2002: A Transitional Year

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2002 Treasurer

During 2002, in the aftermath of the substantial $6.9 million loss from 2001 operations, the association leadership focused its efforts on putting the organization on more sound financial footing for the future.

The 2001 loss was attributable to the economic challenges posed by the current recession in general and to the changing market environment for APA's electronic information products in particular (see the 2001 Treasurer's Report). The fiscal period just ended saw many pivotal events in the association's finances. Progress during 2002, as a transitional year, was modest: APA operations ended the year with a net loss of $1,309,300 after consideration of the $2 million allocation from the association's real estate investments. In the fall of 2002, however, APA laid the groundwork to position the association for a return to fiscal health in the years to come, including the following actions.

- Voluntary staff reduction plan—Salaries and benefits comprise roughly 40% of the association's annual expenses. To ensure balanced budgets in future years, as some of APA's current revenue-producing programs appeared destined for slower growth than in the past, we knew it would become necessary to reduce staffing. Management chose to implement a voluntary program giving staff the option to buy out of their employment or to choose early retirement (under terms comparable to benefits that would have applied under APA policy for involuntary reductions in force), to take unpaid leaves of absence during the latter half of 2002 and throughout 2003, or to reduce their hours worked each week through the end of 2003. The success of the voluntary staff reduction plan enabled APA to significantly reduce its salary expense for 2003.
- Expense reduction efforts—To minimize the deficit in 2002, APA reduced expenses by canceling the fall round of governance meetings, restricting the use of consultants, imposing limits on the use of overnight mail delivery, and reducing the quantity of printed newsletters, brochures, and other materials. Many of these expense reductions will carry forward into 2003 and beyond, as APA staff and governance learn to cope in leaner times and to take advantage of electronic communication in lieu of printed material.
- Buyout of the National Association of Social Workers (NASW) and Trammell Crow—Early in the year, the NASW expressed an interest in selling its 8% limited partnership interest in the 750 First Street building, while simultaneously renewing its lease for an additional 10 years through 2017 and using the proceeds of an installment sale to offset future rent payments. For APA, this offered an opportunity to purchase NASW's interest with no current cash outlay. In September, APA completed the purchase of the NASW's 8% partnership interest. APA also exercised its right to purchase the Trammell Crow Company's 1% interest in the 10 G Street building. As a result of these two transactions, APA now owns 100% of both commercial office buildings it originally built with partners.

Refinancing of APA Real Estate

With interest rates at historic 40-year lows, 2002 seemed an ideal time to refinance APA's real estate holdings. Additionally, with full ownership by APA, a 501(c)(3) organization, it became feasible and desirable to finance a portion of the debt on the headquarters building with tax-exempt bonds.

The basic structure of the new financing is summarized below:

750 First Street (Headquarters Building)			Amortization	Maturity
Bank of America (taxable bonds)	$30.9 million	6.21%	25 Years	November 2012
Bank of America (tax-exempt bonds)	21.1 million	4.34%	25 Years	November 2012
Series B Senior Secured Notes	25.0 million	7.76%	*	July 2012
10 G Street (Investment Property)				
John Hancock (conventional debt)	43.0 million	5.66%	30 Years	November 2012
"Overall blended rate"	$120.0 million	6.01%	—	—

Note. APA has entered into an interest-rate-swap agreement with the Bank of America to fix the interest rates for taxable bonds and tax-exempt bonds at 6.21% and 4.34%, respectively.

* Series B Notes are interest only through July 2010 and principal and interest through July 2012.

Refinancing Highlights

- All new loans are subject to renegotiation in 10 years.
- The refinance enabled APA to structure financing of each building separately, making the 10 G Street loan a nonrecourse loan to APA; that is, the 10 G Street loan is backed by the building itself and not by APA as is the case with the APA 750 First Street headquarters building.
- APA created limited liability corporations to hold title to each of the properties.
- APA prepaid the Series A Senior Secured Notes, including a prepayment penalty.
- APA retained the Series B Senior Secured Notes ($25 million) because of the relative magnitude of the applicable prepayment penalty and the fact that the payments were interest only through July 2010.
- The refinance included an overborrow of approximately $24 million, which replenished APA's working capital reserves for use over the next decade.

In summary, the refinance allowed APA to trade equity in its properties for increased liquidity and to simultaneously obtain a significantly lower blended interest rate of 6.01% versus the 7.61% blended rate on the 1995 debt. The longer amortization period increases annual cash flow substantially, while spreading the payment of the debt out over a longer period of time. In effect, with the longer amortization, APA has spread its debt obligations over an extended time frame with expense sharing by future generations of association members, while moderating the impact on current members.

Special note

The Finance Committee has recommended and the Board of Directors and Council of Representatives have concurred with the principle that some of the additional cash flow from the properties be earmarked for future pay down of the debt. The specifics of this principle will be formulated during the spring/summer meetings of 2003 and presented to the Council of Representatives in August for consideration and approval.

