall net assets increased by \$31,636,590 during the year to total \$275,032,053 at May 31, 2011 (\$243,395,463 in FY10). The overall increase in net assets was primarily the result of unrealized investment gains, contributions for non-operating purposes and operating surplus.

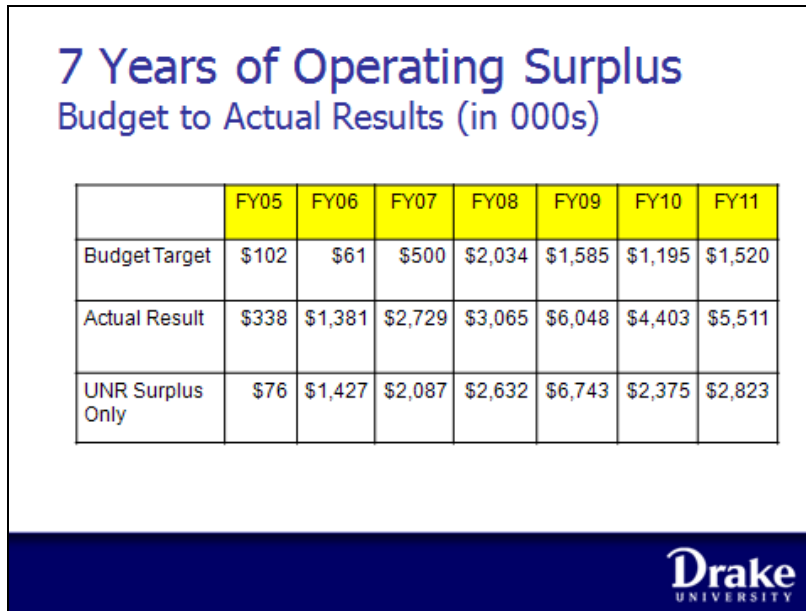
The financial report card below provides a quick review of the University's financial results for the year ended May 31, 2011. The seven objectives cited were selected by the staff several years ago as the most important annual indicators of general institutional financial health. **All seven of the financial report card objectives were met or exceeded for FY11.** Overall, the FY11 operating results were very positive and added significant strength to Drake's balance sheet.

		FY05	FY06	FY07	FY08	FY09	FY10	FY11
Balance Op Budget; Meet Surplus Target		X	X	X	X	X	X	X
Increase Net Assets		X	X	X	-	-	X	X
Create Positive Cash Flow		X	X	X	X	X	X	X
Meet or Exceed All Debt Covenants		X	X	X	X	X	X	X
Meet or Exceed Endowment Return & Spending Targets	R	X	X	X	-	-	X	X
	S	X	X	X	X	X	X	X
Renew & Replace Facilities		-	X	X	X	X	X	X
Receive Unqualified Audit Opinion		X	X	X	X	X	X	X

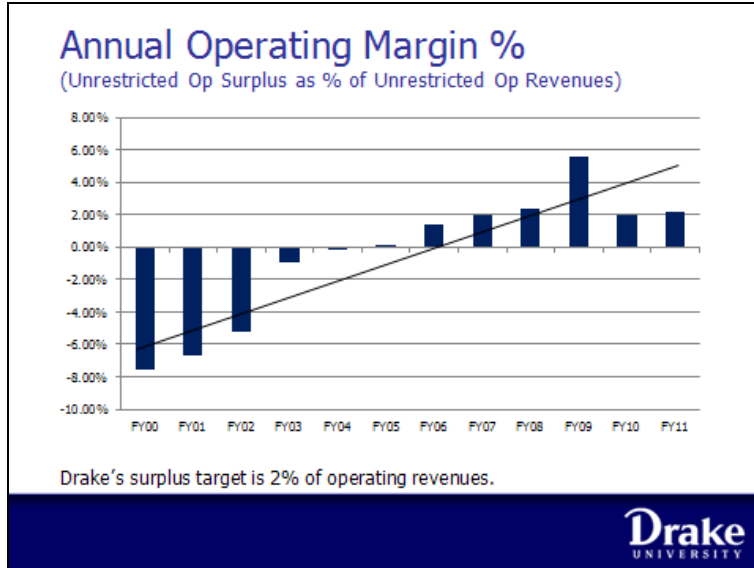
Operating (Budget) Results for FY11

Several years ago, the Board of Trustees adopted a goal of achieving an operating surplus equal to 2% of operating revenues. Drake University ended FY11 with a \$5.5 million operating surplus, which approximated 4.3% of total operating (both unrestricted and temporarily restricted) revenues. FY11 was the seventh straight year of operating surpluses. Most of the unrestricted portion of the operating surplus was used to fund several important capital improvement projects, including the exterior repair of Howard Hall; roof replacements for Opperman Law Library and the Knapp Center; exterior building and directional signage plus various deferred maintenance projects.

