



# Understanding College and University Endowments

Answers to questions frequently asked by students, faculty, alumni, journalists, public officials, and others interested in the financial circumstances of U.S. colleges and universities.



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# What is an endowment?

An endowment is an aggregation of assets invested by a college or university to support its educational and research mission in perpetuity. It represents a compact between a donor and an institution and links past, current, and future generations. These gifts also allow an institution to make commitments far into the future, knowing that resources to meet those commitments will continue to be available.

An institution's endowment actually comprises hundreds or thousands of individual donations. Endowments allow donors to transfer their private dollars to public purposes with the assurance that their gifts will serve these purposes for as long as the institution continues to exist.

Endowments serve institutions and the public by:

**Providing stability.** College and university revenues fluctuate over time with changes in enrollment (tuition), donor interest (gifts), and public support (largely state and federal). Although endowment earnings also vary with changes in financial markets and investment strategies, most institutions follow prudent guidelines that are intended to buffer economic fluctuations and to produce a relatively stable stream of income. Because the endowment principal is not spent, the interest generated by endowment earnings supports institutional priorities year after year. This stability is especially important for activities that cannot readily be started and stopped, or for which fluctuating levels of support could be costly or debilitating. Endowments frequently support student aid, faculty positions, innovative academic programs, medical research, and libraries.

**Leveraging other sources of revenue.** Institutions have dramatically increased their own student aid expenditures in recent years, and endowments have enabled institutions to respond more fully to changing demographics and families' financial need. It is not surprising that the colleges and universities with the largest endowments are the ones most likely to offer need-blind admission (admitting students without regard to financial circumstances and then providing enough financial aid to enable them to attend). At the same time, endowments help institutions provide financial aid to students who cannot afford full tuition. An endowment also allows a college or university to provide a higher level of quality of service at a lower price than would otherwise be possible. This has been especially important in recent years, particularly for publicly supported institutions that have experienced significant cuts in state support. Without endowments or other private gifts, institutions would have had to cut back even further on their programs, increase tuition and fees even further, and/or obtain additional public funding to maintain current programs at current prices.

**Encouraging innovation and flexibility.** An endowment enables faculty and students to conduct innovative research, explore new academic fields, apply new technologies, and develop new teaching methods even if funding is not readily available from other sources, including tuition, gifts, or grants. Such innovation and flexibility has led to entirely new programs and to important discoveries in science, medicine, education, and other fields.

**Allowing a longer time horizon.** Unlike gifts expended upon receipt, an endowed gift keeps giving over time. Endowed institutions can plan strategically to use a more reliable stream of earnings to strengthen and enhance the quality of their programs, even if some of their goals will take many years to achieve. By making endowed gifts, alumni and others take responsibility for ensuring the long-term well-being of colleges and universities. Their gifts help enable future generations of students to benefit from a higher quality of education and allow these institutions to make even greater contributions to the public good. Endowments ensure that the education offered today at a particular college or university will have the same value 25 or 50 years from now.

## Who has endowments and in what amounts?

Although the concept of endowment originated in England in the fifteenth and sixteenth centuries, the development of endowments for higher education institutions is a decidedly American phenomenon. Endowments have supported U.S. colleges and universities for more than 300 years. Many other kinds of institutions in this country also maintain endowments, including churches, hospitals, museums, private secondary schools, and cultural and performing arts groups.

Endowments are frequently described as if they are a single fund, when in fact, they are an aggregation of discrete funds, each with its own stipulations about the purposes for which it can be used. The aggregate size of the institution's endowment may be misleading, especially at institutions with graduate and professional schools because much of the endowment income may not be available to support undergraduate programs.

