

Endowment Spending: External Perceptions and Internal Practices

by *Lucie Lapovsky*

Introduction

The policies and practices followed by educational institutions in managing their endowments are of strong current interest. Prior to the market collapse of last autumn, attention was focused on the outsized returns earned by the top endowments, and the policy debate centered on the appropriateness of these institutions' spending policies in light of those returns. In the current environment, where even the largest and best-staffed endowments have lost nearly one-quarter of their value over the six months from July 1–December 31, 2008, the focus has shifted to the ability of endowments to continue to support their institutions' missions and programs. The common theme running through the debate, however, remains spending: spending policies, spending formulas and spending levels.

During the economic expansion of the past several years, interest in the subject of spending broadened as public interest groups, the media and the Senate Finance Committee voiced concerns about whether colleges and universities were distributing enough from their endowments each year. Critics argued that after many years of strong investment returns, accompanied by rising tuitions, college and university endowments had grown too large and that educational institutions were hoarding money that should properly be spent. Even after the calamitous final three months of calendar 2008, when some of the largest endowments saw their value reduced by billions of dollars, the expressions of concern have continued.

By comparison, relatively little has been written about the other side of the equation—how educational institutions actually use the funds they draw from their endowments. This topic is important on its own, but in the existing environment in which the fairness, and even the desirability, of large educational endowments are being questioned, it becomes even more timely and relevant. How do endowment funds influence the operational priorities of educational institutions? How do they affect the way in which institutional operating budgets are developed and funds are distributed?

This paper examines spending from two different perspectives. The first perspective is external—what outside observers see. The research for this section is drawn from 102 of the letters submitted by colleges and universities in early 2008 in response to a request from the Senate Finance Committee to the 136 educational institutions with endowments of \$500 million or more.¹

The second part of the paper, an examination of endowment spending from an internal perspective, focuses on the annual budgeting and spending practices of colleges and universities, and reviews how these practices differ in institutions of varying types, endowment sizes and other characteristics. Contrary to the external perception that all spending is fundamentally the same, this analysis reveals that, in practice, there is a range of approaches to budgeting and spending decisions and they have consequences for the programs and missions supported by the endowment.

¹ The Senate Finance Committee, led by Chairman Max Baucus (D-MT) and Ranking Member Charles Grassley (R-IA), requested information from 136 colleges and universities with endowments of at least \$500 million about how their endowments are managed and tuition and financial aid policies are set. A copy of the letter is attached as Appendix I.

Part I

Spending and Mission Support as Reported in Responses to the Senate Finance Committee

Background

In early 2008, the Senate Finance Committee requested information on endowment spending and student aid from the 136 U.S. colleges and universities with endowments of \$500 million or more. According to a press statement from the committee dated January 24, 2008, the request was motivated by the release of the annual National Association of College and University Business Officers (NACUBO) Endowment Study that showed “explosive endowment growth.”² The letter describes the committee’s concern over the rising cost of higher education, and expresses interest in knowing what schools are doing to mitigate these costs. The letter also exhibits a concern with the amount that institutions are spending from their endowments and an interest in their spending priorities. Replies to the letter were requested within 30 days; the responses were composed in February 2008, when the equity markets had not yet begun the sharp decline that would characterize the latter part of the year and endowments were still operating in the glow of a four-year period of very strong returns.

The Institutions

This discussion is based on an analysis of 102 of the responses to the Senate Finance Committee, or 75 percent of the total, representing 34 public and 68 private colleges and universities throughout the United States. The responses, which frequently include a detailed description of the institution’s history and mission, highlight their diversity—a feature that would be further magnified if these questions had been asked of a wider sampling of colleges and universities in the U.S. As it is, the colleges that are included in this analysis are among the wealthiest and most selective in the country.

The responses indicate a wide range of variation among the institutions in enrollment, governance practices, tuition and financial aid policies, and endowment management. Each school emphasizes its unique history and the particular circumstances that guide the way it operates. While all the responses indicate a concern over access and provide insight into how individual institutions are working to increase affordability, it is clear that the resources available and the demographics of the student population vary widely, as do endowment size and other non-tuition resources per student.

2 Information in the NACUBO Endowment Study is reported on the basis of a fiscal year which, for educational institutions, typically runs from July 1 to June 30.

The institutions that responded have endowments that range from \$500 million to \$35 billion. Their enrollments range from just over 1,000 full-time equivalent (FTE) students to more than 150,000 FTE students, with the latter being public systems of higher education where many campuses share one or more endowments. Endowment per full-time student, another measure of institutional wealth, ranges in the respondent group from less than \$15,000 per student to more than \$2.5 million per student. All but one of the schools with endowment per student of less than \$100,000 have enrollments of 14,000 FTE students or more. Most of these schools are public, but there are a few large private universities in this group also. (All data are as of the first quarter of 2008, when the institutions responded to the Senate Finance Committee.)

TABLE I
Institutional Enrollment

| Enrollment | % Public | % Private | Avg. End. per FTES |
|-------------------|-----------------|------------------|---------------------------|
| 1-2,000 | 0 | 100 | \$769,165 |
| 2001-4,000 | 0 | 100 | 358,961 |
| 4,001-10,000 | 0 | 100 | 664,291 |
| 10,001-20,000 | 24 | 76 | 386,157 |
| 20,001-30,000 | 63 | 37 | 232,378 |
| 30,001-50,000 | 80 | 20 | 51,205 |
| 50,001 + | 100 | 0 | 38,097 |

Restrictions on Endowments

Responding institutions reported a wide range in the proportion of their endowments that may only be spent for certain designated purposes. The top five categories of restriction are shown in Table II. Seventy-four percent of institutions list faculty and staff among the top five areas of restricted funds, followed by library, undergraduate financial aid, academic programs and research.

TABLE II
Restricted Endowment Funds

| Percent of Institutions with Funds Restricted to: | |
|--|-----|
| Faculty and Staff | 74% |
| Library | 62 |
| Undergraduate Financial Aid | 57 |
| Academic Programs | 56 |
| Research | 46 |

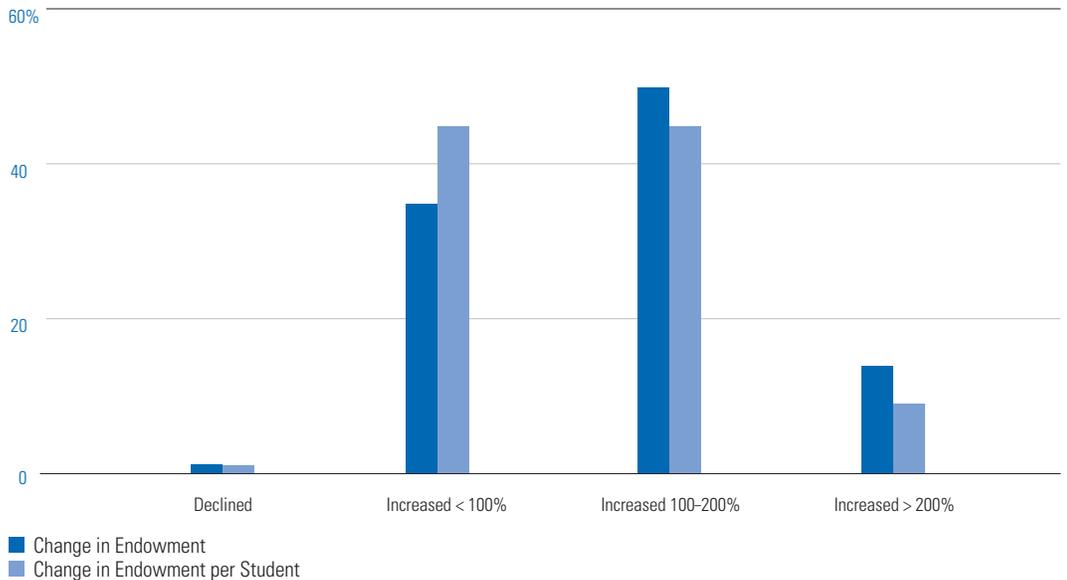
Looking beyond these top five categories, 65 percent of institutions overall reported that some of their endowment is restricted to undergraduate financial aid. The percentage of the endowment restricted to undergraduate financial aid varies significantly, with only a few institutions reporting that more than 50 percent of their endowment is so restricted.

Endowment Growth

The years between FY1998 and FY2007 were a period of significant growth for responding institutions' endowments, despite the declines that accompanied the bursting of the stock market bubble in 2000. During this period, endowment values increased by a cumulative average of 142 percent. Individual institutions' returns varied significantly; only one endowment experienced an absolute decline in value over this period, while 16 percent of the institutions saw their endowments more than double.

Endowment per student, while growing a cumulative 114 percent over this period, did not keep pace with endowment growth because enrollments at almost all responding institutions increased during this period of time. Again, significant variation was observed with endowment per student declining at only two institutions while it more than doubled at 9 percent of the institutions. By comparison, during this same period the Higher Education Price Index (HEPI) increased by 41 percent and the Consumer Price Index (CPI) increased by 27 percent³—rates far below the growth of endowment values and endowment per student. The FY1998–FY2007 period thus saw significant growth in real terms in the endowments of almost all of the responding institutions.

FIGURE I
Increase and Decrease in Endowments
FY1998–FY2007



As noted above, this period saw years of positive and negative investment returns, and both endowment values and endowment per student fluctuated accordingly. In the very strong markets of 1999–2000 and 2006–2007, endowments increased by an average of 20 percent, while during the recession of 2001–2002 endowment values and endowment per student declined.