Approximately one-half of the total operating surplus was the result of new temporarily restricted gifts which will fund future activities and projects.

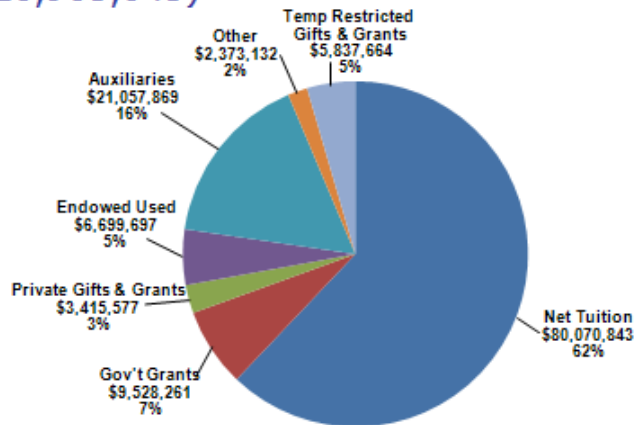


Only unrestricted operating revenues are considered by Moody's in computing the Annual Operating Margin. Drake's AOM for FY11 was \$2.8 million or 2.2% of unrestricted operating revenues, compared to 4.7% on average for Moody's A rated institutions (using Moody's FY10 medians for private institutions).



Revenues exceeded budget by almost \$6.7 million; while expenditures were only over budget by \$2.7 million. The operating surplus of \$5.5 million was largely due to \$2.7 million in unspent temporarily restricted gifts and a \$2.1 million positive variance in net tuition revenue. Net tuition grew by 4.1% over the prior year. The overall tuition discount rate was 37.7 (compared to 31.6% for Moody's A rated private institutions). The key revenue budget drivers are net tuition and room and board which combined total over 75% of unrestricted operating revenues.

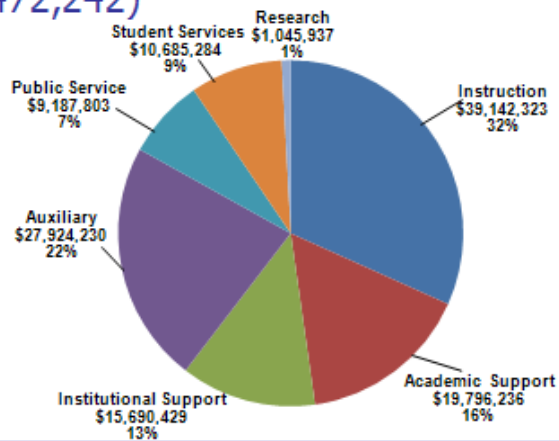
Operating Revenues, FY11 (\$128,983,043)



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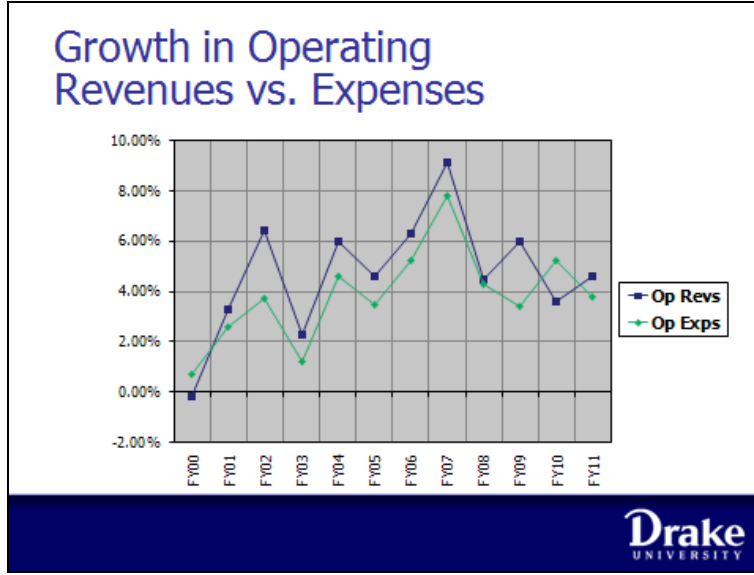
The expenditure budget is generally shown by function (as required by generally accepted accounting principles or g.a.a.p.) with Instruction, Academic Support , Research and Student Services comprising over 57% of the expenditure budget. However, the key budget drivers on the expenditure side are salaries and benefits which make up over 62% of the entire expenditure budget.