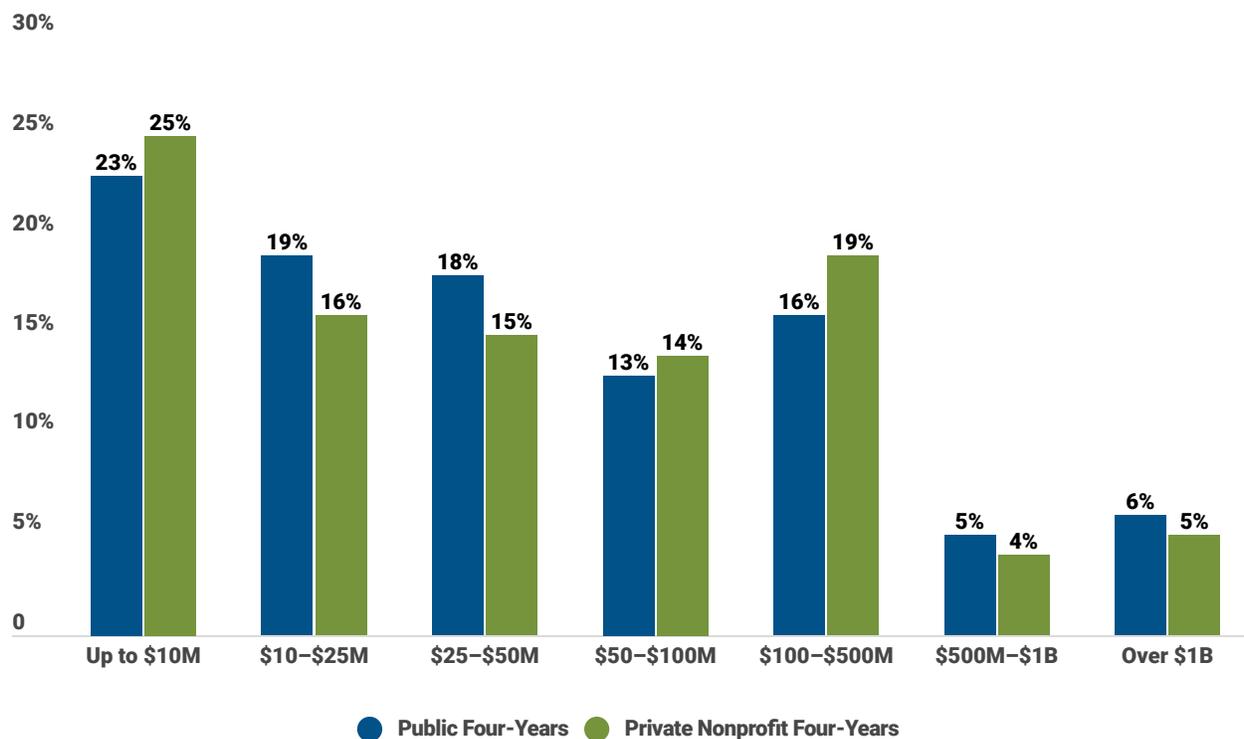
While public attention focuses primarily on the relatively small number of colleges and universities with large endowments, most colleges and universities have only modest endowments or none at all. Although some public universities' endowments rank among the largest, most public institutions have only nominal endowments or none at all (although they may receive significant state subsidies, which typically are not available to private colleges and universities).

In this report, we focused our analysis only on public and private nonprofit four-year degree-granting institutions with reported endowment data. Calculations using data from the National Center for Education Statistics (NCES) show that by the end of fiscal year 2018, 25 percent of private nonprofit four-year colleges and universities and 23 percent of public four-year institutions had endowments of less than \$10 million. The median endowment at private nonprofit four-year colleges and universities is roughly \$37.1 million, which at a typical spending rate of about 4 to 5 percent would support an annual expenditure of between \$1,484,000 and \$1,855,000. This typical spending amount represents 5.1 to 6.4 percent of the median total expenditures of a nonprofit four-year institution (\$29.2 million). By contrast, while the median endowment at public four-year institutions is comparable at approximately \$35.4 million, a spending rate that would similarly support an annual expenditure of \$1,416,000 and \$1,770,000 represents only 1 to 1.2 percent of their median total expenditures (\$143.6 million).

Of the roughly 1,300 private nonprofit four-year institutions with reported endowment data, 546—or about 43 percent—had endowments over \$50 million. Similarly, of the nation's roughly 700 public four-year institutions with reported endowment data, 282—or about 40 percent—had endowments over \$50 million. Overall, only 104 institutions (5 percent of public and private four-year colleges and universities with reported data) had endowments exceeding \$1 billion. Of these, 64 were private nonprofit and 40 were public.<sup>1</sup>

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1 Integrated Postsecondary Education Data System (IPEDS). <https://nces.ed.gov/ipeds/datacenter/InstitutionByGroup.aspx>.

**FIGURE 1. FY 2018 ENDOWMENTS FOR PUBLIC AND PRIVATE NONPROFIT FOUR-YEAR INSTITUTIONS**

Source: Integrated Postsecondary Education Data System (IPEDS)

Whatever its size, an endowment can provide critical support for current programs and the promise of consistent support into the future. But even the largest endowments can only supplement—not replace—annual funding from tuition, non-endowment gifts, federal grants, and, especially in the case of public institutions, state appropriations. Most institutions can cover only very modest fractions of their annual budgets with earnings from their endowments.