3 Commonfund Institute, 2008 HEPI Report, p. 3 (2008).

Table III shows changes in endowment values from year to year over the period FY1999–FY2007. The data show a strong correlation between market conditions and endowment returns. For example, very few responding institutions experienced a decline in their endowments in non-recession years. In contrast, in FY2001 79 percent of institutions saw their endowments’ value decline, and 90 percent of endowments declined in FY2002. As the market emerged from the recession in FY2003, only 11 percent experienced a decline. In FY1999, FY2000, FY2005, FY2006 and FY2007, the majority of the colleges and universities saw increases in their endowments of more than 10 percent; and in FY2007, a majority of these institutions experienced an increase of more than 20 percent.

TABLE III
Percentage Change in Endowment Value FY1999–FY2007

| | FY99 | FY00 | FY01 | FY02 | FY03 | FY04 | FY05 | FY06 | FY07 |
|------------------|------|------|------|------|------|------|------|------|------|
| Declined >20% | 0% | 0% | 0% | 0% | 0% | 0% | 0% | 0% | 0% |
| Declined 10–20% | 1 | 1 | 11 | 9 | 1 | 0 | 0 | 0 | 0 |
| Declined <10% | 0 | 3 | 68 | 81 | 10 | 1 | 1 | 0 | 0 |
| Increased <10% | 32 | 15 | 20 | 8 | 84 | 84 | 23 | 9 | 0 |
| Increased 10–20% | 56 | 45 | 0 | 2 | 4 | 15 | 73 | 88 | 46 |
| Increased >20% | 11 | 35 | 1 | 0 | 1 | 0 | 3 | 3 | 54 |

Components of Endowment Change

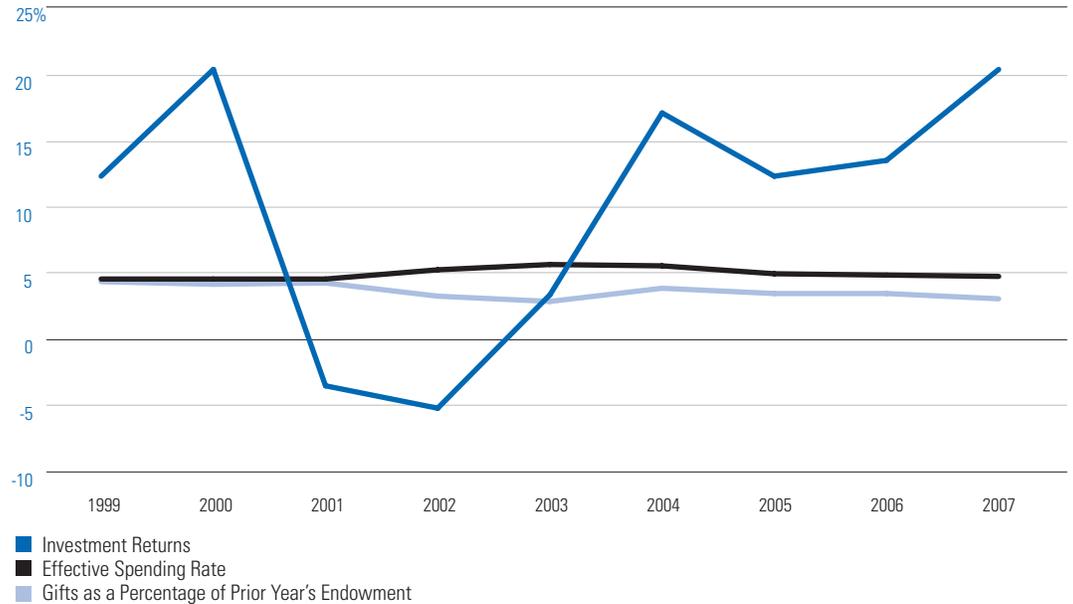
Overview

Changes in endowment values reflect a combination of investment returns (which can be positive or negative), new gifts to the endowment, the amount paid out from the endowment to the institution, and costs and fees. Figure II shows that investment returns are quite volatile, ranging from a high of more than 20 percent on average among all 102 institutions surveyed to a low exceeding -5 percent. However, the effective spending rate—the average amount paid out as a percentage of endowment value—has remained quite steady over time, ranging between 4.4 percent and 5.6 percent. This rate increases in years when endowment returns are negative, as institutions spend to support their missions even in times of market loss. Gifts received as a percentage of the prior year’s endowment value ranged from a high of 4.3 percent to a low of 2.8 percent. In most years, this percentage is below the effective spending rate. The following sections will review each of these factors in more detail.

FIGURE II

Investment Returns, Effective Spending Rate and Gifts

FY1998–FY2007



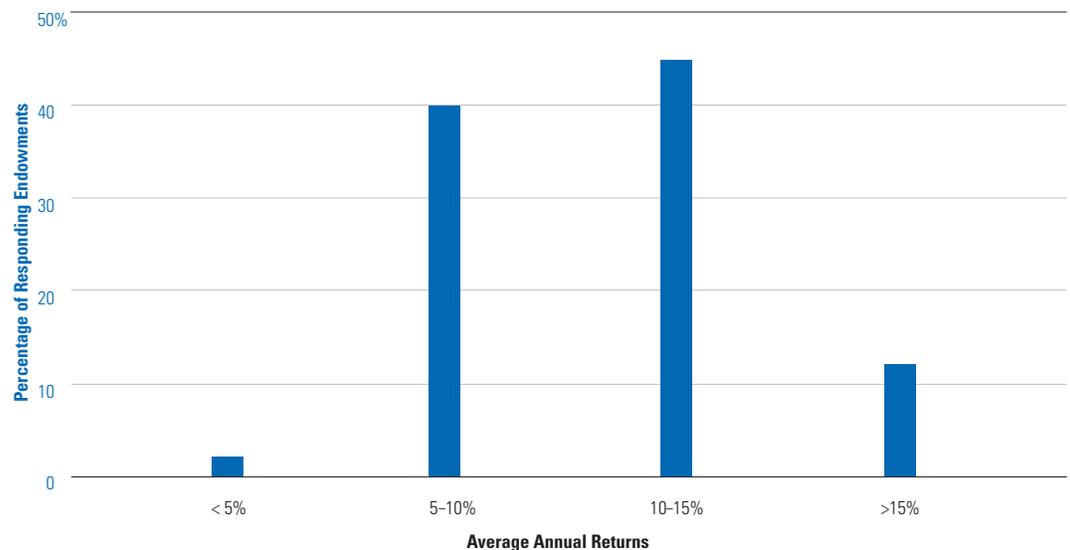
Investment Returns

Investment returns among the institutions vary significantly over the period in question. Between FY1998 and FY2007, only 2 percent of these institutions had average annual investment returns of 5 percent or less while 12 percent had average annual returns in excess of 15 percent. The remaining endowments had average annual returns between 5 percent and 15 percent. Significant numbers of institutions experienced negative returns only in FY2001 and FY2002, although in most other years at least one institution had negative returns.

FIGURE III

Average Annual Investment Returns

FY1998–FY2007



Spending Policies and Spending Rules

Spending policies among these institutions vary, but most are based at least in part on spending a predetermined percentage of the endowment's average value over the prior three or five fiscal years. This averaging is done to smooth fluctuations in the dollars spent, and results in endowment values of all responding institutions declining in dollar terms between FY2001 and FY2003, while the dollars paid out did not.

The details of these spending rules can vary. Key metrics include the number of trailing years, quarters or months used in the averaging of the endowment value and the end-point for the averaging. Most institutions use the endowment value as of the end of the prior fiscal year as an end-point, while a few use the latest quarter. Those using the most recent quarter as their end-point will continue to change the dollars paid out as the budget year advances. A few institutions adjust the endowment payout to account for expected new gifts to the endowment in the budget year. Schools that make such an adjustment will realize the impact of new gifts in their spending sooner than other institutions.

Several of the largest endowments use a hybrid spending rule. This approach uses a weighted average of two components. A 60–80 percent weighting is assigned to the dollars paid out from the endowment in the prior year adjusted by inflation (calculated either by using the CPI or HEPI), and a weighting of 20–40 percent is assigned to the policy spending rate (see following paragraph) applied to an average of prior endowment values. The weights given to these two components vary among institutions, and most institutions limit the amount paid out so that it falls within an upper and lower percentage limit or band around the endowment value.

The other key component to the spending policy is the policy spending rate—that is, the target percentage of the endowment's value (or averaged value) that is intended to be spent each year. At most institutions this amount falls between 4.5 percent and 5.5 percent, although there are a few institutions where it exceeds 5.5 percent. About 15 percent of responding institutions have a range within which the policy rate may fall; here, the board of trustees determines the rate annually as part of the institutional budget process. These institutions have significantly more flexibility to adjust to institutional needs and budgetary situations than those with fixed policy rates.

With the very high returns of the last several years, some institutions have increased their policy spending rates. Some institutions have increased their rates in order to fund specific initiatives, such as to fund increased financial aid for students.

