THE WORTH OF ENDOWMENTS IN HIGHER EDUCATION
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Since 1921, the Association of Governing Boards of Universities and Colleges (AGB) has had one mission: to strengthen and protect this country’s unique form of institutional governance through its research, services, and advocacy. Serving more than 1,300 member boards, 1,900 institutions, and 40,000 individuals, AGB is the only national organization providing university and college presidents, board chairs, trustees, and board professionals of both public and private institutions and institutionally related foundations with resources that enhance their effectiveness.

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The Guardians Initiative: Reclaiming the Public Trust™

ACKNOWLEDGMENTS
AGB is grateful to the TIAA Institute for supporting research integral to this publication and to the Carnegie Corporation of New York and the Andrew W. Mellow Foundation for their support of the Guardians Initiative informational briefings series. AGB also extends its gratitude to the following for their important contributions to this publication: Sandy Baum, nonresident fellow with the Urban Institute and Bryn Mawr College trustee; John Griswold, founder and senior advisor to the Commonfund Institute; Victoria Lee, research analyst, the Urban Institute; Rich Novak, AGB senior fellow for public policy; Kevin Reilly, president emeritus of the University of Wisconsin System and AGB senior fellow; Sally Staley, former chief investment officer of Case Western Reserve University and College of Wooster trustee; and George Watt, former executive director of the College of Charleston Foundation and AGB senior fellow.
“U.S. colleges and universities hold more than $500 billion in endowment assets, but many people have a poor understanding of these assets’ purpose and value. Trustees should be ready to share in plain terms where endowments come from, how they work, and why they exist.”
Executive Summary

Endowments allow colleges and universities, like other public and charitable organizations, to fund a portion of their work continuously, generation after generation. The ways in which these funds have been solicited from donors, applied to expenses, and stewarded over time are ultimately unique to each institution, and public misconceptions have proliferated on each of these points.

Common indicators, such as principal, yield, expenditures, and dollars per student—and even more sophisticated measures such as endowment-to-expenditure and endowment-to-debt—offer limited insights as to any endowment’s value. The real worth of any endowment depends on how well those assets are managed and applied to work of value to society.

The beneficiaries of endowments include a diverse array of college and university constituents and stakeholders. Without exception, students feature prominently among them. Perceptions by members of the public that colleges and universities are building up their endowments at students’ expense have resulted in increased political interest in state and federal governments to curtail endowment growth.

Through public policy changes such as the Tax Cuts and Jobs Act of 2017 (TCJA), endowment returns and the work they support are already in some jeopardy for a small number of large-endowment institutions. However, every trustee has a stake in the reputation of higher education more broadly, and endowments are an important part of the public discourse around the sector’s value, including the value of college itself.

In U.S. higher education, boards approve the missions and budgets of their institutions. They set endowment spending rates in keeping with strategic priorities, and in accordance with state and federal charters, codes, and constitutions. As those legally entrusted with colleges and universities as public and societal assets, trustees have a responsibility to act in the interest of beneficiaries other than themselves, including future generations. Higher education’s boards are appropriately accountable for the value of endowments, and board member voices are indispensable to informed public debate about the work they enable.

A general lack of understanding about college and university endowments is contributing to public skepticism about the value of higher education. As fiduciaries of this sector’s nearly 5,000 institutions of charitable and public purpose, higher education board members are accountable for upholding the value of their own institutions and are well-positioned to help higher education’s beneficiaries understand how endowments contribute to the work of colleges and universities in general. Further, every board member should have a working knowledge of endowments even if his or her institution currently has little or no endowed funds.
Endowments—whether held by colleges or universities, museums, churches, hospitals, or other charitable organizations—are pools of privately donated funds that are invested for the purpose of supporting the institution in perpetuity. Educational institutions build and maintain endowments to supplement and protect against declines in net tuition and fee revenues, state appropriations, and other income. Endowments can also be used to launch new initiatives consistent with institutional mission, strategic priorities, and donor intent, and they can sometimes be used as a source of emergency reserves.

