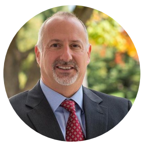
Why Not Use Those Large Endowments To Save Colleges?



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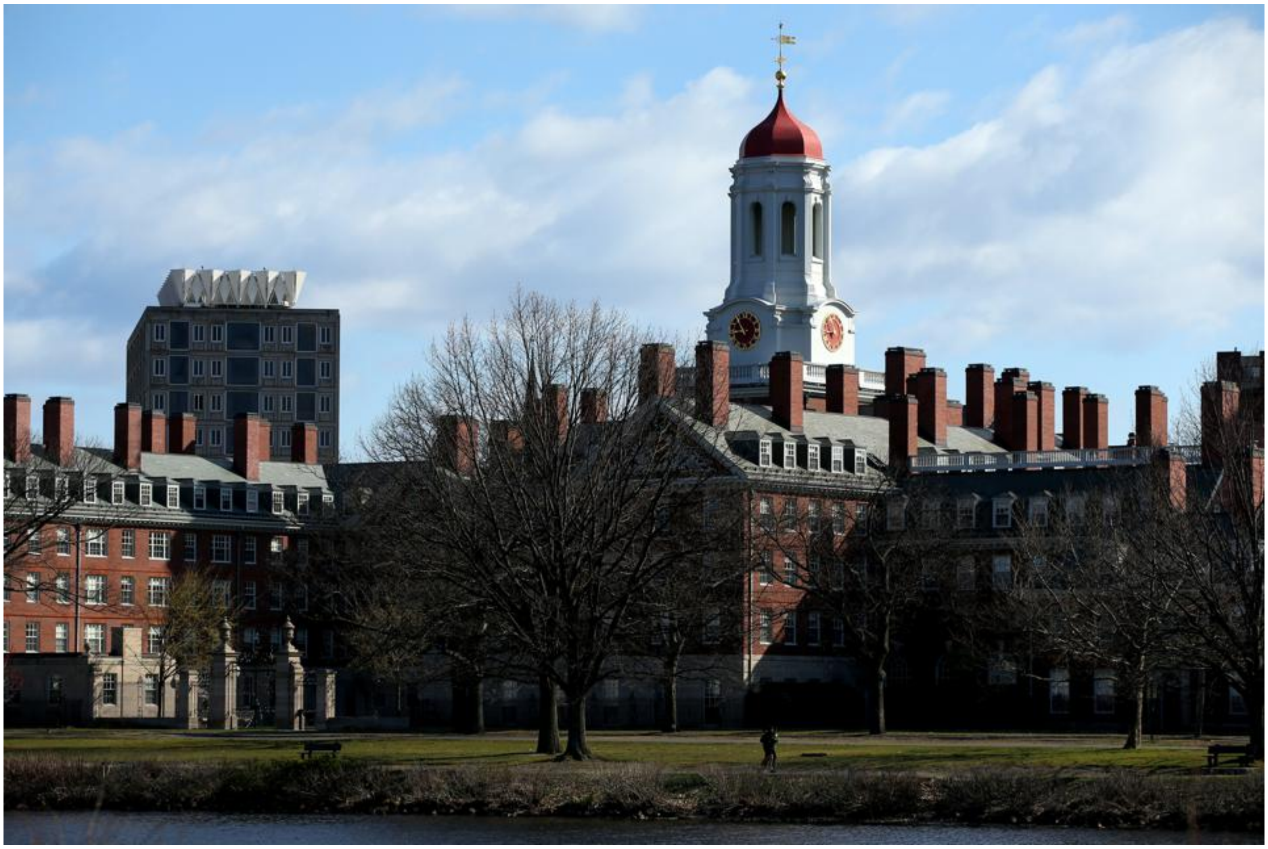
Education

I write about higher ed issues, leadership, finance, and innovation.

