

MYTHS ABOUT COLLEGE AND UNIVERSITY ENDOWMENTS

1. **MYTH: An endowment is a single fund that a school may spend at its discretion.**

FACT: A typical endowment consists of hundreds, sometimes thousands, of individual funds. In most cases, the donors who have created these funds have set restrictions on how their donations may be spent. In 2007-8, about 78 percent of endowment assets at public institutions were under such restrictions; an average of 55 percent of the resources contained in private university endowments were restricted (See National Association of College and University Business Officers (NACUBO) 2008 Endowment Study). In such cases, money restricted for research in a specific subject, for example, may not be applied toward student financial aid, and vice versa. Donations are typically restricted to fund student scholarships, conduct specific kinds of research, finance specific programs to enhance undergraduate and graduate education, create professorships in specified fields, develop or maintain teaching and research facilities, or improve a wide range of campus activities, including the arts, public service, student housing, and athletics.

To help ensure an endowment's ability to support its charitable purpose in perpetuity, which is the intent of most donors and generally made legally explicit in gift agreements, universities usually do not spend the donation, or principal, itself. Instead, they invest the principal and spend part of the investment income on the charitable purpose of the gift and reinvest the rest to protect against inflation and ensure future spending toward that charitable purpose.

2. **MYTH: The public does not benefit enough from university endowments' tax-exempt status.**

FACT: American colleges and universities are tax-exempt organizations because of the educational and research purposes for which they exist, which directly benefit citizens and society. Endowments are tax-exempt because their primary purpose is to directly support and sustain teaching, research, and public service. These comprise the core of a research university's mission.

Endowments are a vital source of revenue that makes possible a university's contributions to the public good. The effects of higher education – the educated student now in the workforce, the research breakthroughs and the new technology we use daily, the lives saved through medical research, the solutions to community problems – can be seen in every aspect of society: health, business, manufacturing, arts and culture, national security, and government. Universities are also home to much of the innovation that fuels America's status as a superpower. University research leads to new technologies that, in turn, create new industries and economic growth. The Internet, Google, and GPS technology are just a few examples of the innovations whose origins are in universities.

American universities have contributed significantly to the nation's economic growth and are the envy of other countries. Locally, communities with universities benefit considerably from university activities, which are partly funded by endowment income. These benefits include research that drives economic development, community outreach to area schools, access to university libraries and museums, jobs, and the delivery of generations of highly-skilled and educated workers. Additionally, university medical centers – which are also supported in part by endowed funds – offer top-notch treatment and care to citizens of their host communities.

It is also important to note that undermining the tax-exempt status of university endowments – by limiting the deductibility of contributions or by changing the status of endowments themselves – would likely reduce charitable contributions to higher education. Universities in countries without the benefit of the American philanthropic model rely much more heavily on governmental appropriations, which would certainly be an undesirable outcome in this country.

3. MYTH: Universities are not using enough of their endowments to make college accessible and affordable for low- and middle-income students.

The cost of a college education is much higher for all students than the tuition prices charged by institutions. For college and universities with sizable endowments, the difference is subsidized by earnings from their endowments. The extensive aid colleges and universities extend to students from low- and middle-income families, which often covers tuition, books and living expenses, helps ensure that a top-quality education remains a path to the American dream. Many institutions with significant endowments are making this dream possible by converting loans to grants and by making college **free** for thousands of low- and moderate-income students (students from families with incomes below \$40,000, and in some cases below \$60,000 or \$70,000 a year). Some of these institutions are: the University of North Carolina at Chapel Hill; Emory University; Vanderbilt University; the University of Washington; Stanford University; the University of Maryland at College Park; Princeton University; the University of Florida; Yale University; the University of Pennsylvania; Indiana University; Harvard University; Texas A&M University; Columbia University; and the University of Virginia. At these and many other institutions, financial aid is not just for low-income students. Middle income students are also offered significant financial support to help make college affordable, including grant aid to help reduce post-graduation debt.