Operating Expenditures, FY11 (\$123,472,242)



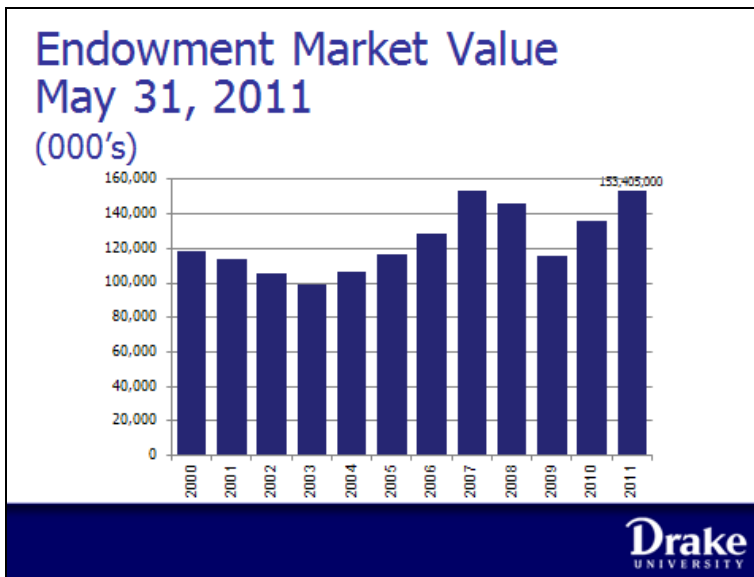
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One of the keys to the maintenance of a balanced operating budget is the principle that the rate of revenue growth should exceed the rate of expenditure growth in any given year. In FY11, operating revenues grew by 4.6%, compared to expenditure growth of 3.8%.



Endowment Update

At May 31, 2011, the market value of the University's endowment fund had increased to \$153,404,794, compared to \$135,714,667 at May 31, 2010. Growth was primarily the result of \$4.3 million in new gifts and \$16.4 million in realized and unrealized investment gains reduced by a spending distribution of \$6.7 million for the year.



The total investment return for the year was a 14.67% net of fees compared to 13.52% for FY10. The overall spending rate was 4.6%.


Endowment growth is a clear and public indicator of long-term institutional financial strength. Drake needs to focus on increasing its endowment over the next several years to ensure that it can provide the appropriate level of resources to fulfill its mission in the future.

Salaries and Benefits

As noted above, salaries and benefits comprise over 62% of the University's annual expenditure budget. For FY11, the total salary expense was \$58.8M, while the total benefit cost was \$18M for a combined compensation cost of \$76.8M.

In 2004, the University initiated a project to dramatically improve faculty and staff salaries. The project involved benchmarking the market rate for various staff and administrative positions and benchmarking faculty positions by rank and discipline. Since FY04, Drake has invested significant budgetary dollars toward improving salaries. All salaries are now distributed on the basis of merit and performance.

FY04	\$1.6 M
FY05	\$1.8M
FY06	\$1.9M
FY07	\$1.75M
FY08	\$1.85M
FY09	\$2.2M
FY10	\$1.5M
FY11	\$2.1M
Total Invested	\$14.7M



Drake's salaries are now generally competitive, approaching the median of our peer group. Updated information on Drake salaries compared with our peers will be provided to the Board in October 2011 as part of next year's budget planning process.

Drake also periodically compares its employee benefits with those of our peer institutions to ensure that our benefit packages are competitive. Drake's employee benefits cost approximately 30.5% of total salaries; the total cost of benefits has increased 22.4% over the past 5 years from \$14.7M in FY07 to \$18.0 in FY11. Some of the benefit growth was attributable to employee retirement contributions (both Social Security and TIAA-Cref), which increase proportionally with salary increases. Another significant increase in benefit costs was the result of tuition benefits, a factor of tuition increases combined with more staff and dependents taking advantage of the benefit. However, employee health claims account for the largest jump in overall benefit costs during the past two years (although from FY04 to FY09, health benefit costs only increased in total by 5%). From FY10 to FY11, employee health benefit costs increased 17.4%, over \$666,000 in one year.

