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INSIGHT

College and University Endowments: Payout Rates and Spending on Student Financial Aid

March 22, 2023

Starting in 2018, certain private colleges and universities with endowments valued at $500,000 or more became subject to a 1.4% excise tax on total net investment income (Internal Revenue Code [IRC] Section 4968). For the purposes of this tax, net investment income is capital gains as well as other sources of investment income (e.g., interest and dividends), less expenses associated with earning that income. For calendar year 2021, the Internal Revenue Service (IRS) reports that 33 institutions paid $68.1 million in tax under this provision. One question policymakers have considered is whether the excise tax should be modified or reduced for institutions that devote a certain amount of their endowment to financial aid or to other forms of support for low- and moderate-income students. This Insight uses data from the National Association of College and University Business Officers (NACUBO) and TIAA Study on Endowments (NACUBO-TIAA study) to look at information related to (1) endowment spending or payout rates; and (2) endowment spending on financial aid. The NACUBO-TIAA study is based on survey responses of institutions of higher education. In 2022, the study is based on the responses of 678 institutions, including both public and private colleges and universities.

Payout Rates of College and University Endowments

Spending from an endowment includes expenditures on student financial aid, faculty research, maintenance of facilities, and other campus operations. The spending rate, or payout rate, is this spending divided by the market value of the endowment at the beginning of the year (net of administrative expenses). Most institutions have a spending policy that ties the payout rate to a moving average of endowment value. The NACUBO-TIAA study groups institutions using seven endowment size categories, ranging from under $25 million to over $1 billion, when presenting endowment data. Oftentimes, payout rates are similar across endowments in different size classes.

Since 2017, the average spending (or payout) rate across all institutions has fluctuated, with a period high of 4.8% in 2021, and a period low of 4.2% in 2022. Across endowment size classes, average payout rates have generally fluctuated between 4% and 5% (with some exceptions). The average payout rate across institutions with the smallest endowments (under $25 million) has tended to be closer to 4%. The average payout rate for institutions with large endowments (over $1 billion) has generally been above 4.5%, although the average payout rate for this size category fell to 3.9% in 2022. While spending rates fell in

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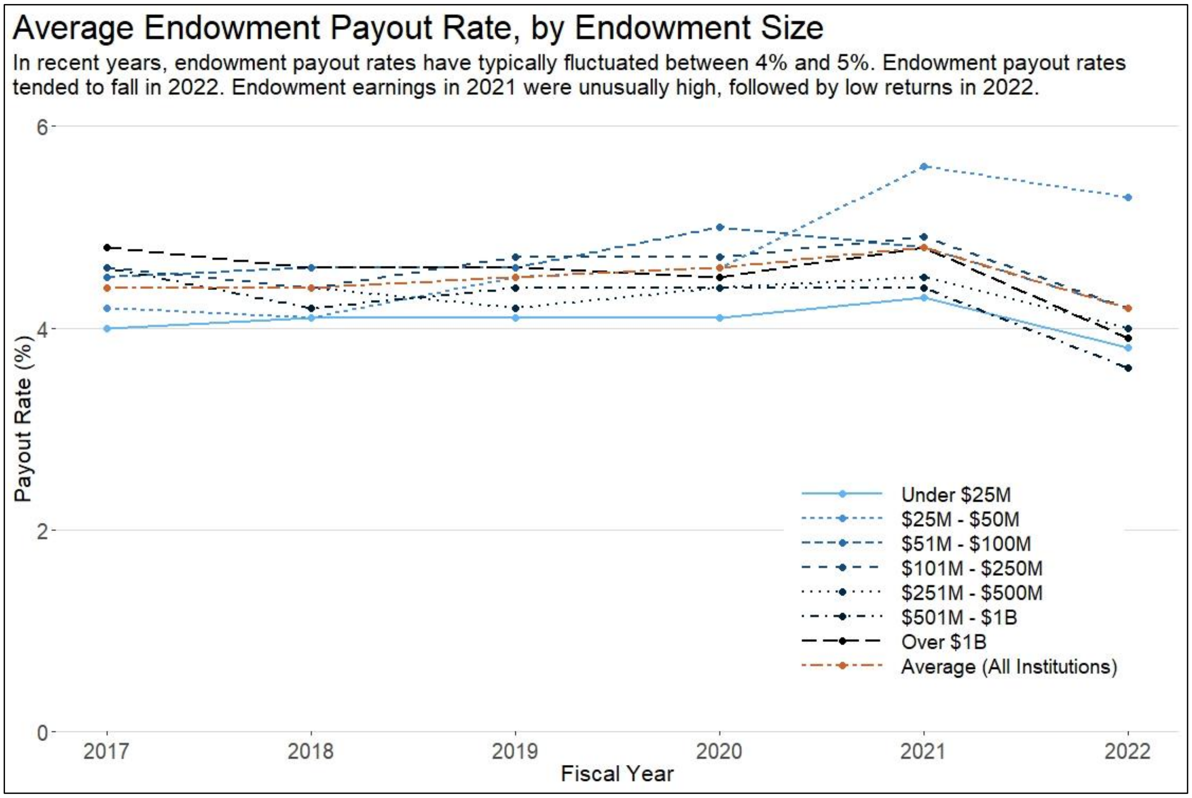
2022, actual spending from endowments rose. High endowment investment returns in 2021 increased endowment balances, such that constant or moderately higher spending amounts are reported as reduced payout rates (i.e., a high beginning-of-year endowment balance makes the denominator large when calculating payout rates).