## How is an endowment created?

An endowment typically includes funds given to an institution by donors who have stipulated as a condition of the gift that its principal may not be spent, and who expect that its value will increase over time through a responsible balance between expenditure and reinvestment of its earnings. In many cases, the donor restricts the income to one or more purposes; if so, the institution must spend the income only for those purposes. In other cases, the institution is given discretion by the donor to select the educational purposes to be served, but it is still restricted to spending just the income.

Occasionally, colleges and universities receive gifts from donors who permit the spending of principal, but the institution's governing board decides for reasons of prudence and stability to treat the gift as an endowment. These may be referred to as "funds functioning as endowment." Institutions typically use these funds to meet long-term obligations that require increasing levels of support year after year, such as professorships or scholarships. For example, a donor may contribute \$1 million to support a university's history department, but with no further stipulation as to how the money is to be spent. The university could decide to spend all \$1 million the following year to augment faculty salaries, support graduate students, conduct research, add library books, or perhaps make

physical repairs to offices, classrooms, or laboratories. Each of these expenditures would address important needs, but at the end of that year there would be no funds remaining to sustain these spending levels or to help meet the many continuing needs of the department.

Alternatively, the university could invest the \$1 million so that its value would be preserved over time and its earnings year after year would be available to the department to meet its continuing commitments, in good times and bad. Assuming the 7.5 percent 10-year average investment rate of return for fiscal year 2020, according to the annual endowment study by the National Association of College and University Business Officers (NACUBO) and TIAA, this investment would generate approximately \$75,000 of spendable income each year at most colleges and universities, increasing annually at roughly the rate of inflation.<sup>2</sup>

## How do institutions with endowments balance the present and the future?

Endowments originated to establish a pact between generations: a promise from past and current donors to future students and faculty that the institution will sustain certain commitments over time. In the face of the international economic crisis following the Great Recession in 2008, most institutions made significant budget cuts, and in some cases, the difficult choice to temporarily increase their spending rate above normal levels in order to help moderate higher tuition increases, maintain or increase student aid, and support the quality of their programs.

In 2020, while the COVID-19 downturn in financial markets lasted for only a few months and most endowments rebounded by the end of the fiscal year, a related financial crisis has taken place. Beginning in March of that year, the pandemic forced colleges and universities to rapidly close their campuses and implement a wholesale shift to online instruction, causing massive disruption and enormous unforeseen expenses and revenue losses. As they planned for and began the 2020–21 academic year, colleges and universities spent millions to purchase personal protection equipment and cleaning supplies, to modify facilities to de-densify their campuses, and to establish testing plans and vendor relationships to implement those plans. ACE and the major higher education associations calculated that the financial impact of the pandemic on students and institutions would total at least \$120 billion.<sup>3</sup> No doubt most institutions temporarily increased their endowment spending rates as a way to help mitigate some of these enormous costs. NACUBO found that in the fiscal year 2020, 70 percent of institutions had increased their endowment spending from the previous year, with an average increase of about \$3.3 million.

There is always a temptation to increase spending to meet the very real needs of today's students and faculty. But institutional leaders understand that this generation could not be supported at today's level of quality if earlier generations had not had the discipline to sustain the purchasing power of their endowments. Similarly, future generations depend on the current one to balance the claims of the future against the claims of the present. In those instances where institutions temporarily increase their endowment spending rate, it is generally for a short period, and then the more conservative rate is reinstated.

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2 2020 NACUBO-TIAA Study of Endowments (public tables). <https://www.nacubo.org/Research/2020/Public-NTSE-Tables>.

3 Letter to House Speaker Nancy Pelosi and Minority Leader Kevin McCarthy. American Council on Education, Sept. 25, 2020. <https://www.acenet.edu/Documents/Letter-House-Fall-COVID-Supplemental-092520.pdf>.

As fiduciaries, trustees have a legal and moral obligation to donors, many long since deceased, who intended that their gifts would support not just one generation, but succeeding generations indefinitely. Many states have statutes, modeled on the Uniform Prudent Management of Institutional Funds Act (UPMIFA), that specifically require trustees to consider both the “long and short term needs of the institution” and its “present and anticipated financial requirements.”<sup>4</sup> To keep pace with the rising costs of education, research, and campus life, trustees must reinvest some of each year’s earnings and add new gifts as well. Fifty years ago, a donor wishing to endow a professorship at a major university could have done so with a gift of about \$700,000.

That amount of principal in 1970 would have generated sufficient income to pay the salary of a distinguished professor. But if all of the income generated over the years by that principal had been spent, leaving only the original \$700,000, its earnings now would not come close to supporting a professor’s salary.