The decision to add a charitable gift to an institution’s endowment is typically agreed upon by the donor and the institution as a legally enforceable condition of the gift. Often, these donations are targeted to support specific activities, such as scholarships, faculty positions, facilities maintenance, or educational programs. The portion of endowments composed of these “restricted-use” funds varies across institutions, but for most colleges and universities, a majority of the endowment is restricted. Institutions work with donors to develop endowment funds in support of a wide range of activities that convey an array of social benefits, but one important objective is to offer future students educational opportunities at least as good as those available to current students.

In addition to educating undergraduates with diverse socioeconomic backgrounds, endowments support scholarly activity, community engagement, and graduate education—activities that align with the public and charitable purposes of higher education. Recognizing the public value of these pursuits, state governments and Congress traditionally have recognized the tax-free nature of charitable gifts to, and the investment income of, endowments. Many public universities have no substantial endowments, and about half of independent institutions hold endowments of $10 million or less (resulting in average annual draws sufficient to support roughly five to 10 faculty positions, for example). The governing boards of organizations with endowments set spending rates for those funds with two goals in mind: a) draw an appropriate amount of revenue to support current expenses, and b) increase the value of the invested sum to, at a minimum, maintain its real value over time.

In recent years, misunderstandings about where endowment revenue comes from and what endowments do, coupled with perceptions based on the large endowments of relatively few institutions, have led to state and federal efforts to curtail endowment growth. Notably, the TCJA imposed a federal excise tax on the earnings of higher education endowments. The tax affects private nonprofit institutions with more than 500 students and endowments valued at more than $500,000 per student.
Colleges and Universities as Public and Charitable Organizations

Charitable organizations such as independent nonprofit colleges and universities have been exempted from income taxation as long as there has been an income tax. Public universities themselves are state entities and are therefore not taxable, although many rely on separately incorporated charitable organizations to manage endowment assets (university foundations share the same charitable 501(c)3 IRS designation as private institutions). The Tariff Act of 1894, which established a flat 2 percent tax on corporate income (later to be declared unconstitutional), explicitly exempted entities organized and conducted solely for “charitable, religious, or educational purposes, including fraternal beneficiary associations.” A series of other laws enacted between 1894 and 1969 established basic principles and requirements for charitable organizations, the income from which cannot be used to benefit individuals associated with the organization. The Revenue Act of 1917 introduced the individual income tax deduction for charitable donations.

It is hard to deny that the public benefits produced by colleges and universities justify some preferential treatment in state and federal tax codes, but quantifying these benefits can be difficult. It is not just enrolling students with financial need and charging them lower than the full tuition price that qualifies as a charitable contribution. Research often holds public purpose and results in benefits to public health, and to state, local, and national economies. And contributing to the cultural richness and resiliency of communities is a central purpose of creative scholarship, public performances, extension services, and other outreach services provided by universities.
How Do Endowments Work?

A central role of any endowment is to provide a reliable source of revenue over an indefinite period of time. The range of expenses for which an institution seeks new endowment donations is typically limited in accordance with a set of strategic priorities. Current expenses (such as new construction, contracts for services, debt payments, and others) must be paid, and while many expenses do not lend themselves to continuous funding, the array of items to which endowments might be applied is considerable. Decisions about which expenses will be supported by endowed funds are, in the end, negotiated between the administration of an institution and prospective donors. For example, a $1 million gift might be used to provide $100,000 in scholarships this year, or it could be used to provide a scholarship of roughly $5,000 each and every year. A $1 million gift might be used to support 10 to 20 faculty salaries this year, or it could be used to support about half of one full-time professorship continuously, from this point forward.

Governing boards set spending rates on endowment assets. Between 2008 and 2017, endowments’ annual rates of return averaged 4.9 percent—roughly three times the annual rate of inflation—but they fluctuated between -18.7 percent and 19.2 percent (see figure 1). Consistent with standards in the Uniform Prudent Management of Institutional Funds Acts (UPMIFA), which is now law in 49 states, colleges’ and universities’ endowment spending rates are typically conservative. In 2017, average spending rates increased with the size

![Figure 1: Average Annual Total Net Returns on Endowments](image)

of the endowment, ranging from 4 percent for institutions with endowments smaller than $25 million to 4.8 percent for those with endowments over $1 billion.