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Revenues (Table 1)

Membership dues and fees increased modestly over the previous year, reflecting the cost-of-living adjustment reviewed and voted on annually by the Council of Representatives. The numbers of fellows, members, and associates have stabilized, while affiliate membership has dropped slightly. **Journal subscription revenues** also increased slightly, reflecting higher prices offsetting a 2.5% decline in the number of subscribers to print products, as the shift to electronic media continues. **Publication sales** increased over the previous year (and resulted in $1.6 million over the amount predicted in the 2002 budget) as revenues from the fifth edition of the *Publication Manual of the American Psychological Association* continued to exceed projections.

Royalties and licensing revenues rebounded in 2002 to $17.7 million. In 2001, licensing revenues were $13.5 million, an amount significantly lower than the 2001 budget estimate and a major cause of the 2001 deficit from operations. This improvement reflects a concerted effort by APA's marketing staff to solidify and stabilize the product pricing and improve working relationships with third-party vendors/distributors. Additionally, APA is in the process of a transition toward recording licensing income on a cash basis. That is, records will reflect revenues only when APA actually receives payment. With these improvements, APA believes that the $18.1 million projection in royalties and licensing revenues for 2003 is attainable.

Expenses (Table 1)

The increased cost of **salaries and benefits** from 2001 to 2002 was primarily attributable to the costs associated with the fall 2002 implementation of the voluntary staff reduction plan described earlier and the retirement compensation paid to APA's chief executive officer after 14 years of service. The full effect of savings from the voluntary staff reduction plan will occur in 2003 and future years. The decline in **production cost** is the direct result of fewer staff, fewer pages published, and a $500,000 asset adjustment based on APA's December 31 actual inventory. The decline in **board and committee expenses and other expenses** is attributable to the cost-saving measures implemented during the year.

Net Loss From Operations (Table 1)

The net loss of $3.3 million from operations was offset in part by the $2 million in cash flow from the properties, leaving a real net loss of approximately $1.3 million. In 2003, APA's goal calls for a modest profit from operations after recognizing $2 million in cash flow from the properties.

Balance Sheet

Cash and short-term investments at December 31, 2002, were up substantially over 2001 because of the $24 million overborrow, a key element of the refinancing of the two APA properties (see Table 2, Balance Sheet). As required under Financial Accounting Standard 124, the association must record the value of its long-term investments at current market prices, and the decline in the value of such investments reflects the decline in the stock market generally. The changes in land, buildings, and equipment reflect the November 15th transfer of the land, building, and the long-term debt* to the books of the limited liability corporations effective with the refinance. See Table 1.1 for a complete listing of all nonoperating items affecting APA's stand-alone balance sheet. In accordance with generally accepted accounting principles (GAAP), the individual transactions that occurred as a part of the building refinancing transaction were classified as extraordinary items related to the loss on extinguishment of debt and accounted for in the current year. The first was the prepayment penalty ($10.2 million); the second was the write-off of unamortized deferred financing costs ($1.3 million). See also Table 1.2.

* This amount excludes the $25 million in Series B Senior Secured Notes, which were retained by APA.

Table 1 • Income and Expense Statement

Operations

	1998	1999	2000	2001	2002
Revenues					
Dues and fees	$11,695	$11,498	$11,613	$11,808	$12,225
Special assessments	4,132	4,280	4,875	—	—
Journal subscriptions	19,101	18,855	19,187	19,828	20,154
Royalties and licensing	10,343	12,385	14,302	13,588	17,716
Sales	7,921	7,550	7,912	11,093	12,335
Other	15,850	14,646	15,314	20,294	19,158
Total revenues	**$69,042**	**$69,214**	**$73,203**	**$76,611**	**$81,588**
Expenses					
Salaries and benefits	$26,885	$27,685	$29,309	$34,436	$38,278
Production costs	8,079	7,762	7,736	10,581	8,571
Space costs	5,875	6,421	6,487	6,725	7,641
Boards and committees	1,902	1,363	1,874	1,866	1,461
Consulting and contractual	6,311	6,473	8,507	7,939	8,406
Other	20,693	20,170	20,897	22,026	20,540
Total expenses	**$69,745**	**$69,874**	**$74,810**	**$83,573**	**$84,897**
Net loss from operations	**($703)**	**($660)**	**($1,607)**	**($6,962)**	**($3,309)**
Recognition of partnership cashflow	**0**	**0**	**0**	**$1,000**	**$2,000**
Net loss from operations	**($703)**	**($660)**	**($1,607)**	**($5,962)**	**($1,309)**

Note. In 2001, the American Psychological Association Practice Organization (APAPO) was created. Revenues and expenses associated with APAPO activities are included in the revenue and expenses for the years 1998–2000; they are not included in the 2001 or 2002 figures.

(All figures shown in thousands.)

Publication sales increased over the previous year as revenues from the fifth edition of the *Publication Manual of the American Psychological Association* continued to exceed projections.