Colleges and universities strive to spend as much as possible on the current generation without diminishing resources available for future generations. That is, they manage endowments to ensure that a fund supporting a faculty position today will still be able to support a faculty position 20, 30, or even 50 years from now. To achieve these two goals, trustees of colleges and universities have established spending policies that allow their institutions to spend endowment earnings each year equal to about 4 to 5 percent of the value of their endowment. Given the uncertainty about long-term investment returns, these spending models assume that endowment value will grow, on average, about 7 to 8 percent over the long term. (Figure 2 illustrates the significant changes in average 10-year returns in recent years.) In addition, the spending models reflect long-term inflation of 1 to 3 percent, on average, and the need to reserve funds for future program improvements.

College and university costs can be expected to rise faster than the Consumer Price Index (CPI) because of the labor-intensive nature of the educational process. In addition, the expanded use of technology in teaching, the rapid rise in cost of libraries, and the dramatic advances in research all call for increased investment in academic programs well above inflation.

For institutions with larger endowments, endowment revenue can be the largest single source of operating revenue. Given that investment returns are volatile (Figure 2), institutions use “smoothing rules” that seek to mitigate variations in endowment revenue. One smoothing rule is to apply the spending formula to the three-year rolling average of endowment. Because colleges and universities have large fixed costs such as salaries and benefits, smoothing rules provide predictability in campus budgets. In addition, smoothing rules are naturally counter-cyclical—when investment returns are good, spending is a smaller share of total endowment value, and during leaner times, spending is a larger share.

To appreciate the importance of preserving the long-term strength of endowments, it is useful to compare the period of 2002–10 with 2011–20:<sup>5</sup>

- The fiscal year ending June 30, 2009, saw the lowest one-year average return (net of fees) for all college and university endowments over the past 20 years, with -18.7 percent. Similarly, the 10-year average annual return was at its lowest in 2010 (2001 through 2010) at 3.4 percent. The preceding 10-year average annual returns were significantly higher, with returns as high as 8.6 to 9.8 percent seen consistently between 2002 and 2007.

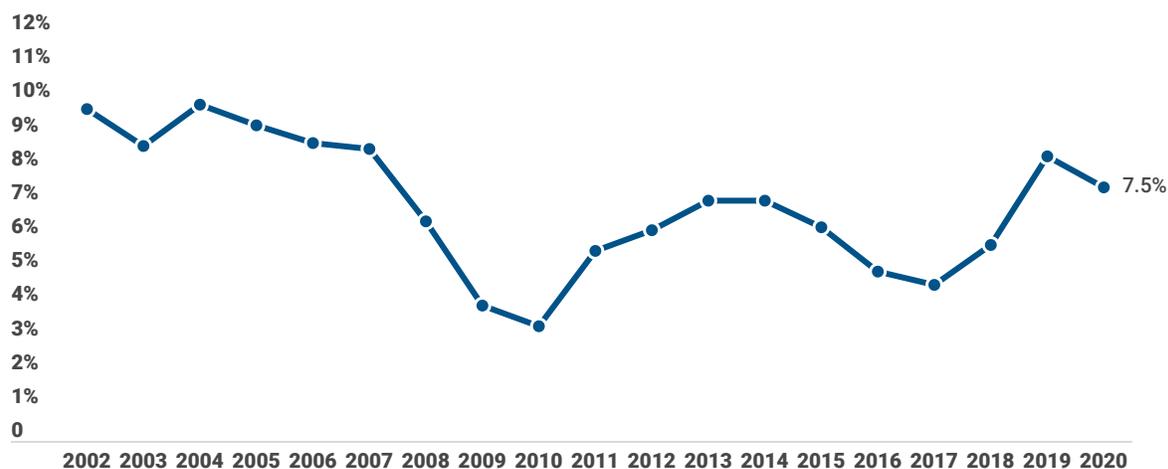
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4 Uniform Prudent Management of Institutional Funds Act. Drafted by the National Conference of Commissioners on Uniform State Laws (July 2006). <https://www.uniformlaws.org/HigherLogic/System/DownloadDocumentFile.ashx?DocumentFileKey=d7b95667-ae72-0a3f-c293cd8621ad1e44&forceDialog=0>.

5 2020 NACUBO-TIAA Study of Endowments (public tables). <https://www.nacubo.org/Research/2020/Public-NTSE-Tables>.

- Since 2010, there have been significant fluctuations in average one-year endowment returns, with some years as high as 19.2 percent (in 2011) and 15.5 percent (in 2015) interrupted by very minimum average returns such as -0.3 percent (in 2012) and -1.9 percent (in 2016).
- In the fiscal year ending June 30, 2020, the average one-year annual return of all college and university endowments was 1.8 percent. The 10-year average annual return from 2011 through 2020 was 7.5 percent.

