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Mandatory endowment spending could hurt returns, curtail investment trendsetting

By [Jennifer Byrd](#)

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WASHINGTON — A mandatory spending rate by college and university endowments would have repercussions for the funds and the overall economy and doesn't take into account long-term market performance, experts say.

Recent strong asset growth among endowments has led some in Congress to question how universities are spending those assets. Sen. Charles Grassley, R-Iowa, ranking member of the Senate Finance Committee, has suggested publicly that the largest college endowments should be required to make the same 5% minimum annual payouts as private foundations.

But mandating a spending level could have repercussions for the long-term financial well-being of educational endowments, said Carl Hess, New York-based director of Watson Wyatt Worldwide investment consulting in North America.

Endowments have done particularly well in recent years because of their flexibility in how they invest their assets, Mr. Hess said. Mandating a specific spending rate would "put a stranglehold" on that flexibility because the funds would have to be more predictable, he said.

"When you're truly investing for the long term, and then you have to come up with that spending, investing becomes more difficult," Mr. Hess said, adding that many endowments have funds tied up in non-liquid assets, such as private equity commitments. When 5% spending is required, there is more stress put on the liquid assets.

Mr. Hess said Watson Wyatt is concerned about the implications a required spending rate could have on the business of money management. Endowments have been trendsetters in money management, and Watson Wyatt consultants often share lessons learned from endowment investors with their clients, Mr. Hess said.

Mr. Grassley and Sen. Max Baucus, D-Mont., the committee's chairman, sent a letter on Jan. 23 to 136 colleges and universities with endowments of \$500 million or more asking, among other things, how much of their endowments was targeted to financial aid for students.

Late last year, officials at the \$35 billion endowment of Harvard University, Cambridge, Mass., and the \$22 billion endowment of Yale University, New Haven, Conn., announced that they would increase spending to improve financial aid available to students.

"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," Messrs. Baucus and Grassley wrote. A spokeswoman for Mr. Grassley did not return a call seeking comment.

Ian Kennedy, director of research at consultant Cambridge Associates LLC, Boston, said many universities use their endowments in different ways and need the flexibility to set their own spending level.

"Mandating X% just doesn't make sense," Mr. Kennedy said. "It's not the case that all these universities are uniform."

Cambridge consults for 94 of the universities that received the letter from Messrs. Grassley and Baucus, Mr. Kennedy said. Generally, endowments have grown significantly in the past 20 years largely because of bull markets in the 1980s and 1990s, he said. Another factor in recent years has been increased donations by baby boomer alumni that are at the peak of their earning potential, Mr. Kennedy said.

According to the Washington-based National Association of College and University Business Officers, 76 colleges and universities had endowments of \$1 billion or more in the latest fiscal year. On average, the endowments had returns of 17.2% in 2007 and an average annual spending rate of 4.6%.

According to NACUBO, assets of 14 of the largest college endowments increased 252.6% between 1991 and 2006. Harvard's increased 309.6% and Yale's grew 364.2%.

The annual spending rate most endowments shoot for is 5%, Mr. Kennedy noted, but the percentage has gone down recently because portfolios have increased dramatically.

"They don't want to hoard money," he said, adding the goal of endowments is to maintain "intergenerational equity," meaning the endowment still needs to be around and available for future students.

"Boards have to try over time to find what a reasonable spending level is after inflation," Mr. Kennedy said. When taking a long-term look at U.S. capital markets, there are periods — for example from 1968 to 1982 — when endowment funds had terrible returns, Mr. Kennedy said. It was not until the early 1990s that endowments such as of Harvard and Yale recovered from that period, he said.

Those calling for increased spending are only looking at the short term, he said. "The notion that endowments can easily earn high returns without any trouble at all after inflation is naïve," Mr. Kennedy said.

Watson Wyatt's Mr. Hess also thinks a mandate could harm the ability of endowments to

invest in non-traditional investments, such as venture capital projects. "Endowment funds are a tremendous engine for various sectors of the economy," Mr. Hess said. "This could have repercussions for the economy at large."

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