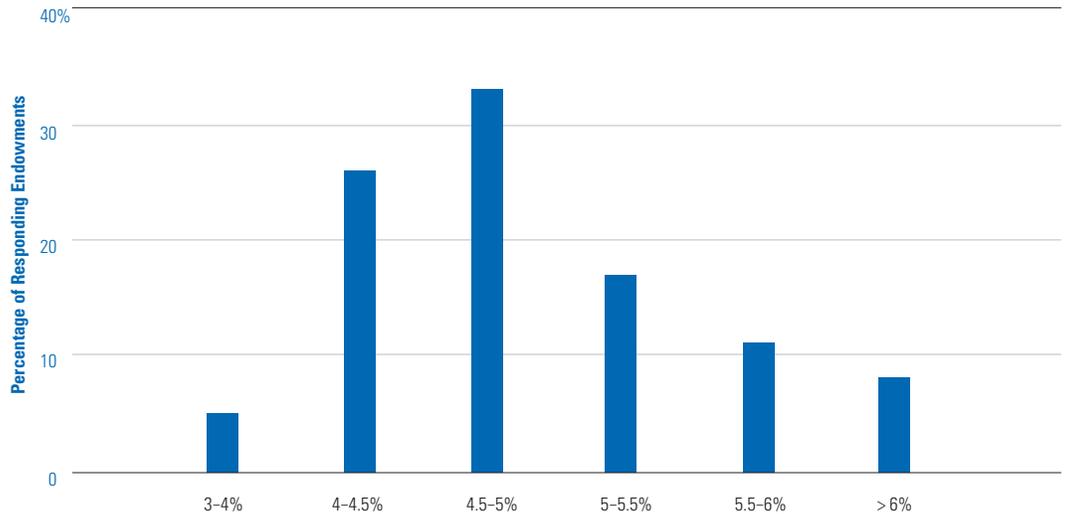
The effective spending rate is calculated by dividing the dollars spent by the beginning endowment value. The averaging that most institutions use in their spending rule results in the dollars spent being below the policy rate in years when investment returns are good and above the policy rate when investment returns are negative. This lagging relationship with investment returns can be seen in Table IV.

TABLE IV
Comparison of Effective Spending Rate and Investment Returns

| | FY98 | FY99 | FY00 | FY01 | FY02 | FY03 | FY04 | FY05 | FY06 | FY07 |
|-------------------------|-------|-------|-------|-------|-------|------|-------|-------|-------|-------|
| Effective Spending Rate | 4.4% | 4.4% | 4.5% | 4.5% | 5.2% | 5.6% | 5.5% | 4.9% | 4.8% | 4.7% |
| Net Investment Returns | 17.6% | 12.3% | 20.4% | -3.6% | -5.3% | 3.3% | 17.1% | 12.3% | 13.5% | 20.4% |

Historical analyses of spending indicate that it is difficult to maintain an endowment’s spending power in real terms, over time, with an effective spending rate in excess of 5 percent. Over the 10-year period covered by these reports, spending as a percentage of the prior year’s endowment for the responding institutions as a group averaged 4.9 percent. The results will look quite different when FY2008 and FY2009 are added to the analysis, as FY2008 was a year of losses that foreshadowed the worst investment returns in decades, and FY2009 may also prove challenging based on the outlook for the economy. Figure IV shows that 36 percent of the responding institutions spent 5 percent or more of the prior year’s endowment value over this 10-year period.

FIGURE IV
Average Effective Spending Rate for the 10-Year Period from FY1998-FY2007

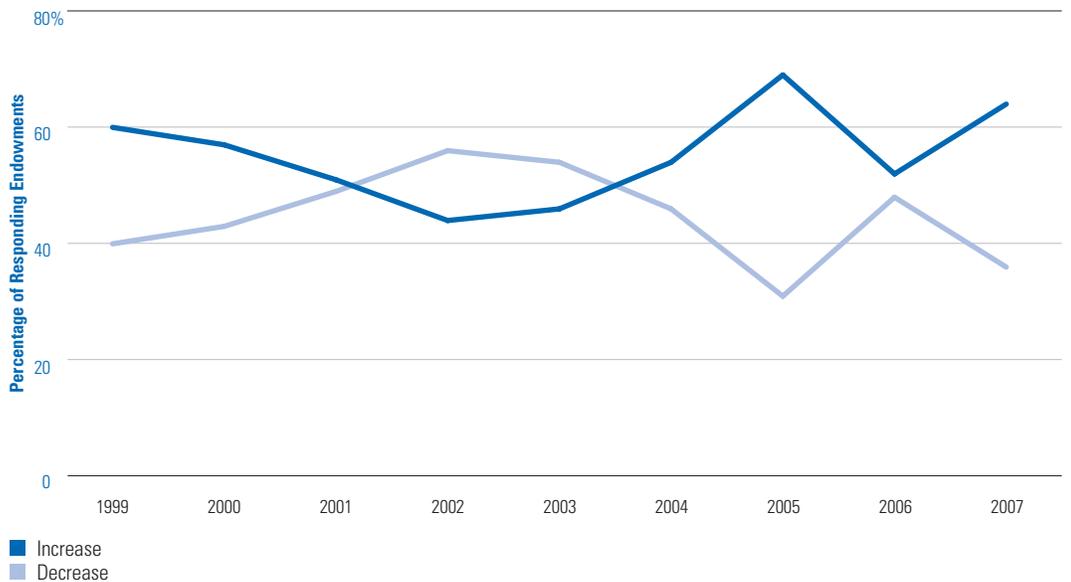


The Role and Effect of Gifts

Endowment gift flows are irregular. This is due in part to the fact that many are the result of bequests; but it is also attributable to the economic cycle and the attendant “wealth effect,” which leaves donors feeling more or less able to give. Capital campaigns can also cause giving levels to surge—and, not infrequently, to decline once the campaign ends.

In the recession of the early part of this decade, endowments’ investment returns were negative. During the same period, the percentage of endowment growth attributable to gifts fell, with the total amount of gifts that responding institutions received in FY2002 and FY2003 being less than the amount received in the preceding year.

FIGURE V
Increase and Decrease in Gifts from Prior Year
FY1999–FY2007

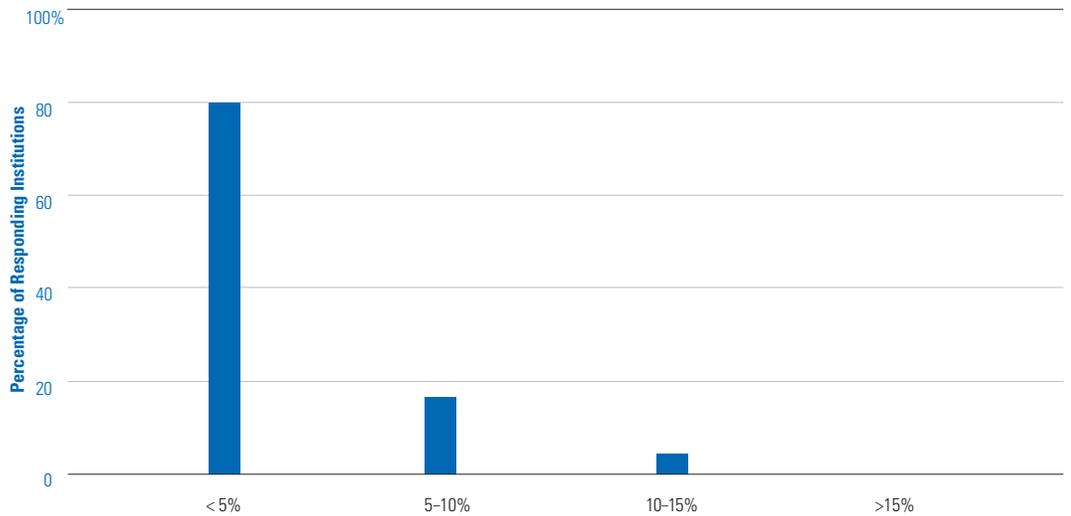


As Figure VI shows, 80 percent of responding institutions reported that gifts added an average of less than 5 percent to their endowments each year between FY1998 and FY2007. Endowment growth over this period owes much more to investment returns than to new gifts, which contributed an average of only 3.2 percent a year to endowment growth as compared with a 10.8 percent average annual contribution from investment returns.

The majority of the institutions where gifts contributed more than 5 percent to the average increase in the endowment were public colleges and universities, whose support foundations typically have been funded relatively recently and whose endowments are, accordingly, relatively small—meaning that gifts have a disproportionately large effect on overall endowment growth at these institutions.

FIGURE VI

Average Annual Contribution to the Endowment from Gifts for the 10-Year Period from FY1998–FY2007



Relationship among Key Variables

The experiences of endowments during the FY1998–FY2007 period provide insight into how they operate under a variety of market conditions and illuminate the relationship between investment returns and institutional support. Endowment values increased by more than 19 percent in FY2000 and FY2007 and declined in nominal terms from FY2000 to FY2001 by -3.8 percent and from FY2001 to FY2002 by -6.6 percent. In FY2003, endowments experienced a modest increase of 2.4 percent as the economy recovered from the recession. During the years in which the endowments declined, responding institutions had both negative investment returns and declines in gifts compared with the prior year; this occurred not only in FY2001 and FY2002 but also in FY2003.

Three of the main metrics used to measure the support that the endowment provides to the institution are the percentage of the operating budget that is supported by endowment income, the dollars that are transferred to the institution from the endowment, and the effective spending rate. The Senate Finance Committee’s request for information did not ask for data on the percentage of the operating budget supported by the endowment, but the 2009 Commonfund Benchmarks Study® *Educational Endowment Report* shows that it ranges from minimal support at schools with low endowments per student to more than 40 percent of the operating budget at some institutions with very large endowments. Institutions that are more heavily dependent on their endowments are less able to tolerate losses that impair the ability of the endowment to provide stable support to the operating budget.

Figure VIII shows that the level of dollar transfers from the endowment increased on average every year, even in years when the nominal value of the endowment declined (primarily as a result of negative investment returns).