**FIGURE 2. FYs 2002 TO 2020 10-YEAR AVERAGE ENDOWMENT RETURNS**



Source: 2020 NACUBO-TIAA Study of Endowments

Every year, some endowments significantly outperform the averages, while others lag behind or may even lose value, depending on their particular investments. Just like individuals, institutions need reserves to protect against unexpected expenses such as future economic downturns or declines in enrollment, donations, or government support, and to pay for unanticipated costs such as those stemming from the COVID-19 crisis, repairs or renovations to comply with new safety standards, or to recover from natural disasters such as hurricanes or earthquakes. Funds functioning as endowment and other capital assets permit an institution to cover its deficits and pay its bills without having to take hasty actions that might seriously damage its quality or financial capacity. When institutions do have to spend principal, they reduce the size of their reserve and the future income that their investments will be able to generate. This, in turn, reduces the stream of steady, reliable income that will be available to make future commitments and enhance the quality of their programs. The challenge is to find an appropriate balance: not being so cautious that important current needs are unmet, but being cautious enough so that the institution is prepared to weather serious reversals in the national economy.

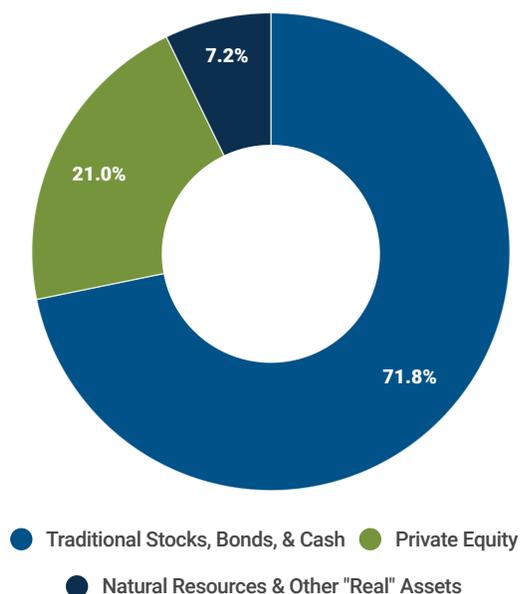
## How are endowments invested?

Before the twentieth century, real estate was a primary endowment asset for educational institutions. Today's endowments are invested most heavily in U.S. and non-U.S. stocks, bonds, real estate, and other illiquid assets such as hedge funds. One of the most important responsibilities of trustees is to oversee the management and allocation of the institution's assets. Trustees are legally obligated to be prudent in their investment management, but they also should make every effort to achieve as substantial a return as prudence will allow.

As the investment world has become more sophisticated in recent years, nontraditional investments such as commercial real estate, venture capital, hedge funds, gas and other natural resources, and other kinds of funds have

received increased attention. According to NACUBO,<sup>6</sup> traditional stocks, bonds, and cash investments accounted for about 87 percent of endowment assets at public and private nonprofit institutions in fiscal year 2002. By 2020 this percentage had fallen to 72 percent, with the remaining 28 percent of endowment investments distributed between private equity (21 percent) and natural resources and other “real” assets (7 percent).

**FIGURE 3. FY 2020 ENDOWMENT ASSET ALLOCATION**



Source: 2020 NACUBO-TIAA Study of Endowments

## Are endowments taxed?

For educational and many other charitable institutions, most endowment investments yield earnings that are generally exempt from taxation. This exemption dates back to the earliest days of the income tax in this country, and recognizes the public purposes that these institutions serve. Because of this exemption, donors know that institutions will be able to use all of the earnings on their gifts to support the purposes the donors wish to serve. The tax exemption on endowment earnings is an important way in which society contributes to the support of U.S. higher education.

However, the Tax Cuts and Jobs Act, the major tax reform legislation enacted in December 2017, included an unprecedented new tax on private nonprofit colleges and universities. Institutions enrolling at least 500 tuition-paying students that have assets of at least \$500,000 per student must now pay a tax of 1.4 percent on their net investment income. On October 15, 2020, the IRS issued final regulations to provide a framework for institutions to determine whether they are subject to the tax and if so, how they can calculate the amount of the tax they owe.<sup>7</sup>

<sup>6</sup> 2020 NACUBO-TIAA Study of Endowments (public tables). <https://www.nacubo.org/Research/2020/Public-NTSE-Tables>.

