What does the recent market downturn mean for college endowments?

4/10/2020

What impact has the recent market turmoil had on endowments in the past month?

NACUBO suspects that nearly all endowments have experienced significant losses. Many endowments are diversified across U.S. and global equities, private equity and venture capital, U.S. and non-U.S. bonds, private debt, and other market classes such as real estate and commodities. While there is variability depending on the specific asset allocation of any given endowment investment portfolio, colleges and universities that have larger investments in U.S. equities (stocks) likely will have the greatest losses.

During the Great Recession of 2008-09, the last time stock markets had a deep decline, the average endowment saw a -22.5 percent return. It is possible that endowment returns for the current fiscal year will be similar.

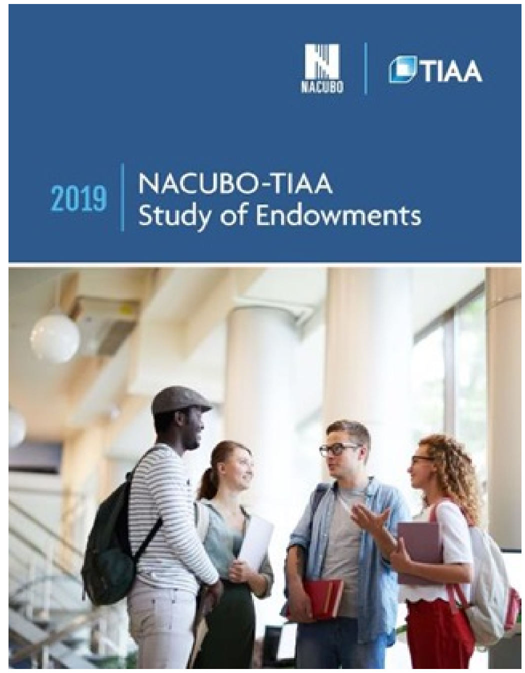
Has the downturn had disparate effects on different types of institutions?

Yes, institutions with fewer resources likely saw disproportionately large losses in recent weeks. However, given the size of these investment portfolios, the upside is that those institutions were, in all likelihood, less reliant on their endowments as a significant revenue source.

(https://www.nacubo.org/rtiaa-study-of-endowments)

The 2019 NACUBO-TIAA Study of Endowments (NTSE) shows that there is significant variability in endowment investment strategies by size of endowment assets.

Endowments over $1 billion had only 11.2 percent of their investments in U.S. equities, while those with $100 million or less had significantly more exposure. Endowments with $25 to $50 million had 37.8 percent in U.S. equities while those with $25 million or less had 45.7 percent in U.S. equities. Those smaller endowments had strong returns in a strong stock market but are at greater risk for investment losses when equity markets decline.



Does this mean endowments will pay out fewer dollars in FY20?

This answer will vary by institution, but the endowment payout rates are unlikely to be radically smaller or larger than the FY19 payout.

How can this be?

Endowments are not rainy-day funds. Endowments are managed to provide colleges and universities with a steady and reliable source of funding over the long term. Investment strategies and spending policies are designed to soften the impact of volatile markets. The 2019 NTSE found that 74 percent of institutions spend a percentage of the moving average of the endowment's market value. A moving average approach softens the impact of market fluctuations by applying spending rates to an average of prior-year endowment balances, such as the past three years, five years, 12 quarters, or even 20 quarters.

Spending policies vary, but as an example, in FY20, a college with a 5-percent payout rate that uses a three-year moving average will withdraw 5 percent of the average value of the endowment over the past three years (not simply 5 percent of the current value).

Are institutions able to spend more from their endowments given the current circumstances? Why can't colleges rely more on their endowments if they are experiencing budget constraints due to COVID-19?

It depends. Some institutions do increase their endowment spending during great financial challenges. In FY09, about half the colleges and universities in that year's endowment study reported that they increased spending from their endowments to support their campus operations. It should be noted, however, that endowments are mostly comprised of funds from donors who require that their gift lasts in perpetuity and that the fund flows are used for very specific purposes. These restrictions, as well as state laws, often prohibit the funds from being used for annual operating expenses; they legally only can be withdrawn for donor-defined functions. There may be other funds within an endowment that do not have these restrictions, and special appropriations are possible.

Are there any legislative solutions that can help address the current situation?

NACUBO is very pleased with recent congressional action that provides a partial charitable deduction for nonitemizers: For individual taxpayers who do not itemize, an above-the-line deduction will be allowed for charitable contributions of up to $300 in the 2020 tax year. Due to changes in the Tax Cuts and Jobs Act, millions of taxpayers who previously had itemized their tax returns no longer do so, which has impacted the charitable deduction as a giving incentive.

Additionally, caps on the deduction tied to the adjusted gross income for donors who do itemize have been temporarily lifted. NACUBO continues to support calls for a larger deduction cap on the above-the-line deduction. This is another giving incentive that help colleges and universities achieve their teaching, research, and public service missions through donations.

NACUBO also supports a full repeal of the net investment income tax enacted as a part of the 2017 Tax Cuts and Jobs Act. The tax simply diminishes resources that impacted institutions have available to dedicate to education, research, and public service. The first payments under this provision are likely to be due later this year, eroding the availability of funds these schools have to respond to COVID-19-related impacts on their campuses.

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