Despite the potential for endowments to cushion budgets, many colleges and universities instead protect their endowments during hard times and cut operating budgets. As far back as the 1950s, economist Robert Eisner expressed concern that spending formulas would “reinforce and perpetuate the university practice of using endowments to build forever for the future. Jam tomorrow and jam the next day, but never jam today.” Fellow economist Perry Mehrling argues that if colleges cut programs and people to preserve the endowment, they are undermining the very reason for an endowment and that the policy of holding current spending below the expected rate of return shifts risk onto present students to protect future students. Institutions with large endowments are more likely to use them as a source of reserve funds. From 2009 through 2011, following the recession, institutions with small endowments lowered their spending rates, while those with larger endowments increased them.

Disagreements over spending rates in colleges and universities are often philosophical and disconnected from the incremental nature of year-over-year decisions. In most cases, boards have adopted mechanisms for stabilizing annual draws by basing expenditures on three- to five-year average returns. Even then, earnings instability poses a substantial challenge to the maintenance of endowments’ real value over time. For instance, in many private institutions, growth in expenditures outpaced endowment growth between 2005 and 2015, and in many public universities, net endowment growth did not exceed the rate of inflation (see figures 2, 3, and 4).

Whatever one’s own views, debates over endowment expenditures often miss important context. At the end of academic year 2015–16, the nearly 5,000 public and nonprofit colleges and universities in the United States held cumulative endowment assets of about $532 billion. About 40 percent of these assets belonged to 20 independent nonprofit universities—and 20 percent of the total belonged to just four of them. The concentration of endowment funds at a small number of institutions means that the vast majority of colleges and universities cannot count on this source of income to provide significant support for their operations.
How Are Endowments Evaluated?

The most common way to refer to the size of college and university endowments is by their total amount of financial assets. But the value of an endowment also depends on the size of the operations it supports. It is more reasonable to base comparisons on endowment per student, but that metric also has serious drawbacks when comparing institutions with different missions, locations, and business models. A more revealing measure than endowment per student—although one that is more difficult to estimate—is the size of the endowment relative to total expenditures. Since the purpose of an endowment is to support the range of activities in which the institution engages, this ratio may be most indicative of its value. Figures 2, 3, and 4 illustrate the endowment and total expenditure trends for independent nonprofit (“private”) research universities and bachelor’s colleges, as well as for public research universities, from 1990 to 2015. They show endowment-to-expenditure rates in the nonprofit sectors fell measurably in 2008 and have not risen to their pre-recession levels, although average endowment values were higher in 2015 than in 2007.

At private research universities, both overall and among the 12 with the largest endowments, endowments grew more rapidly than expenditures between 1990 and 2005, with the endowment-to-expenditure ratio rising from 1.5 to 2.5 for the sector as a whole and from 2.9 to 4.6 for the 12 largest-endowment institutions, but not between 2005 and 2015. In other words, on average, endowments have not grown relative to expenditures in recent years.

In contrast, at private bachelor’s colleges, both overall and among the 20 with the largest endowments, expenditures grew more rapidly than endowments between 1990 and 2015, with endowment-to-expenditure ratios falling from 3.0 to 2.4 for the sector as a whole and from 8.2 to 6.8 for the 20 wealthiest institutions.

At public research universities, endowments have grown more rapidly than expenditures—as public appropriations have covered a declining share of the cost of education. Growth in the endowment-to-expenditure ratio suggests that the share of expenditures covered by tuition revenues would have grown even more without the development of endowments, which tend to be smaller in the public sector overall.

Notwithstanding the analytic value of endowment-to-expenditure ratios, attributing a sense of net worth or “wealth” to an institution based on the size of its assets is misleading. One reason is that asset sizes are poor proxies for the effectiveness of any endowment. At minimum, two elements of knowledge are essential to assessing an endowment’s effectiveness: 1) the percentage of an institution’s revenue mix that is provided by the endowment, and 2) how well the allocation of endowment accounts aligns with current and anticipated spending priorities.