FIGURE VII
Relationships among Key Variables
 FY2000–FY2007

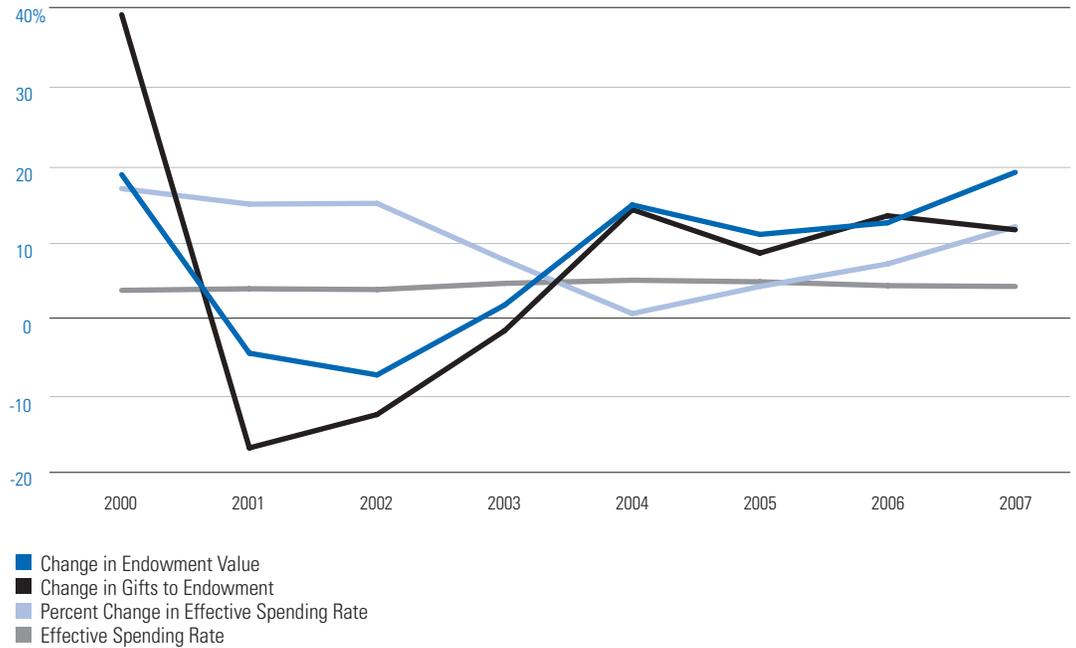
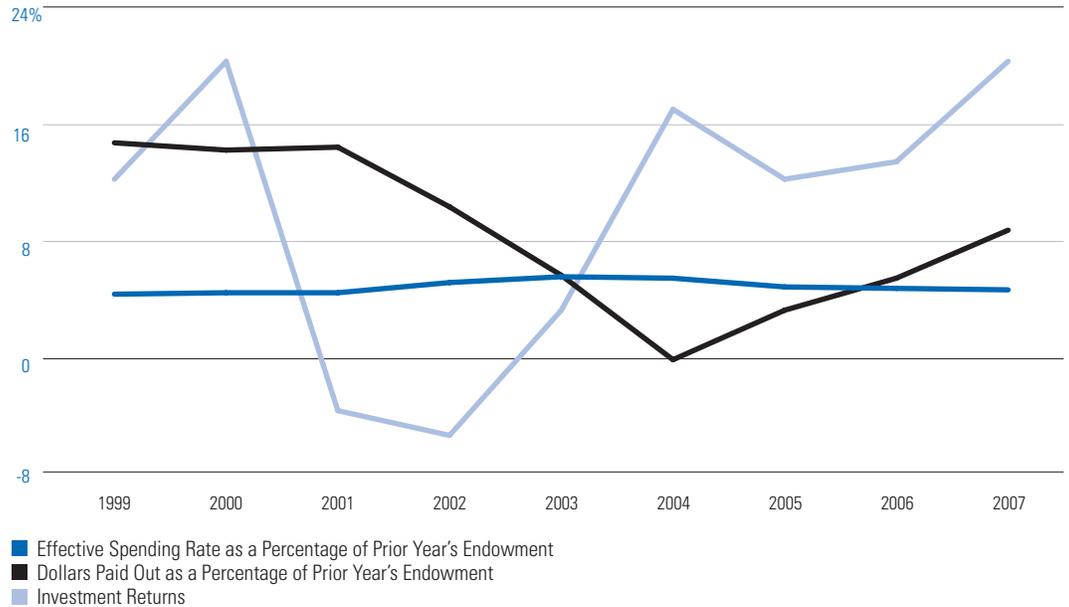


FIGURE VIII
Payout Data
 FY1999–FY2007

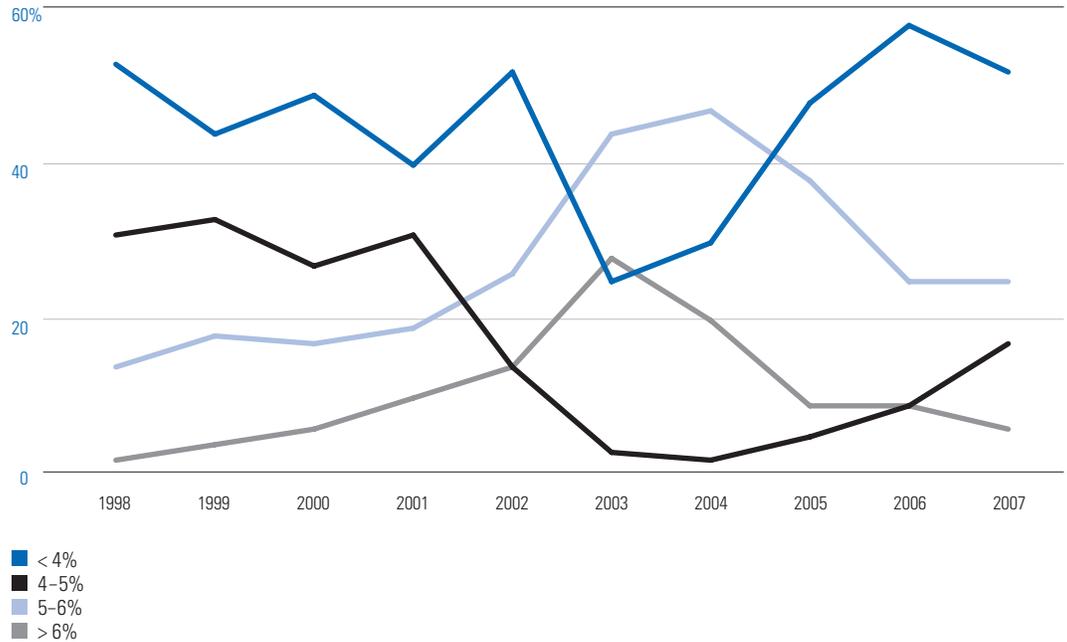


The dollars paid out by endowments increased in all years surveyed, except during FY2004 when the figure was essentially the same as in FY2003. Between FY1999 and FY2001, the dollars paid out increased by 15 percent per year. During the recessionary years, the dollars paid out increased from the previous year, albeit at a slower rate, and the effective spending rate increased to compensate for the decrease in endowment value. In FY2002 the dollars paid out increased by 10 percent, followed by a 5 percent increase in FY2003.

The effective spending rate remained between 4 percent and 6 percent during this time. As noted above, FY2004 was the only year in this period when the dollars paid out were not materially greater than the prior year's amount. In that year, FY2003, the effective spending rate was at its highest, 5.6 percent. This inverse relationship is attributable to the decline in the value of the endowment during this period.

Examining the effective spending rate as a percentage of the prior year's endowment value, we see that it hovers around 4.5 percent in FY2000, FY2001 and FY2002, increases to above 5 percent for FY2003 through FY2005, and then begins to decline below 5 percent once again. Figure IX on the next page shows the fluctuations in effective spending rates.

FIGURE IX
Fluctuation in Effective Spending Rates
FY1998–FY2007



Fewer than 10 percent of the endowments had effective spending rates of 6 percent or higher before FY2001 or after FY2005, but during the years when endowments had low investment returns or were declining in value, the effective spending rate increased, peaking in FY2004 when more than 30 percent of the institutions had rates of 6 percent or more.

TABLE V
Effective Spending Rate and Percentage Change in Dollars Spent

| | FY99 | FY00 | FY01 | FY02 | FY03 | FY04 | FY05 | FY06 | FY07 |
|-------------------------|-------|-------|-------|-------|------|-------|------|------|------|
| Effective Spending Rate | 4.4% | 4.5% | 4.5% | 5.2% | 5.6% | 5.5% | 4.9% | 4.8% | 4.7% |
| Change in Dollars Spent | 14.8% | 14.3% | 14.5% | 10.4% | 5.7% | -0.1% | 3.3% | 5.6% | 8.8% |

Policy Review and Relation of Endowment to Executive Compensation

Respondents were asked to describe their practices with respect to review of the various policies relating to the endowment. All stated that they conduct periodic policy reviews and due diligence, but the frequency of these reviews for the spending policy, investment policy and target asset allocation varied, with the target asset allocation being altered most frequently. Many schools said that they review their policies annually, but do not always make changes.

In light of recent compensation-related scandals at some prominent nonprofits, the Senate Finance Committee's letter requested information about compensation levels at the responding institutions. None of the institutions reported any direct relationship between the president's compensation and endowment performance. A few reported that they invest the president's deferred compensation funds with the endowment, thus providing an indirect link between endowment performance and a portion of the president's future compensation. Many institutions reported a relationship between the compensation of their endowment managers and the performance of the endowment.