<sup>7</sup> Guidance on the Determination of the Section 4968 Excise Tax Applicable to Certain Colleges and Universities. *Federal Register* (Vol. 85, No. 200, Oct. 15, 2020). <https://www.govinfo.gov/content/pkg/FR-2020-10-15/pdf/2020-20933.pdf>.

Opposed by the higher education community, the so-called “endowment tax” is highly controversial, with bipartisan efforts in Congress to repeal it. As enacted, the excise tax makes no effort to create incentives for institutions to spend their endowments in certain ways, such as on student financial aid or other initiatives to address college costs. Instead, the revenue generated by the excise tax, projected to be about \$200 million per year, will simply go to the federal government to be used for any purpose. The tax imposes a new cost on these institutions both in terms of funds spent on the tax itself as well as the costs incurred to ensure compliance with the complicated regulations.

## How are endowments managed?

Each institution adopts its own strategies and rules to maximize its endowment’s capacity to support both current spending and future needs. Some institutions manage their endowments with their own staff; others rely on their trustees, contract with professional managers, or use a combination of approaches. Some institutions seek to maximize income, while others focus on total return (defined as income plus capital appreciation).

Many institutions adopt formal spending rules that seek: (1) to ensure a growing stream of revenues from the endowment to support each year’s expenditures; (2) to ensure sufficient reinvestment so that the value of the endowment is maintained relative to rising costs over time; and (3) to permit greater predictability in budgeting by smoothing out year-by-year fluctuations in earnings. For many institutions, this last strategy has proven to be preferable to expanding the institution’s budget in response to higher returns, only to have to make substantial spending cuts in a later year to accommodate a more typical—or an unusually low—level of income.

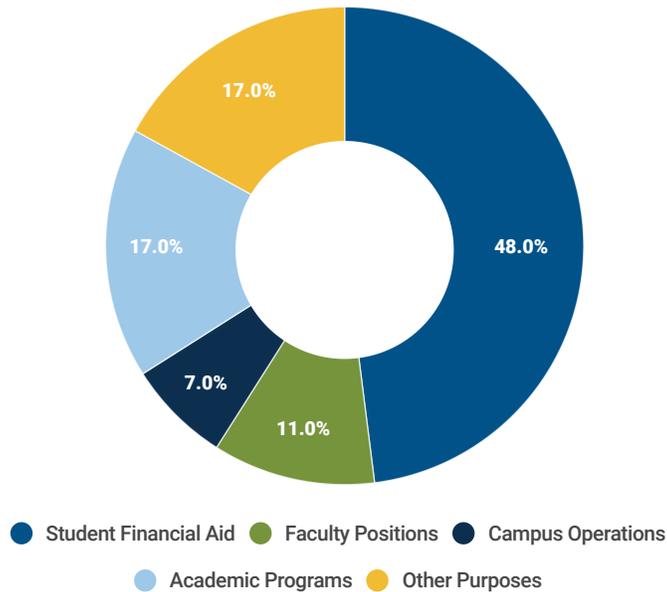
Spending rules are the planning mechanism through which institutions seek to deliver a maximum quantity and quality of educational services today without eroding their capacity to support equivalent educational services in the future.

## How are endowments used?

For private nonprofit colleges and universities—and increasingly for public institutions—endowments provide stability, flexibility, and a degree of confidence for the future. They enable institutions to aim higher and to achieve their educational and charitable purposes more effectively. These benefits, both to the institutions and to those they serve, justify the effort necessary to build and maintain endowments. For students, their families, and society generally, endowments allow institutions to deliver greater value and attain a higher level of quality than would otherwise be possible in their teaching and research. The reliable long-term support from an endowment enables institutions to increase student financial aid, make commitments to senior faculty, initiate pioneering research, develop stronger teaching programs, invest in new technologies, and maintain their libraries, laboratories, and other physical assets.

According to NACUBO, institutions are overwhelmingly spending their endowments on supporting their students; for fiscal year 2020, 65 percent of spending was on student financial aid and academic programs. Even in difficult financial times, an endowment can sustain an institution’s teaching and research and allow it to provide essential support to its faculty and students.

**FIGURE 4. FY 2020 ENDOWMENT SPENDING**



*Source: 2020 NACUBO-TIAA Study of Endowments*

Endowments also allow institutions to engage in long-range planning with confidence that they will have the resources necessary to complete their most important projects. Institutions need long horizons to make capital improvements, build strengths in emerging academic fields, and adapt to the changing needs and interests of their students and the broader society. Finally, endowments stimulate contributions from donors who want to be sure that their gifts will benefit an institution’s educational purposes in perpetuity. This charitable impulse to commit private dollars to support of valued public purposes continues to create and strengthen endowments for the benefit of this and future generations.