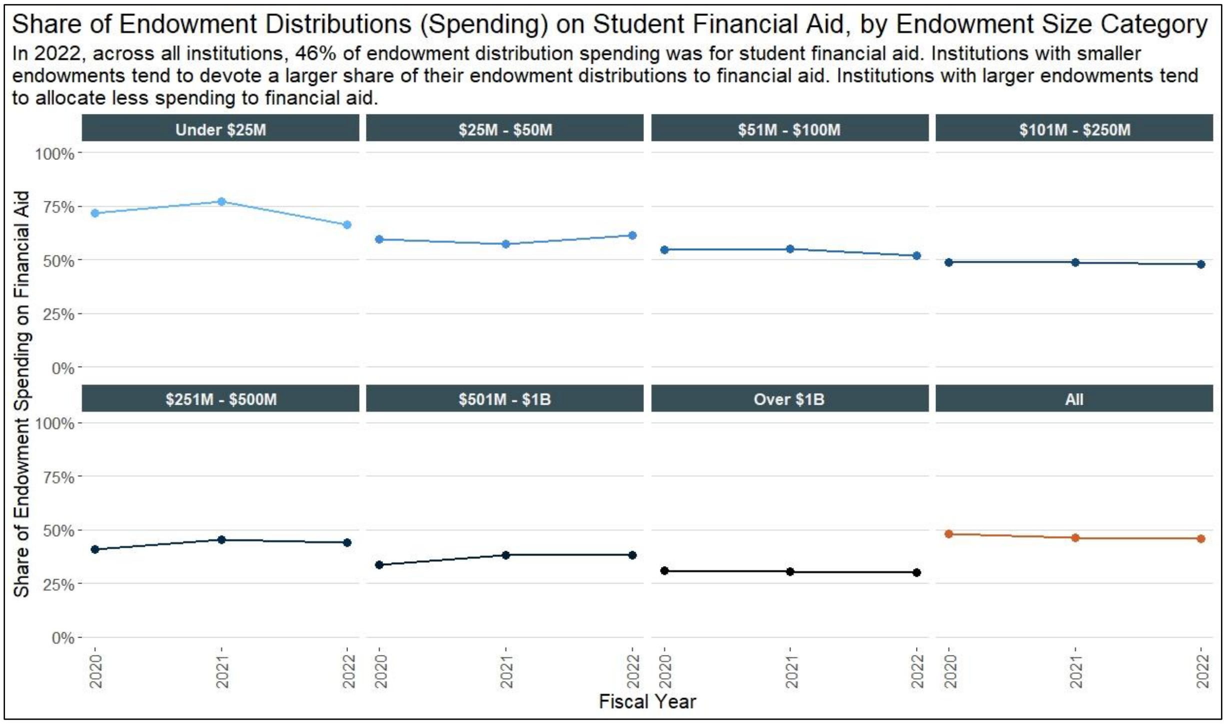


Source: CRS analysis of NACUBO-TIAA Study on Endowments, various years.

Notes: Spending (payout) rates are total endowment spending divided by the beginning-of-year market value. Spending includes all withdrawals from the endowment, other than fees and expenses associated with managing the endowment. Average payout rates are equal-weighted across institutions. Fiscal years end June 30.

Share of Endowment Spending for Financial Aid

There is variation in the share of endowment spending that is for financial aid across endowment size categories. Institutions with smaller endowments tend to devote a larger share of their endowment spending to financial aid. For institutions with the smallest endowments (under $25 million), about three-quarters of endowment spending supports financial aid. This could potentially reflect the importance of financial aid in student recruiting for smaller institutions. Institutions with larger endowments tend to devote a smaller share of their endowment spending to financial aid, on average spending more on academic research and programs and endowed faculty positions. On average, institutions with the largest endowments (over $1 billion) spend less than one-third of their total endowment spending on financial aid. Larger institutions may devote more resources to financial aid, however, due to their larger endowment balances and distributions.



Source: CRS analysis of NACUBO-TIAA Study on Endowments, various years.

Notes: Shares are equal-weighted across institutions. Fiscal years end June 30.

Policy Considerations and Recent Legislative Proposals

The endowment excise tax, as a 1.4% tax on net investment income of taxable institutions raising $68.1 million in 2021, is small when compared to total endowment assets or endowment distributions. In FY2022, the total market value of endowment assets of the 678 institutions participating in the NACUBO-TIAA endowment study was $807.3 billion (with $185.8 billion of this total held by public institutions' endowments). Endowment distributions, or spending, totaled $25.9 billion. Most of this spending, $20.2 billion, can be attributed to 118 institutions with endowments