Association of American Universities
Inquiry · Innovation · Impact

College and University Endowments

Internal Revenue Code 4968

What are University Endowments?

Endowments are collections of donated funds that are managed to provide permanent support for nonprofit universities' educational, scientific, and charitable missions – namely, teaching students, performing research, and addressing problems affecting communities, states, and the nation.

Endowments are not savings accounts or rainy day funds. Rather, they are steady and reliable sources of long-term funding to support students, research, and other programs that otherwise would be paid for by tuition, state and federal funding, or other resources. Most endowment funds have a legally-binding, donor-directed purpose, such as student scholarships or cancer research, and universities invest those funds for the long term to balance the current and future needs of the universities' students, faculty, and employees.

Each dollar spent from an endowment to deliver an education — from libraries to laboratories — reduces the cost to all students.

What do University Endowments do?

Endowments are a critical source of student financial aid. Universities provided $60 billion in grant aid to their students in 2017-2018 alone, much of it from endowment income. Many institutions with large endowments make college free or very low-cost for thousands of low- and moderate-income students through endowment-supported financial aid grants. Such grant aid also reduces post-graduation debt.

Endowment spending not only funds scholarships for low- and middle-income students, but also subsidizes the cost of education even for those students who pay full tuition. Universities believe it is appropriate to ask students and their families to contribute to the costs of their educations to the extent they are capable of doing so. At the same time, they want to ensure that the opportunity to get a university education is available to all students.

At many institutions with the largest endowments, funds from endowments are their main source of financial support, ranging from 20-50 percent of their operating budgets.

Endowments also fund student services (such as career counseling), internships, and other real world training opportunities, faculty office hours, cutting-edge laboratory facilities, libraries, and other vital components of a student's education and preparation for the 21st century workforce.

Endowments sustain universities' research and public service missions, too, and have become particularly important at a time when other revenue sources have declined.

Endowments provide funding for everything from world-class research in established and emerging fields to inventions that lead to the creation of start-up companies that provide local jobs to university-based youth and community development programs. Endowments also support, among many other things, patient care at university medical centers.

How do Nonprofit Universities Manage Their Endowments?

Universities prudently manage their endowments for the long-term to strike a balance between addressing current needs and preserving resources to fund future needs. A typical nonprofit university pools together its many individual endowments into a single investment fund, much like a mutual fund, which allows for a consistent investment approach.

Charitable donations are the primary source of funds for endowments, and most, though not all, university endowment spending must be dedicated to purposes legally specified by donors. Donors typically restrict their gifts to specified purposes, such as student scholarships and funding research into particular diseases.

In 2018, colleges and universities raised $9.9 billion in new financial contributions to their endowments – about 90 percent of these new gifts were restricted by the donors for specific purposes. Universities take very seriously their legal obligations to comply with their donors' wishes and be good stewards of their gifts.

Institutional governing and advisory boards, as well as government agencies, oversee universities to help ensure that they are honoring donor conditions on gifts, prudently managing their investments, and meeting their fiduciary obligations to the public. Both public and private university endowments are organized and governed as public charities, overseen by the IRS and subject to its regulations. In addition, states regulate charities by such means as attorney general oversight and application of the Uniform Prudent Management of Institutional Funds Act (UPMIFA).

Because endowments are established to exist in perpetuity, the funds are usually invested for the long term. Long-term investment strategies allow institutions to better control risk during market turbulence. In the 2018 fiscal year, for example, the 802 U.S colleges and universities participating in the NACUBO-TIAA Study of Endowments returned an average of 8.2 percent (net of fees) compared with -1.9 percent for the 2016 fiscal year; the mission-critical 10-year average annual return improved by 1.2 percent to 5.8 percent from last year's 4.6 percent.

Universities also rely on the flexibility of endowment spending rates, because even though differences between spending rates seem small, they can dramatically affect an endowment's principal over time. According to the 2018 NACUBO-TIAA Study of Endowments, annual investment return of approximately 7.2 percent is needed to achieve the typical spending or payout rate goal of 5 percent while maintaining purchasing power after spending, inflation, and investment management costs. As noted above, the 2018 long-term 10-year average of annual returns was 5.8 percent, well below this 7.2 threshold.

2017 Tax Law Implications

The Tax Cuts and Jobs Act imposes a new, ***unprecedented*** 1.4 percent excise tax on private colleges and universities with assets (other than those used directly in carrying out the institution's educational purposes) valued at the close of the preceding tax year of at least $500,000 per full-time student on net investment income. The IRS was expected to issue rules implementing this tax in 2018 but have since been delayed.

Some suggest that one way for colleges and universities to hold down tuition increases and lower the cost of attendance for low- and middle-income students is to impose new federal mandates on university endowments. This argument ignores the fact that many institutions are already devoting a great deal of their resources, including from endowment funds, to increase access and affordability for these students.

However well-intentioned, federal mandates such as excise taxes will do more harm than good, redirecting funds to the U.S. Treasury and away from their charitable purpose while making it more difficult for institutions to meet their charitable, legal, and fiduciary obligations. The implementation of such policies will harm students and a nonprofit universities' ability to meet their educational missions and serve the public good.

Additional Information

CRS Report
"College and University Endowments: Overview and Tax Policy Options"
https://fas.org/sgp/crs/misc/R44293.pdf

Inside Philanthropy Article
"A Look at the Law Governing Endowment Funds"
https://www.insidephilanthropy.com/the-gift-adviser/2015/3/10/a-close-look-at-the-law-governing-endowment-funds.html

2018 Endowments Report
NACUBO-TIAA Study of Endowments
https://www.nacubo.org/Press-Releases/2019/US-Educational-Endowments-Report-8-2-Percent-Return-in-FY18

Washington Post Op-Ed
George Will on Endowments and Academic Excellence
http://wapo.st/2zsj6bw?tid=ss_mail&utm_term=.7da8e6b2c915