Conclusions

In the past 10 years, responding institutions have experienced several periods of extraordinary investment returns. The widespread use of spending rules that smooth the amount taken annually from the endowment, the tendency of policy spending rates to average around 5 percent, and the fact that the actual payout as a percentage of the prior year's endowment value averaged 4.9 percent for the period from FY1998 to FY2007 indicate that most schools appear to be attempting to balance the interests of current and future generations of students. Many schools have adjusted their policy spending rates upward in response to high returns in recent years, in order to enable current students to benefit from endowment growth. Effective spending rates have exceeded 5 percent in the years of negative endowment returns, testimony to responding institutions' commitment to current students and to providing continuing and reliable support to the operating budget. It is likely that schools will face challenges in the next few years as effective spending rates rise to compensate for the adverse investment environment of FY2008-09.

Part II

Endowment Spending and its Effect on Institutional Budgets

Purpose and Background

The purpose of this section is to describe and analyze the effect of endowment spending on the annual operating budgets of colleges and universities. Hence, the focus of the discussion now shifts from a primarily quantitative perspective to one that is more qualitative.

The percentage of the operating budget that is supported by endowment spending differs widely among institutions. On average, according to the 2009 Commonfund Benchmarks Study of *Educational Endowments*, 10.5 percent of the operating budget is funded by the endowment while the median is 4.8 percent. This percentage tends to grow with endowment size, with the exception of the largest endowments, where the presence of some large public university budgets has the effect of reducing the endowment contribution.

TABLE VI

Percentage of Operating Budget Funded by Endowment

| Endowment Size | Responding Institutions | Average Percentage | Median Percentage |
|---------------------------|-------------------------|--------------------|-------------------|
| Total Institutions | 629 | 10.5% | 4.8% |
| Over \$1 Billion | 49 | 16.7% | 9.5% |
| \$501M-\$1B | 37 | 20.5% | 20.0% |
| \$101M-\$500M | 189 | 13.7% | 7.0% |
| \$51M-\$100M | 92 | 9.0% | 5.0% |
| \$10M-\$50M | 191 | 7.4% | 3.8% |
| < \$10M | 71 | 4.6% | 1.0% |

Source: 2009 Commonfund Benchmarks Study of Educational Endowments

Information in this section was gathered differently from that for Part I. The methodology employed for this research centered on confidential interviews conducted by the author with 18 chief financial officers (CFOs) or other senior financial administrators at institutions of higher learning who have significant understanding of their institution's endowment and budget. The majority of the interviews were with financial officials from private educational institutions with endowments ranging in size from \$200 million to several billion dollars. The questionnaire used for these interviews is included as Appendix II. These interviews were supplemented by information taken from the 102 responses to the Senate Finance Committee analyzed in Part I and the Commonfund Benchmarks Study of Educational Endowments.

The major questions analyzed in this section are:

- How does endowment spending interact with the development of the budget? Are endowment funds distinct or are they absorbed by the operating budget?
- How do endowment funds influence the distribution of institutions' general operating funds? Are they the first or last dollars allocated, or something in between?
- When are endowment funds used to offset general operating funds, and when are they used to supplement them?
- When are endowment funds used to mitigate inequities in wealth among schools, divisions and programs within an institution?
- What effect do restricted endowment funds have on operating budgets?
- What are the relationships between the incentives provided to different segments of the college or university for raising endowment funds and the way those funds are used or budgeted?
- What effect do endowment funds have on institutional priorities? Do they help institutions to make the most efficient use of their resources?

As might be imagined, there is no single answer to these questions, but there are areas of similarity, clustering primarily around two types of distinction: 1) differences between private institutions that are centralized in their management and those that are decentralized; and 2) differences between public and private institutions.

Regarding the former, decentralized institutions as used in this context are those that are sometimes referred to colloquially as operating with “each tub on its own bottom.” This has come to mean that each school or division of the institution is responsible for its own revenues and expenditures. In contrast, those institutions that operate more centrally tend to have the institution's general revenues (including tuition) allocated by the central administration to various parts of the institution without regard to their origin. Similarly, institutions that operate centrally develop expense budgets that do not bear a direct relationship to the revenues generated by a particular school or division, but rather are formulated in accordance with institutional priorities.

In contrast, endowment funds at institutions that operate in a decentralized manner tend to be restricted to individual schools. This practice clearly limits the use of these funds in supporting overall institutional priorities—although, within the schools supported by these endowments, the budgeting of these funds may be similar to the process followed by more centrally managed institutions.

Budgeting Methodologies as they Relate to the Endowment

Our research identified five general approaches to budgeting in relation to the endowment of educational institutions. These five approaches are summarized in the table below and are discussed and analyzed in more detail in the sections that follow.

TABLE VII
Budgeting Practices

| Approach | Description |
|--|--|
| <i>All-funds (top-down)</i> | Centralized management of the budgeting process and of the annual allocation of endowment funds to operating priorities. |
| <i>Distinct funds (bottom-up)</i> | At decentralized institutions, individual schools are expected to be financially self-sufficient and all funds are budgeted at the individual school level. At some small colleges, financial decisions are centralized but the attempt is made to keep endowment funds as distinct as possible, thus stopping short of an all-funds approach to budgeting. |
| <i>Unbudgeted restricted funds</i> | Restricted funds are not considered part of the operating budget but are available to support the general operation of the institution. These funds are considered to be gravy or resources in addition to the operating budget. |
| <i>Hybrid</i> | A combination methodology, this term also refers to the manner in which institutions treat <i>ad hoc</i> gifts and grants having a specific purpose or a finite life. |
| <i>Initiatives to support underfunded endowments</i> | This term refers to budgeting practices that provide financial support to restricted endowments that lack sufficient assets to support fully the activity to which they are dedicated. |

The All-Funds Approach (Top-Down)

At centrally managed institutions, endowments are nominally restricted to spending in areas that are consistent with institutional priorities, but these restrictions tend to be loose enough to permit them to support general operating expenses in the areas identified. This type of practice occurs despite the fact that at such institutions more than 75 percent of endowment funds may technically be restricted. Typically, the truly restricted spending tends to be used to award prizes, support museums, fund specialized academic programs or provide scholarship funds for students with unique skills and talents.

Many centrally managed institutions practice what is called an “all-funds” approach to budgeting. The goal in budgeting at these institutions is to use all funds in an efficient way to support institutional priorities. For example, restricted funds are considered when allocating unrestricted funds, and this interplay of endowment funds and general funds is used to mitigate differences in wealth among activities, programs and departments. Thus, a well-endowed department is likely to receive little, if any, general funding from the institution compared to a department with little or no endowment.

Similarly, if a department at an all-funds institution were to receive a generous restricted gift, a nearly equivalent amount of the department’s general funds would be taken back and replaced by the funds from the restricted gift. At institutions managed in this way, endowment funds tend thus to be viewed as “budget relief.” This newly-endowed department would usually be left with slightly more funds than it had before it received the gift, but much less than the total amount that the gift and the general funds together would have represented. The additional funds would be left to honor the intent of the

gift, and to provide the department with an incentive to seek more gifts in the future. At institutions that operate in this way, department chairs naturally negotiate to keep as much as possible of their previous general endowment allocation, and this becomes a dance between the CFO and/or provost and the department chair. One CFO said that endowment funds are used as budget relief whenever possible. Schools that use their endowments in this way want their budgets to operate efficiently in order to maximize institutional priorities while still honoring donor wishes.

Unavoidably, at some all-funds institutions there are cases where endowments have been restricted to activities that are not considered central to the institution's mission or where the specific fund provides more income annually than the institution would have otherwise chosen to spend on a particular activity. In these instances, which tend to be relatively few in number, endowment funds do influence institutional priorities. Activities endowed in this manner tend to receive no general funds, and in years when income from the restricted endowment declines, general funds are not provided to offset the loss in endowment income. Put another way, if these endowments did not exist, general funds would not support these activities.

Other things being equal, most institutions that operate in this manner would prefer that individual departments not engage in fund-raising for their own programs. Instead, they prefer that the fund-raising be done centrally and spending priorities decided institutionally. A corollary to this preference is that colleges and universities that operate in this way have a strong need for predictability in the amount of endowment income flowing into the budget since there is comparatively little back-up funding in the form of restricted endowments. These institutions often have spending rules that take into account the prior year's spending in order to smooth departmental income across years. This imperative increases in importance as the proportion of the endowment's contribution to the operating budget grows.

Distinct Funds (Bottom-Up)

Institutions of two types operate using this structure: decentralized colleges and schools within universities, where each unit is expected to be financially self-sufficient, and some small colleges that operate centrally but do not use an all-funds approach to budgeting. At the decentralized institutions, budgeting takes place at the individual school level. Endowment funds are almost always restricted to support of a particular school and institutional revenues, including tuition income, are school-specific. It follows that each school within the college or university must operate within its income. Institutions that operate in this manner can exhibit great differences in resource levels at their various schools or departments. This is manifest in faculty salary levels, available facilities and other operational parameters. It is not surprising, moreover, that within these decentralized institutions the method of budgeting may vary between schools, with some adopting an all-funds budget approach within each school, while other institutions may continue to operate in a way that requires each program within the school to be self-sufficient. At such institutions, the central administration rarely has significant resources of its own and is usually supported by a "tax" imposed on each of the schools. Colleges and universities that operate in this way encourage fund-raising by each school in the belief that this practice maximizes incentives and leads to greater fund-raising in total.

Among the colleges and universities that encourage each school to operate relatively independently, there is always the issue of competition for donors. Although schools are encouraged to fund-raise, there is a need for coordination so that various parts of the institution do not trip over each other. This can often become quite competitive when different schools at the institution each want to lay claim to the same donor. Some schools that operate this way will only allow the president and his staff to deal with the largest donors and will put them off limits to the individual schools so that their gifts are maximized and the requests are coordinated.