Additionally, most institutions with endowments also hold debt. An institution that borrows $100 million, leaving its endowment intact, is no wealthier than one that spends $100 million from its endowment instead of accruing debt. According to the NACUBO-Commonfund Study of Endowments 2017, which over-samples institutions with large endowments, 584 of the 809 participating institutions reported that they held long-term debt, with an average of $208.1 million. The institutions with the largest endowments have the largest debt, with averages declining from $1 billion for those with endowments larger than $1 billion to $103 million for those with endowments between $101 million and $500 million, and $28 million for those with endowments under $25 million.
Figure 2: Private Nonprofit Research University Endowment Assets Relative to Total Institutional Expenditures, 1990 to 2015

<table>
<thead>
<tr>
<th>All Private Research Universities</th>
<th>Top 12 Private Research Universities</th>
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</thead>
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<tr>
<td><strong>Endowment Growth</strong></td>
<td><strong>Expenditures Growth</strong></td>
</tr>
<tr>
<td>1990 – 1995</td>
<td>9.00%</td>
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<tr>
<td>1995 – 2005</td>
<td>10.10%</td>
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<tr>
<td>2005 – 2010</td>
<td>1.00%</td>
</tr>
<tr>
<td>2010 – 2015</td>
<td>2.60%</td>
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</tbody>
</table>

**Source:** Independent calculations based on IPEDS data.

**Notes:** The institutions included in top 12 calculations are those with the largest endowments each year. Data are not available for private nonprofit institution endowments from 1997 through 2002. Data on endowment growth are not available for 2000.
Figure 3: Private Nonprofit Research College Endowment Assets Relative to Total Institutional Expenditures, 1990 to 2015

<table>
<thead>
<tr>
<th>All Private Bachelor’s Colleges</th>
<th>Top 20 Private Bachelor’s Colleges</th>
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</thead>
<tbody>
<tr>
<td><strong>Endowment Growth</strong></td>
<td><strong>Expenditures Growth</strong></td>
</tr>
<tr>
<td>1990 – 1995</td>
<td>8.10%</td>
</tr>
<tr>
<td>1995 – 2005</td>
<td>6.70%</td>
</tr>
<tr>
<td>2005 – 2010</td>
<td>0.40%</td>
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<tr>
<td>2010 – 2015</td>
<td>1.40%</td>
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</tbody>
</table>

**Source:** Independent calculations based on IPEDS data.

**Notes:** The institutions included in top 12 calculations are those with the largest endowments each year. Data are not available for private nonprofit institution endowments from 1997 through 2002. Data on endowment growth are not available for 2000.
**Figure 4**: Public Research University Endowment Assets Relative to Total Institutional Expenditures, 1990 to 2015

<table>
<thead>
<tr>
<th>All Public Research Universities</th>
<th>Top 20 Public Research Universities</th>
</tr>
</thead>
<tbody>
<tr>
<td>Endowment Growth</td>
<td>Expenditures Growth</td>
</tr>
<tr>
<td>1990 – 1995</td>
<td>10.20%</td>
</tr>
<tr>
<td>1995 – 2005</td>
<td>9.10%</td>
</tr>
<tr>
<td>2005 – 2010</td>
<td>6.60%</td>
</tr>
<tr>
<td>2010 – 2015</td>
<td>5.80%</td>
</tr>
</tbody>
</table>

**Source**: Independent calculations based on IPEDS data.

**Notes**: The institutions included in top 12 and top 20 calculations are those with the largest endowments each year. Data on endowment growth are not available for 2000.
Who Benefits from Endowments?

When evaluating the benefits of endowments, it is important to recognize both direct and indirect beneficiaries. Indirectly, college and university endowment investments carry the same scope of benefits to the economy and the public as personal investments: mostly, they provide capital for business growth. And while colleges and universities account for only 6 percent of nonprofit organizations in the United States, their endowments account for more than half the invested assets of such organizations.

In terms of these investments’ returns, many institutional constituents and stakeholders enjoy what might be considered direct benefits. Student benefits include scholarships, internships, and other learning opportunities; faculty and staff benefits include compensation; many constituents benefit from the maintenance of classrooms and laboratories, performing arts and athletic centers, roads, technology, and more, as well as a spectrum of public outreach initiatives. However, with education comprising a central or primary element of any college or university’s mission, it is especially important to ascertain the benefits of endowments to students.