## Why do institutions with large endowments keep increasing tuition?

Institutions with endowments use them, along with other resources, to offer programs of greater quality than either the endowed funds or the institution’s other resources could support by themselves. In many cases, donors explicitly direct their gifts toward expenditures that expand or enhance programs, and may even make the institution more expensive to operate. It is not uncommon for a donor to pay for the construction of a building but not for its maintenance or operation, or to seek assurance that the institution will not substitute endowment dollars for other funds. At the best-endowed institutions, endowment income typically represents the single largest source of revenue of the overall operating budget.

Tuition plays an important role in meeting other costs. At the same time, endowments help institutions provide financial aid to students who cannot afford full tuition. This is evident when comparing the net prices of the wealthiest private nonprofit four-year institutions to that of the national average. Of the top 10 highest endowed private institutions, the calculated 2018–19 average net price was approximately \$22,000, about 70 percent less than the posted term bill (of \$73,000).

**TABLE 1. NET PRICES OF THE WEALTHIEST PRIVATE NONPROFIT FOUR-YEAR INSTITUTIONS**

	Percent Awarded Any Type of Grant Aid	Average Net Price	Posted Price	Calculated Discount Rate
<b>National Private Four-Year Average</b>	87%	\$26,440	\$51,874	49%
<b>Top 10 Private Four-Years</b>	56%	\$21,978	\$73,033	70%
<b>Top 25 Private Four-Years</b>	54%	\$25,455	\$72,632	65%
<b>All Private Four-Years over \$1 Billion</b>	63%	\$27,090	\$68,789	61%

*Note: All data is in reference to only full-time, first-time undergraduate students.*

*Sources: Integrated Postsecondary Education Data System (IPEDS), 2018–19 NCES Digest of Education Statistics*

Given the highly competitive nature of these top endowed institutions, some with acceptance rates in the single digits, they generally choose to provide significant financial aid as a matter of policy to benefit low- and middle-income students, made possible at least in part by the resources in their endowments. If institutions spent additional endowment earnings or principal rather than increasing tuition thereby depleting the purchasing power of the endowment over time, tuition would have to rise more sharply in the future as endowment earnings declined, and there would be less funding available for financial aid.

## Why do institutions conduct campaigns to increase an endowment rather than raise funds for immediate needs, such as student aid or building renovations?

Most institutions do both. They raise annual funds to help meet immediate needs, but they also raise endowments to help meet future needs. Endowed institutions meet the needs of today with earnings from gifts they were given in the past, and the endowed funds they raise now will help ensure that they can continue to educate students and support faculty research even when government budgets are tight or economic downturns reduce annual voluntary contributions.

## Why should a donor give to a college or university with a large endowment as opposed to a charity in greater need of funds?

Most colleges and universities hope that donors will do both. Institutions typically encourage students, and in some cases alumni and others, to participate in community service. But the costs of high-quality education and research are growing rapidly as colleges and universities expand financial aid programs to support students—

particularly from low-income backgrounds, thereby providing social mobility—pursue the very best faculty, adopt new technologies, and try to keep pace with the expansion of knowledge. Institutions need additional resources if they are to serve their public purposes effectively and remain world leaders in their fields.

## **Why shouldn't colleges and universities be required to spend a minimum amount from their endowments each year, much as foundations are required to meet minimum payout standards?**

Foundations and universities are very different kinds of institutions. In the case of a foundation, the public has an interest in ensuring that the foundation is adequately serving its charitable purposes in return for the tax advantages granted to the donor, and the most effective way to ensure this may be through a minimum payout requirement. In contrast, funds donated to college and university endowments are given for the express purpose of supporting designated educational or scholarly activities over a long period of time. There are many constituencies that play a role in ensuring that these dollars are spent for their intended purposes, including students, faculty, alumni, local residents, and government agencies. If anything, the pressures on colleges and universities push in the direction of spending more of the endowment's earnings on current purposes, to the potential detriment of sustaining the purchasing power of the endowment for a future in which the costs of high-quality education and research are likely to be even greater.