Another smaller set of colleges and universities operates centrally but attempts to keep endowment funds as distinct as possible. At these institutions, tuition revenues are considered the property of the institution rather than of the school or program responsible for generating the revenue. General funds are allocated equitably to all departments to provide base levels of funding irrespective of endowment funds available to departments. Endowment funds, however, belong to the individual school or program and those with large endowments are able to operate with substantially greater resources than those that lack endowments. General funds at these institutions are only used at the margin and in small amounts to mitigate serious inequities in resources among departments; departments with little or no endowments of their own will receive only slightly more in general funds than other departments. It follows that at these institutions funding levels will vary significantly among departments. Institutions that operate in this way usually want faculty and departments to engage in fund-raising, and believe that this approach motivates fund-raising that leads to an increase in institutional resources.

Unbudgeted Restricted Funds

Some institutions do not budget restricted funds as part of the operating budget but instead consider them as gravy or resources on top of the operating budget or as a supplemental funding source for key elements of their program. At colleges and universities that operate in this manner, endowment funds alter institutional priorities to some extent. This budgeting concept is not too different from those institutions that operate centrally but keep their endowment funds distinct.

Hybrids

It should not be surprising to learn that there are some hybrids among these models. Some institutions keep very restricted endowment income distinct from the budget while including restricted funds that support institutional priorities. Among institutions that either do not budget endowment funds or keep endowment funds distinct from the budgeting process, there is much less need to replace endowment income with general funds in years when endowment income decreases since the core budget is unaffected. In some ways, institutions that operate in this way are treating their restricted endowment funds as the equivalent of a one-time grant that will not be replaced when revenues fall.

Initiatives to Support Underfunded Endowments

Some institutions have restricted endowments whose assets are insufficient to support fully the activity to which they are dedicated. Examples include underfunded faculty chairs, lecture series or scholarships where fund-raisers, in their zeal to persuade a donor to support an initiative, have compromised on the true level of the required endowment in order to secure the gift. This situation also arises when institutions fail to maintain the real purchasing power of an endowment and find that, for example, the cost of a faculty chair has increased beyond the level supported by the previously enunciated price.

Institutions with this type of problem may find it necessary to supplement underfunded initiatives with general funds. Some institutions rotate the full funding of these initiatives—for example, only funding certain chairs every second or third year. Situations such as this can leave the institution in an awkward situation when the donor wants to see the effect of his or her gift.

Situational Analyses

In order to add depth to the five approaches just described, it may help to analyze some particular situations and circumstances and to further review the context in which budgeting and funding decisions are made.

Changes in the Policy Spending Rate vs. Special Draws

When an institution's policy spending rate is changed, institutions that take an all-funds approach to budgeting typically reevaluate the distribution of general funds across the institution. If the rate increases, there is a need to redistribute the general funds away from the areas with restricted endowments in favor of those programs that are not endowed. At institutions where general funds are distributed without regard to endowment income, the well-endowed areas may receive significant increases or decreases in resources, which can be disruptive.

In contrast, institutions that want to fund specific initiatives may take a special draw from unrestricted endowment or from the restricted endowments that support the initiative rather than increase the resources to all areas of the institution that have endowments. This may be done to support initiatives in a strategic plan or to support capital programs. Special draws will have a much more limited effect on the institution than changes to the spending rate of the endowment as a whole.

Rather than taking a special draw from the endowment, some institutions may use general funds as seed money in order to jump-start an initiative in expectation of future receipts from an endowment that will be raised in the future. In these cases, the general funds will be taken back once the endowment has been raised.

Fund-Raising, Spending Rates and the Budget

There is a relationship between the way endowment funds are budgeted and the way fund-raising is done. Institutions that encourage fund-raising at multiple levels in the organization usually budget in ways that make endowment income an addition to the general fund. Institutions that favor centralized fund-raising tend to use an all-funds budget approach. Clearly, there is room between these two extremes, and it is in this broad middle ground that most institutions appear to operate.

At institutions that use an all-funds approach to budgeting, new funds that are raised in support of areas that are not a priority result in general funds being reduced in those areas. But when funds are donated for high priority areas, the new funds will be used to supplement the general funds. For example, many institutions are putting a priority on raising additional funds to support financial aid, as they intend both to increase their allocation to this budget item and to pursue outside funding to help support it. In these cases, all new funds raised for student financial aid will be allocated to that purpose.

Some institutions support increases in financial aid by raising their policy spending rate. As at least some part of the endowment at most institutions is restricted to programs other than financial aid, an increase in the spending rate will result in an increase in resources to other areas as well unless there is a reduction in general funds to those other areas and a reallocation of those general funds to financial aid. This is the only way to maximize the impact of a change in the spending rate on funding for financial aid. There may be some areas where this practice cannot be followed, because activities and programs exist that are supported by endowment funds that do not have any general fund support.

Institutions that have a large percentage of their endowment restricted to financial aid realize significant increases in funds for financial aid when they increase their policy spending rate. Those whose endowment is significantly restricted to areas other than financial aid may be able to generate more funds for financial aid by making a special appropriation from the unrestricted or quasi-endowment funds to support increased financial aid funding without increasing support for other areas that are not a strategic priority.

At several institutions where there are strategic initiatives that require funding, spending rates are in excess of 5 percent. At these institutions, the high spending rate is supported by the need to implement the strategic plan and to keep the momentum going. Most of these institutions have plans to reduce their spending rate to one that is consistent with the long-term and widely recognized objective of intergenerational equity.

Endowment Spending at Public Colleges

Our survey of public universities was more limited than that for private institutions. The practice of fund-raising at public institutions is a relatively recent development. In fact, since endowments at the substantial majority of public universities are quite small—especially when measured on a per-student basis—most of the public institutions we contacted responded that their endowments are too small to have any meaningful impact on their budgeting.

TABLE VIII
Average Endowment Assets Per FTE Student

| Endowment Size | Total | Public | Independent |
|-----------------------------|--------------|---------------|--------------------|
| Greater than \$1B | \$148,598 | \$50,644 | \$434,537 |
| \$500M to \$1B | 43,875 | 22,815 | 147,760 |
| \$100M to \$500M | 24,786 | 11,895 | 53,703 |
| \$50M to \$100M | 11,015 | 4,460 | 27,496 |
| \$25M to \$50M | 7,291 | 3,410 | 13,826 |
| Less than or equal to \$25M | 3,132 | 1,571 | 8,966 |

Source: NACUBO

At public institutions with endowments of more than \$1 billion, the endowment per student averages only \$50,644 compared with eight times that amount at independent institutions. In any range of endowments by size, the endowment per student at the public institutions is significantly less than it is at independent institutions. This result is due to the significantly higher enrollments at most of the public institutions as compared with the independent institutions.

At many public institutions, endowment income accounts for less than 2 percent of the institution's operating budget and is therefore relatively immaterial when considered at an institutional level. As a result, at most of these institutions donor restrictions are honored and the funds fall outside the regular budget process; they are budgeted in the same manner as the unbudgeted restricted funds approach discussed previously.

One early proponent of fund-raising among public institutions was the University of California. As early as 1961, according to a document from that year, the "Board of Regents was concerned that any major fund-raising efforts by UC might be counterproductive to our relationships with private institutions." As a result, the board adopted a gentlemen's agreement that stated:

This policy acknowledges the private institutions' heavy dependence upon gifts and endowments for their support, and stipulates that every effort will be exerted not to interfere in any way with their sources of support. It provides that the University shall limit its fund-raising efforts to its "immediate family", and further provides that the University shall not embark on widespread public solicitations...⁴

The university did not officially change this policy until early in this decade.

As a result of policies such as the University of California's—along with a belief that the state should provide the resources for public colleges and universities—fund-raising is, as noted above, a relatively new endeavor at many of these institutions and, therefore, endowments at public colleges and universities are much smaller than those at their private counterparts. The difference in endowment size is magnified when we compare endowment per student, as public institutions not only have smaller endowments but also tend to have many more students than private institutions.

Some public universities have endowments that have been granted to them by their states. For example, the University of Minnesota has the Permanent University Fund (PUF), which derives from the land that was granted to the university as a part of the 1862 Morrill Land Grant Act. The PUF was given by the state to the university in 1987 to support capital construction and faculty chairs. Prior to 1987, these funds were used by the state to provide part of the appropriation to the university.

The University of Texas has two restricted endowment funds from the state: the PUF, which is derived from oil rights and the Permanent Health Fund (PHF), which is derived from tobacco litigation settlement funds. Use of the PUF is restricted by the state to payment of principal and interest on capital projects at the university. Residual amounts from this fund, if any, can be used to support operations at UT Austin and administrative oversight by the UT system administration. Use of the PHF is restricted to health-related research at the health institutions of the university. The University of Texas also has a Long-Term Fund, which is funded from money that it raises in a way similar to those raised by private institutions. These funds can be used as directed by donors and typically provide for scholarships, faculty chairs and other operating and program support. In an effort to encourage the growth of the endowment gifts for academic purposes at the University of Florida, the state has been allocating funds to match all endowment gifts of \$100,000 or more.

4 University of California, Response to Senate Finance Committee, February 2008 p. 3.

There are a number of models for fund-raising at public institutions. Many public institutions have support foundations that conduct fund-raising and manage the funds separately rather than giving them directly to the institution. Others have multiple endowment pools, some of which may be in a support foundation and some held directly by the institution. This can complicate and confuse both the investment of these funds and the uses of the endowment. The rules of the game with respect to budgeting and spending differ depending on where the endowment resides, and the budgetary impact of the use of the funds may be quite different depending on the source of the funds.