Despite rising tuition prices, most public or nonprofit colleges and universities—and particularly those with sizeable endowments—subsidize all of their students by charging prices lower than the full cost of education. Private institutions make up the difference through annual giving, or current-use donations, plus income from their endowments. Public institutions combine any revenues from these sources with state and local appropriations. Notably, in 2015–16, net tuition and fee revenue covered only 54 percent of education and related expenditures on average at private research universities, where the median endowment per student was $55,000. In those institutions, students received a subsidy covering, on average, 46 percent of those expenses. By contrast, at private master’s universities, where the median endowment per student was $14,000, tuition and fees covered 84 percent of education and related expenditures, and students received a subsidy covering only 14 percent of the total. Very few students in public and nonprofit colleges or universities pay the full cost of their education.

In both public and private institutions, those with the greatest endowment per student accept smaller shares of their applicants. For example, average estimated endowment spending per student ranges from $100 at open-admission public four-year institutions to $1,800 per student at those accepting a quarter or fewer applicants. Among private nonprofit colleges and universities, the range of average endowment spending per student is from $700 per student at open-admission institutions to $16,100 at those accepting a quarter or fewer applicants.

Related to their selectivity is the fact that larger-endowment institutions enroll much smaller shares of Pell Grant recipients (low-income students) than smaller-endowment institutions. In the private four-year sector, nearly half of students at institutions in the lowest decile of endowment per student receive Pell Grants (see figure 5a). In contrast, 15 percent of
students at the highest decile colleges and universities receive them. The pattern is the same at public four-year institutions, though the range is smaller (see figure 5b).

The share of Pell Grant recipients among the undergraduate population at an institution is an imperfect measure of the share of low-income students because it excludes international students and undocumented students who are not eligible for federal aid. Moreover, while Pell grants are well targeted to students with limited ability to pay, students just above the eligibility level face financial constraints similar to those just below the cutoff. Nonetheless, these data indicate that students attending institutions with large endowments disproportionately are academically well-prepared students from households that are not near the lower end of the income distribution.

Despite enrolling fewer low-income students overall, institutions with large per-student endowments use those funds to provide significant subsidies to all enrolled students. As figure 6 shows, this includes providing generous need-based aid to high-need students, charging considerably lower net prices to low-income students than they would pay at other colleges and universities. The pattern in the public sector is similar: low-income students who succeed in enrolling at larger-endowment institutions pay less than their more affluent peers, and less than they would pay at public institutions with smaller endowments.
Figure 5b: Share of Students Receiving Pell Grants, by Deciles of Endowment Assets per Student

Source: Sandy Baum and Victoria Lee (2018, April), Understanding Endowments, Urban Institute.
Data from IPEDS
**Figure 6:** Average Net Price by Family Income and Decile of Endowment per FTE Student, Private Nonprofit Four-Year Institutions, 2015–16

*Source:* Sandy Baum and Victoria Lee (2018, April), *Understanding Endowments*, Urban Institute. Data from IPEDS.

*Notes:* Average net price is total cost of attendance less average grant aid from federal and state governments, in addition to institutional grant aid.
Why Have Policymakers Singled Out Endowments?

The public perception that colleges and universities are building up their endowments at students’ expense has resulted in increased political interest by state and federal governments in introducing legal reforms. Several proposals, and indeed the TCJA, apply politically determined thresholds of endowment per student to tax institutional wealth.

Similarly, U.S. Senate Finance Committee Chairman Charles Grassley has supported a 5 percent payout requirement for college and university endowments akin to the policy applying to private foundations. Others have proposed even higher payout requirements. According to the senator, the questions regarding college endowments are the same as those relating to private foundations, which are tax-exempt not by virtue of their own activities but via the financial support they provide to other public and charitable organizations. Sen. Grassley contends that colleges and universities charging high tuition prices and not adequately supporting their students are not performing their public mission.