The refrain is all too common. As projected losses for the coming year due to Covid-19 continue to grow, and as the full impact of lost revenue and new expenses become known, some people point to colleges' large endowments (which are, in some cases, very large) and ask what seems like a reasonable question. "Why not dip into (or even spend down) your endowment?"



Harvard has the largest endowment of any college or university in the world. GETTY IMAGES

The question comes equally from those within the university (faculty and students) and those outside the university. It reflects a lack of understanding of how such endowments work (why they are created, and how they are managed and accessed) and a lack of appreciation for the purpose/strategy of creating such permanent funds for colleges and universities. In general, with the exception of those donors engaged to help create these endowments, there has been little interest in these details. But now that we hear stories of tens and hundreds of millions of dollars of losses due to the COVID-19 pandemic, and we juxtapose these on the stories of universities having hundreds of millions and even billions of dollars of endowment (which themselves have seen losses in value due to the pandemic), the question "Why not dip into (or spend down) your endowment?" may seem reasonable on its face.

It is not. In fact, it is neither strategic for the university, nor respectful of the donors' intent. It is neither financially responsible/prudent, nor is it permissible.

College endowments are not savings accounts earning CD-level interest. Nor are they rainy day funds. They are sophisticated, complex investment strategies, often professionally managed. They are permanent funds, comprised of thousands of individual donor fund accounts, that generate spendable interest in perpetuity. While there are differences institution to institution, the vast majority of endowment gifts are "restricted" or donor-specified, generally following a period of cultivation through which the university's priorities/needs are aligned with the interests of the prospective donor. University foundation CEO's estimate on average more than 90% (and likely more than 95%) of endowment funds are restricted for a specific purpose. This is fully spelled-out in the gift agreement and cannot be changed without the donor's consent. While such changes are possible, they are rare and generally are neither welcome nor received well by donors. Many donors also expect their gifts to be "additive" and not used to replace other funding commitments by the university. They hope their philanthropy creates the "margin of excellence" with the additional resources that in many instances state funding cannot provide or the institution cannot otherwise generate through tuition revenue, for example. Unlike what may be seen in other non-profit organizations and even some private colleges and universities, those who donate to higher ed institutions do not want to give to budget relief.

Fundraising campaigns by colleges and universities seek to raise funds (both current-use and endowment) for priorities of the institution that nearly always fall into four buckets: (1) student support, e.g., scholarships and fellowships, (2) program support including those for specific academic departments, programs, and research, (3) faculty support most often in the form of endowed professorships/chairs, and (4) facilities, e.g., support for capital project construction. In nearly every case, support for students is the largest bucket and for decades has been a top priority, and likely will be for generations to come. The other three may vary in importance depending on the institution, its highest priorities and greatest needs at the time, and the campaign strategy.

Philanthropic support is one of the four significant revenue streams for a university, the others being net tuition revenue (often the largest revenue source), state support (in the case of public institutions), and indirect costs (or overhead) on extramural research grants (in the case of research universities). But whereas these other three sources provide more or less current-use funds, support realized through philanthropic giving can take many forms and come over long periods of time. Not all funds associated with a gift are immediately realized or available (whether current-use or permanent endowment) to the university. Some funds may be provided by the donor up-front all at once, while others may be realized through a phased multi-year payment on the gift, and still others may be part of an estate plan, potentially many years away from being fully realized.

University fundraising programs (whether separate Foundations or embedded advancement/development offices) have two major functions: (1) to raise money for the university, and (2) to counsel the president, senior leaders, deans, and others on donor intentions. They also advise the university president and board in times of financial crisis on the degrees of flexibility they have in accessing and deploying the endowment. But there are only a small number of levers that the president and board can pull. "Spending down" or "selling off" the endowment usually is not one of them – no matter how dire the need, or how angry the rhetoric, demands, and accusations become. In many states, laws exist to protect donor intent and ensure the prudent use of gifts that were entrusted to institutions to be available through investment and the use of investment income.