In some cases, institutional expenditures may be supported by a foundation rather than reallocated to the institutional budget for appropriation. Many institutions make direct budget requests to the foundation to support specific activities, and these activities may be funded directly by the foundation. For example, we observed many institutions where the foundation supplements the salary of the college president and provides other benefits that would be difficult for a public institution to justify using public funds. Some public colleges use their endowment funds for items or programs that are not supported by the state appropriation. There is a widespread concern among public institutions that the states may reduce their appropriations in response to the presence of endowment funds; as a result, some institutions are very careful not to use endowment funds for regular, ongoing items but rather to use them for new initiatives and one-time items that the state would not otherwise support.

The University of California's current endowment policy states that "endowment funds and income therefrom should be used for enrichment of university programs and not for programs for which state funds are deemed requisite for the necessary educational activities of the university."⁵

Viewed from this perspective, many public universities see endowment funds as providing a margin of excellence to differentiate their institution by creating programs or hiring faculty that would otherwise be out of reach. Some public institutions, on the other hand, use their endowment funds to "backfill" their budgets in areas where state support is inadequate, while others use them to smooth out changes in state funding, which can arise precipitously due to state budget deficits.

Congressional Pressure on Spending Rates

The potential effect of recent Congressional hearings on the spending policies followed by the higher education community could be significant, but will differ depending upon the institution. Some institutions that were considering reducing their spending rates in order to build their endowment have now decided against this step, given the political climate. Other institutions have reevaluated their spending rates in light of considerations of intergenerational equity, the political situation and the desire to increase access to their institutions, and have decided to increase their rate. A third group, also reevaluating spending rates with a view to intergenerational equity, has concluded that their spending rates should be reduced. These institutions did not report feeling any pressure from Congress to reassess this decision at this time. The responses to Congress were provided before the steep declines in endowments that have occurred in the last several months. It will be interesting to see what adjustments, if any, institutions make to their spending policies for the next budget cycle.

5 University of California, Policy on the Use of Endowment Funds for Enrichment, Approved September 23, 1960, <http://www.universityofcalifornia.edu/regents/policies/6054.html>

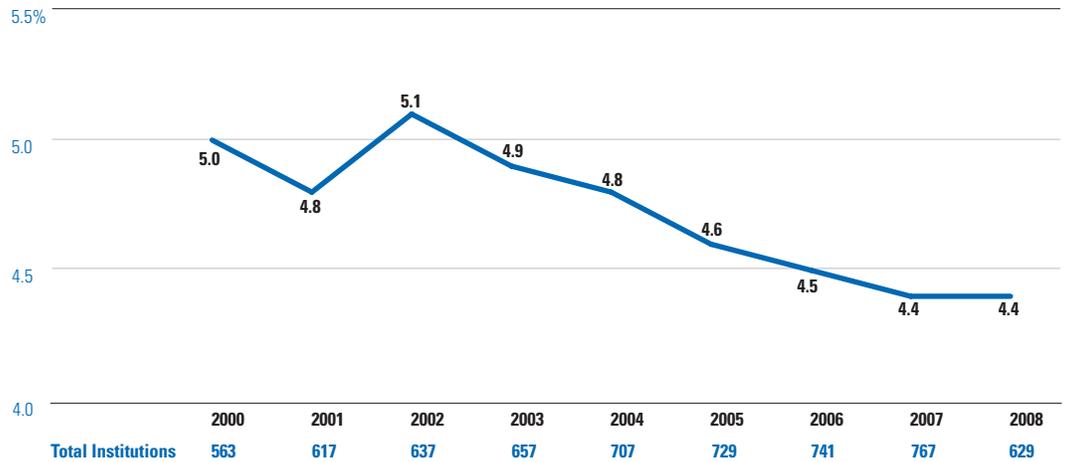
Conclusion

The impact of endowment income on institutional budgets varies significantly, depending on the size of the endowment relative to the operating budget, institutional budgeting practices and philosophies, and, for public institutions, state restrictions on endowment spending practices. The impact also differs depending on the financial situation, i.e. whether institutional revenues are increasing or decreasing. In the current environment there is great stress on institutional revenues from a variety of sources—cut-backs in state funding, increased need for financial aid, concerns about fund-raising and significant disruptions in the financial markets. While these stressors are having adverse effects on endowments, the impact from the decline in the endowment value will be lagged for most institutions with spending rules that are based on averaging the value of the endowment over several years. For these institutions, the endowment will provide some cushion to the more precipitous changes in other revenue sources. Institutions that use an all-funds approach to budgeting will be able to use endowment funds to help mitigate funding shortfalls, while at those institutions where the endowments are distinctly budgeted or not budgeted at all, the funding reductions will have to be absorbed by a smaller group of programs in the short-run. At schools that do not take the endowment into account in equalizing resources, those areas that are heavily endowed will be affected by the decrease in the endowment in the next few years when other areas of the university may be benefiting from improved revenue streams. Clearly, the opposite effects occur when times are good and resources are increasing. We are likely to see the average effective spending rate increase above 5 percent for at least the next few years; this number has been below 5 percent for most institutions in the last few years given the strong market returns, but was above 5 percent in FY2002 following a year in which endowment results were negative for most institutions.

FIGURE X

Average Annual Spending Rates for Total Institutions for Fiscal Years 2000-2008

Numbers in Percent (%)



Source: Commonfund Benchmarks Study Educational Endowment Report 2009

This analysis takes a step toward a better understanding of current practices and policies, but the issue is clearly deserving of a more in-depth look.

Certainly, it is an important issue. Some critics may be seeking an easy answer—a mandated minimum spending rate—to a question that, in reality, is complex and multi-dimensional. Educational endowments are not monolithic funds to be spent as colleges and universities choose; instead, the vast majority of endowment funds are restricted as to their use and endowments are usually made up of many hundreds (if not thousands) of individual gifts, donations and bequests. This discussion demonstrates that the complexity of the issue is compounded by the fact that there is no single philosophy or implementation methodology that governs annual budgeting and the allocation of endowment funds to operating expenses. Further, it would be difficult to argue that any one method is superior to the others. Rather, the various approaches have evolved over the years according to the wants and needs of each institution. We would encourage colleges and universities to review their own philosophy and process with the aim of making it as efficient and effective as possible. To the extent that campus leadership can direct the process to the overall benefit of the institution and its constituencies, colleges and universities may find opportunities for reduced waste, greater cost savings, enhanced institutional focus and, perhaps, better understanding among important external influences.

Appendix I

United States Senate Committee on Finance

For Immediate Release

Thursday, Jan. 24, 2008

Baucus, Grassley Write to 136 Colleges, Seek Details of Endowment Pay-outs, Student Aid

WASHINGTON—Sens. Max Baucus and Chuck Grassley, the leaders of the Senate Finance Committee, today wrote to the 136 U.S. colleges with endowments of \$500 million or more, asking a series of questions about endowment growth and spending on student aid. The senators are seeking answers in light of a new study showing explosive college endowment growth.

“I have been encouraged by the recent changes that several universities have made to ensure access to higher education for low and middle income students. We need to engage America’s colleges and universities to come together to address the fact that college tuition for young Americans and their families is increasing at a faster rate than inflation,” said Baucus. “The questions we put forward in this letter will help Congress better understand how colleges use their endowments to make certain that talented young folks in Montana and across the country aren’t left out of the classroom.”

Grassley said, “Tuition has gone up, college presidents’ salaries have gone up, and endowments continue to go up and up. We need to start seeing tuition relief for families go up just as fast. It’s fair to ask whether a college kid should have to wash dishes in the dining hall to pay his tuition when his college has a billion dollars in the bank. We’re giving well-funded colleges a chance to describe what they’re doing to help students. More information will help Congress make informed decisions about a potential pay-out requirement and allow universities to show what they can accomplish on their own initiative.”

Baucus is chairman and Grassley is ranking member of the Committee on Finance, with jurisdiction over tax policy, including the tax-exempt policy that covers colleges and universities. Federal law requires most private foundations to pay out 5 percent of their assets each year toward their charitable purpose. No such requirement exists for university endowments. Donations to universities are tax-exempt, and endowment funds are tax-exempt. A Finance Committee hearing last September explored endowment growth. Since then, three colleges—Harvard, Yale, and Dartmouth—have announced increased student aid.

A new study from the National Association of College and University Business Officers (NACUBO) released today shows double-digit endowment growth at hundreds of colleges over the past year. According to the study, 136 colleges in the United States now have endowments of \$500 million or more. The study is available at <http://www.nacubo.org/x2376.xml>.

The text of the Baucus-Grassley letter to the 136 colleges follows here.

January 24, 2008

Dear

A top concern for Americans, and for Congress, is the rising cost of higher education. Congress has long looked to tax breaks, targeted spending, and loan programs to help families and students meet the burden of saving and paying for college. The results have provided some benefits but haven't resolved the problem of low and middle income students and families will face ever-higher tuition costs. We are interested in approaches that universities and colleges can adopt to address this problem.

It seems clear from recent actions by our nation's top universities that there is much that can be accomplished by colleges and universities, particularly those with significant endowments, to control costs and provide real relief for students from low and middle income families. In fact, many colleges and universities are now focused on controlling rising tuition costs and assisting low and middle income families. These efforts, by several of the nation's top universities, are already having a broad positive effect throughout the university community. This is a very positive trend that we'd like to see continue.