Facilities Stewardship

	FY05	FY06	FY07	FY08	FY09	FY10	FY11
Deferred Maintenance Backlog	\$26.7M	\$27.5M	\$16.6M	\$15.0M	\$14.0M	\$14.6M	\$13.9M
Capital Budget		\$583K	\$1.99M	\$1.89M	\$1.93M	\$1.5M	\$2M
GSF	\$1.856M	\$1.780M	\$1.784M	\$1.784M	\$1.784M	\$1.844M	\$1.852M



Physical Plant Update

Drake's campus encompasses 144 acres and 60 buildings, covering 1.85 million square feet. The current deferred maintenance backlog is roughly estimated at \$14 million. At May 31, 2011, the average age of Drake's plant is estimated at 12.6 years, which compares to the average of Moody's A rated private institutions at 11.4 years (10.5 years for Aaa). Drake's capital spending ratio (i.e., the cash flow spent on fixed assets divided by depreciation expense) for FY11 was 1.38, compared to 1.34 for other Moody's A rated private institutions (1.92 for Aaa). Together these two ratios further demonstrate Drake's commitment to the joint goals of fiscal and physical stewardship.

Since 2002, the University has invested over \$96 million into physical plant improvements. During the past twelve months, the following facility improvements were completed:

- Howard Hall underwent a major exterior facelift during the 2011 summer.
- The Campus Cleaners building on the corner of 27th and University Avenue was demolished and turned into green space.
- The Mainstay building (at the corner of 26th and Forest Ave.) was demolished and converted to green space.
- A number of science lab and classroom spaces were renovated in Harvey Ingham and Cline
- New building and directional signage was installed in the 2011 summer.
- New roofs were installed for the Opperman Law Library, Hubbell Dining south and the Knapp Center during the summer of 2011.


A complete update regarding the progress on Drake's Campus Master Plan is available on the Business and Finance web.

Debt Management

During FY11, Drake's outstanding debt decreased from \$62,600,000 million to \$56,730,000 as a result of a \$3 million balloon payment (against the original 2001 bond) and other regularly scheduled principal payments. The required liquidity covenant was exceeded on May 31, 2011 (81.4% compared to the required 35%).

A summary of Drake's outstanding debt at May 31, 2011 is shown below.

	Balance 5/31/11	Purpose	Interest Rate	Annual P & I	Final Maturity
1996 Bonds	\$1,240,000	Knapp, Law, Other	5.5 to 6.5% Fixed	\$1.3M	Dec. 2011
2007 Bonds	\$17,480,000	Quads	4 to 5% Fixed	\$1.9M	April 2022
2008 Bonds	\$38,010,000	Refunding 2001,03,05	Variable with swaps	\$5.1M	Various 2011 to 2031
Total	\$56,730,000			\$8.3M	



Conclusion & Recommendations

Drake's operating budget remains balanced and stable despite the difficult times in the broader economy. The balance sheet at May 31, 2011 looked considerably stronger than in FY10 due to investment gains, contributions receivable, improved cash and reduced long-term debt.

However, continued volatility in the global investment markets and in the US jobs outlook after yearend does not bode well for Drake's endowment fund or future enrollment growth. As a result, our overall financial situation is still vulnerable.

It is vitally important to remain conservative regarding future growth projections and be ever vigilant about adding new "fixed" expenditures to the budget (particularly for staffing). Tuition discount rates, the percentage of tenured faculty, and the growth rates of revenues compared to expenditures are key factors to watch going forward, since they can dramatically impact the institution's future flexibility.

The University's capital budget should be carefully managed to preserve cash. Gifts for various capital improvements will be required to continue improvement in the campus's physical appearance. As reflected in the Board debt policy, future capital improvements should not be funded from debt unless fully supported by written pledges. Various liquidity measures will become more critical metrics to be watched in the future.

Likewise, growth in endowment and unrestricted net assets will be necessary to future success. Many of our financial ratios and key indicators are strongly influenced by the broader financial markets, specifically investment market trends. Continuing to maintain a lower spending rate around 4.5% is still a prudent approach. Furthermore, reinvestment of at least 50% of the surplus into quasi endowment is recommended in the future.

Drake's ability to fulfill its academic mission is dependent on a strong, sound financial picture. Keeping short-term demands in balance with longer-term goals is a critical discipline. The current turbulence in the financial markets reemphasizes the need for diligent attention to the fundamentals and for building a stronger balance sheet.