So what CAN colleges and universities do with their endowments and the strategies that underpin their creation and management in such challenging times? How can seemingly wealthy institutions tap into and optimally deploy their resources to maximize benefit now and in the future? And are the über-wealthy institutions better off than those having more modest endowments? All reasonable questions. Here are some of the strategies offered by University foundation CEO's (typical at public universities) and vice presidents of advancement (typical at private institutions) that may – if desired – be employed:

1. Increase the *spending rate*. Deploy more of the fund's accrued value for the university's use. This doesn't add flexibility to how these funds can be used, but may provide temporary relief to the university's general fund budget. Spending rates are set by institutional policy overseen, typically, by an investment committee of the Board. Spending rates are typically tied to something like a 12-quarter trailing average of earnings and are

sometimes adjusted for inflation. This has the effect of smoothing out the annual allocation to the university, i.e. avoiding sudden spikes up or down with the markets, which would make the endowment earning less dependable and endowment spending more volatile. Increasing the spending rate may mean riskier investments strategies, however, and this can have longer term consequences.

2. Consider liquidating (or fully deploying) and *quasi-endowments*. These are generally board-designated and have fewer restrictions.

3. Sell-off selected *real estate* or other holdings that may not be part or the long-term endowment pool and provide the flexibility to be liquidated.

4. Use funds from endowed *scholarships* first, before using general funds (e.g., tuition revenue) to support scholarships. In some cases, colleges may be forced to change their financial aid strategy at least temporarily. Even the wealthiest universities may need to return to being need-aware rather than truly need-blind.

5. Temporarily use discretionary funds, often called *excellence funds* available to the president, provost, or dean to offset the university's general fund obligation to the unit. As with others, this can provide temporary relief as it likely cannot (and should not) become a permanent strategy. Excellence funds provide needed latitude and resources for leaders to invest strategically in their highest priorities.

6. Temporarily alter solicitation strategy to focus more on *current-use* funds, engaging donors in this strategic, timely, and more urgent approach to philanthropy.

7. Deploy *unspent* funds. This may sound obvious, but Foundation CEO's and Advancement VP's report significant amounts of unspent endowment income throughout their campuses, as deans and others choose to "bank" some endowment distributions year-after-year (i.e., saving for an emergency or perhaps far-our long-term spending strategy such as a new building or expensive piece of equipment). Some Foundation leaders report tens of millions, and in some cases more than $100M of unspent endowment distributions being held at various offices across the campus. *Now is the time to activate those funds*. University and foundation leadership should develop an "underutilized funds initiative" to deploy these resources as quickly (for example over the next two years) and strategically as possible. This can provide much needed general fund relief AND demonstrates good stewardship of donor funds, especially important when returning to that donor to consider another gift.

University endowments are vehicles to create and ensure perpetual, intergenerational wealth transfer. Ensuring intergenerational equity, while certainly a goal, is becoming increasingly difficult as university expenses are outpacing revenues. The costs of delivering a university education are increasing beyond many families' ability to pay. This means they will be increasingly dependent on philanthropy for need-based scholarships. Consider a scholarship that today provides 25% of the tuition costs. Unless the growth in the endowment fund is able to keep up with increases in tuition, that same scholarship will be worth less to students and their families in future generations. Many advancement leaders will share that their third major function is addressing this need for intergenerational equity and recognize many endowment donors have interest in supporting financial aid and the student experience for generations to come.

Endowments are established to provide *guaranteed sources of funding* to support students, faculty, programs, and facilities. They are not meant to be savings accounts that can be accessed without bound during times of need or even crisis. Doing anything to permanently reduce the power of these precious and generous gift instruments, entered into in good faith with donors over generations, would hurt the university in future generations *and* likely severely impact the trust and relationships that have been stewarded for many years and upon which universities depend (and will increasingly depend) for philanthropy.

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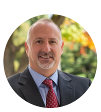

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