We would appreciate additional information about tuition costs and your institution's endowment. University endowments receive very generous tax breaks under the Internal Revenue Code. We want to better understand how these tax benefits for higher education endowments are improving education and making undergraduate studies more affordable for low and middle income families today.

The newspapers have been filled with stories of a few universities taking steps to increase endowment spending and provide free tuition for low-income families and greatly reduced tuition for middle-income families. This has been the first good news in a long time for families struggling with the burden of ever-increasing tuition. These actions have given hope to many that a top education is possible without having to take on crippling debt.

We are also pleased about steps that some universities are taking to exercise increased transparency in defining the actual amount of financial assistance a student will receive and the actual cost a family will have to pay for tuition, fees, room and board—for example, by providing an online calculator. Too often, colleges and universities do not provide enough information to students and families. Families and students need to have greater certainty regarding the costs of education so they can better assess their education options.

The recent release of figures from the National Association of College and University Business Officers (NACUBO) makes it clear that institutions with endowments over \$500 million dollars a year are seeing very significant growth—and have been for many years. That is good news because much good can be done now. We hope that these strong returns will encourage you and your Board of Trustees to review your endowment payout policy and ensure that it reflects best practices.

To assist the Senate Finance Committee in better understanding this area, we request your response to the following questions:

1) Please provide the number of undergraduate and graduate students year-by-year for the last ten years.

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- 2) Please provide the total cost of undergraduate tuition (including all fees)—both sticker and average, mean and median—year-by-year for the last ten years. Please provide the amount of tuition assistance (not including loans or work study) that the university has provided to undergraduate students year-by-year for the last ten years. For the most recent year, please provide the percentage of students receiving university grants (for example 25 percent; 50 percent; 75 percent and 100 percent of tuition and fees). Please provide the average grant amount.
 - 3) Please explain your university's financial aid policy. How do you inform students and parents of that policy? What outreach efforts does your university take to recruit potential low-income students? How is low-income defined? What is the amount spent on these efforts?
 - 4) Who determines and decides when tuition increases are necessary? What is the process for making this decision? Does the full Board of Trustees vote on tuition increases? Are students, parents and the public provided an opportunity to comment on tuition increases prior to final decisions being made? What role does your university endowment play in providing financial assistance to students?
 - 5) Please explain how your university's endowment is managed and the role of the Board of Directors? What are your university's endowment payout and investment policies? What is the mission of your university's endowment? When was the last time that the university's endowment policy was reviewed? When will it next be reviewed?
 - 6) Please provide the year-by-year net growth of the university's endowment for the last ten years (in both percentage and dollars). What is the amount of donations the endowment has received year-by-year for the last ten years? Please provide the percentage of investment in each asset class (equity, fixed income, hedge funds, private equity, venture capital, etc.) and the amount invested outside the United States.
 - 7) Please explain how you determine what is considered part of the university endowment. In other words, how is your endowment defined? Are there any other long term investments that are not included in the endowment as reported to NACUBO? If so, what are they and what are their values?
 - 8) What has been the cost of management of the endowment year-by-year for the last ten years?
 - 9) What was the payout (both in dollars and percentage) from the endowment year-by-year for the last ten years? What is the targeted payout (in percentage) from the endowment year-by-year for the last ten years? If either the actual and/or targeted payout is below 5 percent, please explain how this meets the needs of the current student body. If there is a material variation between actual and targeted, please explain. What were the top 10 major expenditures from the endowment last year?
 - 10) How much of the endowment is subject to permanent spending restrictions or limitations set by the original donor? Of the portion subject to permanent limitations, what percentage is restricted for need-based scholarships? What portion is restricted for undergraduate financial aid? Please provide the top five types of restrictions on the endowment by category. What percentage of the endowment is subject to significant limitations placed on it due to a decision by the board (or a subcommittee of the board) or a college or university official—such as a set-aside for a specific program? Please provide the investment return to the endowment year-by-year for the last ten years.

11) Please explain the fee arrangement to investment advisors. How is the fee and compensation measured and determined? What is the process to review reasonableness of the fee and compensation and what comparables are used? Who reviews and approves the fee? Who pays the fee (the endowment, general funds)? Please explain what relationship, if any, exists between endowment size and/or growth and the compensation given to the college or university president and the endowment manager. Please list what endowment-related bonuses, if any, either the college or university president or the investment manager has received year-by-year for the last ten years.

In advance, we appreciate your time and consideration in responding to these questions. Your responses will help us better understand this area and inform our deliberations as we consider potential policies. We encourage you to contact the Finance Committee staff so we can work with you on your response and ensure that it is not unduly burdensome. We envision that many or most of the answers can be answered in brief—a page or less. Please respond within thirty days. Thank you.

Sincerely,

Max Baucus
Chairman

Chuck Grassley
Ranking Member

Appendix II

Interview Questions for Study on Endowment Spending

January 2008

The purpose of this study is to begin to understand the impact of endowment spending on institutional budgets and expenditure priorities. The study is being conducted by Commonfund Institute and Lucie Lapovsky. Confidentiality of all institutions involved will be strictly honored.

Below are the questions for discussion.

1. How much was your endowment corpus on June 30, 2007?
 - a. What percent is restricted?

2. How much did you spend from your endowment last year?
 - a. How much of this went to support your operating budget?
 - b. How much supported other initiatives?
 - c. What were the other initiatives?
 - Campaign expenses
 - Special Capital Expenses
 - Other

3. What percent of your annual operating budget is supported by funds from your endowment?

4. What percent of your scholarship expenditures are supported by endowment funds?

5. In your strategic plan, are you expecting to increase or decrease your spending rate? If you are planning to increase your spending rate, how are you planning to mitigate risk?

6. How does your endowment spending interact with the development of the budget? Are the endowment funds distinct or are they absorbed in the operating budget?

7. How do your endowment funds influence/interact with the distribution of your “general operating funds?” Are they the first or last dollars allocated or something in between?

8. When are endowment funds used as offsets to general operating funds?

9. When are endowment funds used as supplements to general operating funds?

10. Do you use endowment funds to mitigate inequities in wealth among programs/schools/divisions?

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11. What is the relationship between incentives for raising endowment funds by different departments/programs, etc. and the way those funds are used/budgeted?
 12. How much do endowment funds alter your institutional priorities? What is their impact on maximizing the efficient use of all resources?
 13. Has your board recently made a decision to significantly change your financial aid policies and support them with endowment funds? Did they increase the spending rate or reallocate existing endowment expenditures? What was the implication, if any, for other restricted endowment funds?
 14. Are the Congressional discussions on this issue having any impact on your institution's policies or practices?

Appendix III

About the Author

Lucie Lapovsky

Lucie Lapovsky is an economist who consults, writes, teaches and speaks on issues related to higher education finance, strategy, leadership, governance and enrollment management. Much of her recent work has been with boards of trustees and has focused on governance, planning and effectiveness. Her clients include public and private colleges and universities throughout the United States as well as companies and organizations throughout the world. She is actively engaged in research on endowment spending, tuition discounting and cost containment in higher education. She also specializes in search work for chief financial officers.

Lapovsky served as President of Mercy College, a diverse, multi-campus college with a budget of \$100 million, 10,000 undergraduate and graduate students, and campuses in New York City, Westchester and online from 1999 to 2004. She remains on the faculty as a Professor of Economics.

Lapovsky has almost 30 years of experience in higher education finance. Prior to coming to Mercy College, she served as Vice President for Finance at Goucher College, Special Assistant to the President of the University of Maryland at College Park, Director of Finance and Facilities for the Maryland Higher Education Commission, and as Fiscal Planner for the Maryland State Department of Budget and Fiscal Planning.

Lapovsky chairs the finance committee for four institutions, sits on the audit committee of several and is a member of the executive committee of six boards. She is the editor of two books and the author of numerous papers.

Lapovsky received a B.A. from Goucher College, and M.A. and Ph.D. degrees in economics from the University of Maryland at College Park. She also attended the Institute for Educational Management at Harvard. In 1999, she was named one of the 100 top women in Maryland.

Appendix IV

About Commonfund Institute and Commonfund

Commonfund Institute

Commonfund Institute was founded to house the education and research activities of Commonfund and to provide the entire nonprofit community with investment information and professional development programs. Commonfund Institute is dedicated to the advancement of investment knowledge and the promotion of best practices in financial management. Commonfund Institute provides a wide variety of resources, including conferences, seminars and roundtables on topics such as endowments and treasury management; proprietary and third-party research and publications including the annual Commonfund Benchmarks Studies of Educational Endowments, Foundations, Operating Charities and Healthcare Organizations and the Higher Education Price Index (HEPI); and events such as the annual Commonfund Endowment Institute and the Commonfund Prize for the best contribution to endowment investment research. Its broad range of programs and services are designed to serve financial practitioners, fiduciaries and scholars.

Commonfund

Founded in 1971, Commonfund is devoted to enhancing the financial resources of educational and other nonprofit institutions including endowments, foundations, healthcare and service organizations through superior fund management, investment advice, and treasury operations. Directly or through its subsidiaries, Commonfund Capital, Commonfund Realty, and Commonfund Asset Management Company, Commonfund manages approximately \$25 billion for approximately 1,900 nonprofit educational endowments, foundations, operating charities, healthcare and other nonprofit institutions. In response to the growing needs of nonprofit institutions, Commonfund, together with its subsidiary companion organizations, offers more than 35 different endowment investment programs. All securities are distributed through Commonfund Securities, Inc. www.commonfund.org.

15 Old Danbury Road
P.O. Box 812
Wilton, CT 06897-0812

Tel 888-TCF-MAIN
Tel 203-563-5000
www.commonfund.org

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