In addition to financial aid, universities conduct a variety of outreach programs to attract low-income applicants. These extensive outreach efforts include sending school representatives to low-income communities, paying for low-income high school students to visit the campus, and waiving application fees.

4. MYTH: Increasing endowment spending would halt tuition increases.

FACT: Universities and colleges with large endowments actually increase tuition at a slower rate than schools that lack such resources and charge even full tuition-paying students less than the actual cost of their educations. Because of restrictions on endowments, much additional spending would be in areas unrelated to tuition, such as research. Increasing tuitions are a direct function of a combination of factors, including: reduced state support for public institutions; increased federal and state regulatory requirements; increased health care and other employee benefits costs; increased energy costs; the need for up-to-date information technology; and, student and family demands for increased services. Universities and colleges, however, work continually to find cost efficiencies, such as consolidated purchasing agreements, streamlining administrative structures and personnel, use of energy cogeneration facilities, and more energy-efficient buildings. Furthermore, most public universities do not determine their own tuition rates. In all but 14 states, these decisions are made by state boards of education or state regents, or are directly set by state legislatures.

5. MYTH: Athletic programs receive more endowment funding than most academic programs.

FACT: When asked by the Senate Finance Committee in January 2008 to list their ten highest endowment expenditures, very few universities that made their responses publicly available included athletics in their responses. By far the most common categories of endowment expenditures are scholarships and financial aid, faculty chairs and salaries, and academic support programs. While some institutions have individual endowments that donors have restricted to support athletics, many athletic programs and coaches' salaries are supported by other sources of funds, including athletic ticket revenues, television revenues, advertising, and corporate sponsorships.

6. MYTH: Endowment spending sacrifices the interests of present students to the university's future needs.

FACT: When an individual makes a donation to a university endowment, she is knowingly supporting the present and the future of the university. Just as donations from the past support students today, today's donations are managed to support current and future generations of students and faculty. Endowment funds are the working capital colleges and universities use to support today's operations and tomorrow's capacity and operations. It is important to protect the endowment and the institution from poor market conditions, inflation, and natural or economic catastrophes. The challenge is not just to sustain current programs but to create the capacity to enter new fields and apply new technologies. Given the nation's current economic recession, endowments are particularly vital to public institutions, which will likely face increasingly scarce state support. At the same time, the real costs of providing high-quality education and research are likely to be even greater in the future than they are now.

7. MYTH: College and university endowments are just like private foundations and should be subject to the same payout rules.

FACT: Private foundations and universities are very different. Private foundations are generally a creation of a family or a single individual and exist primarily to give money away to meet their charitable goals. They generally remain under the control of the donor or donor's family. Congress enacted payout requirements for private foundations to ensure – in the absence of other public participation in their decisions – that private foundations were working toward their charitable goals. In contrast, universities are organized as public charities or state entities with substantial public support provided either through state government support in the case of public institutions or through gifts in the case of private institutions.

Universities are tax-exempt entities because of the educational, scientific, and charitable purposes they serve – teaching students, performing research, and addressing problems affecting communities, states, and the nation. Like other public charities (and unlike private foundations), these activities are funded through various sources, including endowment payout, current use charitable gifts, tuition, private foundation grants, sponsored research grants, and other sources. Trustees, regents, students, faculty, alumni, local residents, and other institutional stakeholders are closely tied to an institution's actions and act to ensure that it manages its finances and

activities and spends its endowment earnings commensurate with its mission and needs each year.

Moreover, university endowments fund ongoing programs, while private foundations typically do not run operations but make grants to external parties. This gives foundations flexibility to adjust the size of grants year by year to meet their payout requirements. Universities do not have this kind of flexibility.

8. MYTH: There is no external or legal oversight of college and university endowments.

FACT: Private colleges and universities and public college and university foundations are organized and governed as public charities and thus are overseen by the Internal Revenue Service (IRS) and subject to its regulations and rules. The IRS maintains an active program to audit tax-exempt, charitable organizations, including universities and university foundations. Congress regularly holds oversight hearings on issues affecting tax-exempt organizations.