# Endowment fact sheet

## SIZE

- Twenty-five percent of private four-year and 23 percent of public four-year institutions have endowments of less than \$10 million.
- The median endowment at private four-year colleges and universities is roughly \$37.1 million, which at a typical spending rate would support an annual expenditure of between \$1,484,000 and \$1,855,000. The median endowment at public four-year institutions is roughly \$35.4 million, which would support \$1,416,000 to \$1,770,000 of annual expenditure. Such typical spending amounts represent 5.1–6.4 percent of the median total expenditures of nonprofit four-year institutions (\$29.2 million), while only 1.0–1.2 percent of expenditures at public four-year institutions (\$143.6 million).
- Of the nation’s roughly 1,300 private nonprofit four-year institutions that reported data, about 43 percent had endowments over \$50 million. Similarly, of the nation’s roughly 700 public four-year institutions with reported data, about 40 percent had endowments over \$50 million.
- Five percent (104) of the public and private nonprofit four-year colleges and universities with reported data had endowments exceeding \$1 billion, 64 private and 40 public.
- In addition to colleges and universities, other institutions with endowments include churches, hospitals, museums, private secondary schools, and performing arts groups.

## COMPOSITION

- An endowment typically includes many different funds.
- Some endowments are given with the stipulation that the principal will never be spent. In many of these cases, the donor restricts the income to one or several purposes, programs, or departments. Especially at research universities, a significant fraction of the endowment may not be available to support undergraduate programs.
- In other cases, the institution can select the educational purposes the gift will serve, but it can still only spend income.
- Sometimes donors permit the spending of principal, but the institution decides to treat the gift as endowment so it can continue to yield income in support of long-term obligations. These are called “funds functioning as endowment.”

## SPENDING RULES

- Most college and university governing boards adopt endowment spending policies that are designed to maintain a smooth spending course while achieving intergenerational equity. The principle of intergenerational equity ensures that future generations of students and faculty receive at least the same level of support from an institution’s endowment as the current generation enjoys.
- Typical spending policies aim to prevent weak investment returns from forcing commensurate decreases in spending. When investment returns are robust, smoothing rules help ensure that any increased spending can be sustained into the future.
- Institutions, on average, seek endowment growth (dividends plus appreciation) of 7 to 8 percent a year to keep up with inflation, cover investment management costs, and approach a 4 to 5 percent spending rate.

- Different assumptions about the long-term rates of increase in costs or in the value of the endowment might yield a different rule. In periods with consistently strong financial markets, institutions may go beyond their rules and make additional upward adjustments in their spending of endowment income, while also creating additional reserves for those years when markets fall short of their long-term targets.
- In fiscal year 2020, institutions allocated 72 percent of endowment assets to traditional stocks, bonds, and cash investments, 21 percent to private equity, 7 percent to natural and other “real” assets.
- Over the past decade (2011–20), the average return for college and university endowments was 7.5 percent. In 2020, the average was 1.8 percent.
- Over the past decade (2011–20), the average spending rate for college and university endowments was 4.6 percent; in 2020, the institutions with the largest endowments (over \$1 billion) spent an average of 4.5 percent.
- In fiscal year 2020, 70 percent of institutions increased their endowment spending from the previous year, with an average increase of about \$3.3 million.

## BENEFITS TO SOCIETY

- Endowments allow institutions to deliver greater value and attain higher levels of quality than would otherwise be possible.
- Reliable long-term support from an endowment enables institutions to increase student aid, make commitments to senior faculty, initiate pioneering research, develop stronger teaching programs, invest in new technologies, and maintain their libraries, laboratories, and other physical assets.
- Even in difficult financial times, endowments can sustain institutions’ teaching and research and allow them to provide essential support for faculty and students.
- Endowments also allow institutions to engage in long-range planning with confidence that they will have the resources necessary to complete their most important projects.
- Institutions need long time horizons to make capital improvements, build strengths in emerging academic fields, and adapt to the changing needs and interests of their students and the broader society.
- In fiscal year 2020, institutions spent 48 percent of endowments on student financial aid, 17 percent on academic programs, 11 percent on endowment faculty positions, 7 percent on campus operations, and 17 percent on other purposes.

## ENDOWMENT EXCISE TAX

- The Tax Cuts and Jobs Act, the major tax reform legislation enacted in December 2017, included an unprecedented new tax on private nonprofit colleges and universities.
- Institutions enrolling at least 500 tuition-paying students that have assets of at least \$500,000 per student are now subject to a tax of 1.4 percent on their net investment income.
- Opposed by the higher education community, the excise tax does nothing to incentivize endowment spending that benefits students, research, or other aspects of institutional educational missions. Instead, the revenue generated by the excise tax, projected to be about \$200 million per year, will simply go to the federal government to be used for any purpose.
- The tax imposes a new cost on the institutions subject to the statutory framework both in terms of funds spent on the tax itself as well as the costs incurred to ensure compliance with complicated IRS regulations.