in excess of $1 billion. Most institutions with billion-dollar endowments are private, and most of the assets held by billion-dollar endowments are held by private institutions. Using these figures, endowment excise tax collections are equivalent to about 0.3% of endowment spending of all (private and public) institutions with billion-dollar endowments. This figure is intended to provide context on the magnitude of the tax, but it should be noted that information is not available on excise taxes paid relative to endowment spending for specific institutions.

Concerns related to rising college costs and college affordability are a motivation behind many higher education-related policy proposals. Recent legislative proposals to modify the endowment excise tax reflect these concerns. For example, the Higher Education Accountability Tax (HEAT) Act (H.R. 8883, 117th Congress) proposed increasing the endowment excise tax to 10% and revising the tax to apply to institutions with $250,000 or more in endowment assets per student. Additionally, the legislation would have increased the tax rate to 20% for institutions increasing tuition by more than the rate of inflation. A sponsor of this legislation highlighted a 2022 National Bureau of Economic Research (NBER) working paper that empirically examined how endowments use their investment income. This research found that colleges and universities with large endowments that experienced endowment growth due to investment returns tended to increase selectivity and national rankings, but also tended to enroll fewer Pell Grant-eligible students and fewer students of color.

The Build Back Better Act (H.R. 5376, as reported in the House on September 27, 2021) included a provision that would have phased out the endowment excise tax for institutions that provided grants and scholarships to undergraduate students. Colleges and universities otherwise subject to the tax would have been able to eliminate their tax liability if scholarship assistance was high enough. This provision was not included in the House-passed version of the legislation or other later versions of the Build Back Better Act.

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