In addition, state attorneys general supervise the operations of charitable organizations to ensure that their resources are used to benefit the public. States also regulate fundraising by charities, and state laws further govern fiduciary obligations for charitable gifts. This includes the new Uniform Prudent Management of Institutional Funds Act (UPMIFA) and its predecessor Uniform Management of Institutional Funds Act (UMIFA), which was enacted in 47 states. Both provide uniform and fundamental rules for the investment of funds held by charitable institutions and the expenditure of funds donated as endowments. UPMIFA rules promote two general principles: 1) assets should be invested prudently in diversified investments that promote growth as well as income, and 2) the appreciation of assets should be prudently spent for the purposes of the endowment fund held by the charitable institution. These two principles have been key features of endowment asset management since UMIFA was widely adopted in the 1970s.

9. MYTH: Universities “hoard” their endowment investment returns to maximize endowment growth.

FACT: In determining how much of their endowments to spend each year, colleges and universities aim for a spending rate that will provide maximum support for current activities at a level that can be sustained in the future. This prevents significant drops in endowment spending during periods, such as the current one, when the value of investments declines significantly. Such drops could, for example, deprive students of anticipated scholarships or undermine ongoing research. Institutions employ payout rules designed to maintain the purchasing power of the endowment against inflation and variable market conditions. According to NACUBO, the most common spending rule adopted by institutions is to spend five percent of the three-year average of an endowment’s market value. This “smoothing” rule bases spending on a multi-year timeframe that promotes consistent funding over time to ensure sustained academic quality and support for students. College and university spending rates have averaged between 4.5 and 5.1 percent of market value over the last decade. Although the differences between spending rates seem small, they can dramatically affect an endowment’s principal over time, and universities rely on the flexibility of spending rates to manage their resources. Among the 796 institutions in NACUBO’s 2008 study, the institutional spending average was 4.6 percent.

10. MYTH: Colleges and universities are overly aggressive in endowment investments.

FACT: Universities pursue diverse investment strategies in line with their fiduciary obligations to their donors to protect and grow their charitable gifts. Like many large institutional investors, universities pursue diverse investment opportunities to guard against the risk of too much exposure in a small number of investments. Endowments are generally invested in securities, bonds, real estate, pooled funds, and commodities. The mix of investments differs from institution to institution, but it is not that different from the investments of pension funds and retirement accounts. This is in accordance with the UPMIFA rules cited above. Despite the recent decline in the markets, university endowments have outperformed the S&P 500 and other institutional investors due in part to long-term and diverse investment strategies.

11. MYTH: It is in a university president's best interest to minimize current endowment spending because his/her compensation is tied to endowment performance.

FACT: This notion is false. Presidential compensation is not tied to the performance of university investments, as clearly indicated in the publicly released responses to the Senate Finance Committee's January 2008 survey of university endowments.

12. MYTH: Universities provide insufficient information about their finances and endowments.

FACT: All public universities release annual financial statements and annual reports that are usually available online; most private institutions also offer this information on their Web sites. All private universities and public university foundations are required to complete the publicly available IRS Form 990, which has been redesigned this past year to increase the transparency of nonprofits, including their endowments.

The Form 990 requires new information for organizations that maintain endowment funds including: beginning- and end-of-year balances; contributions to endowment; investment earnings or losses; grants or scholarships from endowment; other expenditures for facilities and programs; and administrative expenses. The Form 990 also requires the information on the percentage of endowments held as board designated, permanent or term endowments; whether endowment funds are held by other organizations, related or unrelated, for its behalf; and a description of intended uses of the endowment funds. Universities fully support this increased transparency, which will be evident on the 2009 forms for the 2008 tax year.

Additionally, the Senate Finance Committee in January 2008 sent a letter of inquiry about endowments and college costs to all colleges and universities with endowments over \$500 million. The committee received a response from every institution, and many made their extensive, detailed responses available on their campus website and to the media.

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