One underlying concern regarding these kinds of proposals is that they reflect misconceptions not just among politicians but on the part of the publics they represent. If colleges and universities are suspected of accumulating wealth at the expense of taxpayers and tuition payers, then institutions whose missions are to change lives for the better will be even more hard-pressed to meet such ambitious goals. Annual endowment returns and the work they support are at immediate risk for a small number of large-endowment institutions. However, every trustee has a stake in the reputation of higher education more broadly, and endowments are an important part of the public discourse around the sector’s value, including the value of college itself.

The Tax Cuts and Jobs Act of 2017

The stated motivation for Congress’ imposition of a tax on the endowment incomes of a small number of private colleges and universities included in the Tax Cuts and Jobs Act (TCJA) of 2017 was to induce them to make college more affordable for students. But the tax is unrelated to the prices charged and the level of aid offered to students, and some observers have argued that the tax is designed to send a political message, punishing institutions viewed by many conservatives as too liberal. Calling the tax “vandalism,” columnist George Will views the tax, which affects only colleges and universities, as a dangerous violation of long-held principles. The Cato Institute’s Neal McClusky characterizes the tax as “little more than a politicized ‘Take that, Harvard!’”

The TCJA imposed a 1.4 percent tax on endowment income for private colleges with at least 500 students and at least $500,000 in endowment per student. Estimates suggest that it will generate only around $200 million per year now, rising to $400 million per year in a decade. Even a tax at the corporate rate of 21 percent on all income from endowments, dramatically higher than the one Congress passed, would add only about 2 percent to corporate tax revenues of $500 billion per year, according to the Tax Policy Center.
Conclusion

Endowments allow colleges and universities to fund a portion of their work on an ongoing basis. The ways in which these funds have been solicited from donors, applied to expenses, and stewarded over time are unique to each institution. However, for institutions that have these resources, the draw on endowments remains just one source of the revenue on which their charitable and public work relies.

The full worth of endowments ultimately cannot be measured in terms of principal, yield, expenditures, dollars per student, or even well-considered ratios such as endowment-to-expenditure and endowment-to-debt. The real worth of any endowment depends on how well those assets are managed and applied to work of value to society. Much of the public concern about endowments extends from a limited perspective of a few large-endowment colleges and universities and from doubts about whether those with significant resources devote enough of them to increasing access and affordability for today’s students.

In U.S. higher education, boards approve the missions and budgets of their institutions. They set endowment spending rates in keeping with strategic priorities, and in accordance with state and federal charters, codes, and constitutions. As those legally entrusted with colleges and universities as public and societal assets, trustees have a responsibility to act in the interest of beneficiaries other than themselves, including future generations. Higher education’s boards are appropriately accountable for the value of endowments, and board member voices are indispensable to informed public debate about the work they enable.

Endnotes

1. Some institutions also maintain quasi-endowments, which are generated from operating surpluses (state and federal appropriations cannot be used for this purpose). These pools may be invested alongside endowment funds, but they tend to be much smaller. For context, Moody’s Investors Service reported about 25 percent of independent nonprofit colleges and universities ran budget deficits in 2017. Institutions often choose to allocate surplus operating funds for current use rather than investment, but where quasi-endowments do exist they are a source of unrestricted revenue.

2. Subtracting the typical endowment draw of 4.5 percent of the value of the endowment from expenditures to eliminate the changes in spending that are the direct result of changes in the value of the endowment increases the ratio of endowment value to expenditures, but does not measurably change the shape of the patterns over time.

3. Data from the National Association of College and University Business Officers (NACUBO) show institutions with endowments totaling $100 million or less invest more of them in U.S. equities (averaging 33–42 percent of assets), and those with endowments of over $100 million invest more of them in alternative strategies (averaging 32–57 percent).

4. As evidenced in a series of focus groups conducted in 2017 with the support of AGB, many Americans—even college-educated ones—mistakenly believe institutions have built their endowments using tuition revenue and/or state appropriations, in effect requiring students to pay costs over and above that of their own education.
Suggested Reading


Sandy Baum and Victoria Lee (2018, April), *Understanding Endowments*, Urban Institute.