Table 1.1 • Nonoperating Activity

	1998	1999	2000	2001	2002
Long-term investment activity:					
Gain (loss) on sale	$1,224	$2,044	$1,580	($163)	($1,010)
Investment management fees	(235)	(258)	(318)	(311)	(303)
Unrealized gains (FASB 124)	1,464	1,735	5,021	(648)	(3,626)
Net long-term investment activity	$2,453	$3,521	$6,283	($1,122)	($4,939)
Buildings and partnerships activities:					
Interest on loans	$701	$717	$733	$750	$644
Square 677 and 10 G Street operations	(2,676)	(1,482)	(934)	(642)	1,255
G Place and 750 First Street operations	550	1,213	1,493	1,918	(140)
NASW buyout	—	—	—	—	(1,789)
Unrealized loss on interest-rate swap	—	—	—	—	(2,709)
Interest expense—Series B Notes	—	—	—	—	(485)
Income tax benefit	—	—	—	—	3,912
Deferred rent and real estate taxes and misc.	(348)	(73)	(121)	(100)	690
Net building and partnership activity	($1,773)	$375	$1,171	$1,926	$1,378
Total nonoperating activity	$680	$3,896	$7,454	$804	($3,561)

(All figures shown in thousands.)

Table 1.2 • Extraordinary Items

	1998	1999	2000	2001	2002
Prepayment penalty	—	—	—	—	($10,167)
Writeoff of deferred financing costs	—	—	—	—	(1,308)
Total extraordinary items	—	—	—	—	($11,475)

(All figures shown in thousands.)

Table 2 • Balance Sheet

	1998	1999	2000	2001	2002
Assets:					
Cash and short-term investments	$13,276	$6,892	$5,464	$2,348	$25,549
Long-term investments	29,083	33,273	40,074	39,466	30,356
Land, buildings, and equipment*	122,943	120,458	115,335	110,861	4,912
Other	9,295	11,601	14,801	15,499	26,629
Total assets	**$174,597**	**$172,224**	**$175,674**	**$168,174**	**$87,446**
Liabilities:					
Divisions and other groups	$3,377	$3,589	$4,112	$3,988	$4,521
Long-term debt*	101,080	96,750	92,085	87,055	25,000
Accounts payable	6,844	6,620	7,653	7,655	6,992
Deferred revenues	26,443	24,937	25,365	29,068	26,264
Deferred rent and real estate taxes	5,157	5,231	5,352	5,452	2,899
Other	1,315	1,480	1,643	1,650	1,221
Total liabilities	**$144,216**	**$138,607**	**$136,210**	**$134,868**	**$66,897**
Net assets	**$30,381**	**$33,617**	**$39,464**	**$33,306**	**$20,549**
Net assets beginning balance	**$30,404**	**$30,381**	**$33,617**	**$39,464**	**$38,894**
Operations (see also Table 1)	(703)	(660)	(1,607)	(6,962)	(3,309)
Nonoperating items (see also Table 1.1)	680	3,896	7,454	804	(3,561)
Subtotal net assets before restatements	30,381	33,617	39,464	33,306	32,024
Prior-year audit restatements:					
Income tax benefit (asset)	—	—	—	1,965	—
Deferred revenue reversals	—	—	—	1,774	—
Deferred real estate tax expense reversal	—	—	—	1,849	—
Extraordinary loss (see also Table 1.2)	—	—	—	—	(11,475)
Total change in net assets	**($23)**	**$3,236**	**$5,847**	**($570)**	**($18,345)**
Net assets ending balance**	**$30,381**	**$33,617**	**$39,464**	**$38,894**	**$20,549**

* Effective with the November 15, 2002, refinancing, the land, buildings, and long-term debt have been transferred to the books of the limited liability corporations (with the exception of the $25 million Series B Senior Secured Notes, which were retained by APA).

** 2000–2002 activity excludes net assets of the APA Practice Organization.

(All figures shown in thousands)

As compared to the other elements impacting our net worth (Table 1.1—operations and non-operating), the total extraordinary loss ($11.5 million) represents a substantial portion of the reduction in the association's net worth in 2002 from $33 million (before prior year restatements) to $20 million. Improvements in the stock market, rising interest rates (which may result in a hypothetical "gain" on our interest rate swap agreement) plus the future return on our real estate investments should rapidly rebuild the association's net worth in the coming years.

The Future—A Word of Caution

Although APA has restructured its long-term debt, reduced the cost of operations, and continued its efforts to expand its revenue base from nondues sources, we live in difficult economic times, with a great deal of uncertainty about the future state of the economy. As APA learned so painfully in 2001, adverse events in the national economy can and will affect APA. While APA has benefited enormously this past decade from property ownership, with 605,000 square feet of office space, two thirds of which APA leases to other organizations, APA still faces many inherent risks. A continued economic downturn may affect APA's ability to lease space or may harm existing tenants, which could reduce the anticipated cash flow from the properties.

APA is well positioned for the future if it exercises the discipline necessary to live within its financial means and maintains sufficient reserves to protect itself from unexpected financial adversities. Such discipline will require balanced budgets, rather than the deficit spending of the past several years. Your Finance Committee is committed to such policies and has made and will continue to make specific recommendations to the Board of Directors and Council of Representatives toward that end. If we fail to do so, the future of the association will be in jeopardy. ■

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