HIRTLE CALLAGHAN & CO
Chief Investment Officers

EXPANDING THE ENDOWMENT TAX: WHO REALLY PAYS?

Congress is currently considering options to raise revenue to fund a wide range of priorities, including the expiration of the 2017 Tax Cuts and Jobs Act. At the center of this effort are proposals to expand and raise the tax on university endowments. While most attention has focused on the specifics of the tax proposals, far less has been given to which schools they would affect—and how damaging the impact could be.

The proposed tax changes would significantly broaden the universe of colleges and universities that pay the tax from large, wealthy institutions to smaller, regional ones. The proposals also call for much higher taxes on endowment income. In doing so, they threaten to do irreparable damage to many schools which are significantly weaker financially than the schools paying the current tax.

WHAT ARE THE ENDOWMENT TAX PROPOSALS?

The current endowment tax impacts 56 of the wealthiest colleges and universities—those with endowment assets per student of $500,000 or more. These schools pay the government 1.4% of annual endowment income.[1] This includes schools like Harvard and Princeton with endowments of $53 billion and $34 billion, respectively.

Congress is considering various proposals to raise the endowment tax from 1.4% of investment income to between 10% and 21%. It is also considering proposals to lower the endowment per student threshold from $500,000 to $200,000.[2]

The impact of these proposals is enormous. Our analysis shows that the endowment tax could apply to more than 150 additional schools, many of which are smaller and have very few resources. The government will go from taxing Yale, Harvard and Princeton at 1.4% to taxing schools such as Spelman College, Goshen College, and Goldey-Beacom College at up to 21%.

SPELMAN COLLEGE is a 2,700 student women's HBCU and a global leader in the education of women of African descent. U.S. News and World Report ranks Spelman as the #1 top performer in social mobility. 85% of its students receive financial aid.

GOSHEN COLLEGE is a Hispanic-serving institution in Indiana renowned for its distinctive hands-on, real-world educational opportunities. It has approximately 700 students, 99% of which receive financial aid that is supported by its $149 million endowment.

GOLDEY-BEACOM COLLEGE is a 639 student school located in Wilmington, Delaware. For over 125 years, GBC has provided a quality education at an affordable

[1] *Under current law, only those colleges and universities with at least 500 students and investment assets exceeding $500,000 per student must pay tax of 1.4% on investment income and realized gains.*

[2] *Endowment per student is calculated by dividing the total cash, investments and endowment market value by the number of students (excluding international students).*

price for students. In addition to having low tuition relative to peers, 85% of the students receive financial aid with help from the school's $190 million endowment.

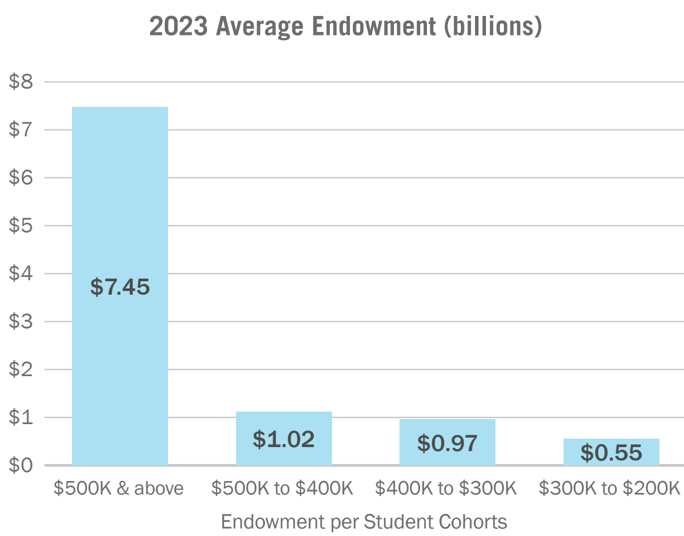
These institutions are the heart of the communities they serve. Collectively, they will pay millions in taxes, funds that could be better used to serve their students.

WHAT ARE THE IMPLICATIONS OF THE PROPOSED TAX CHANGES?

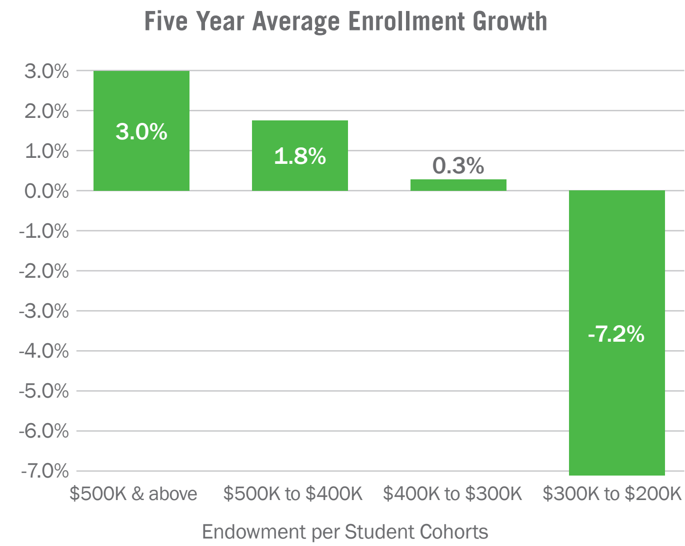
There are roughly 160 schools in the "new tax cohort" which has an endowment per student between $200,000 and $500,000. To gauge the implications for this new cohort, we analyzed their financial data and compared it to the "original cohort" of schools with an endowment per student of $500,000 and above.[3] Our findings highlight the dramatic difference between those currently taxed and the new cohort.

These are not wealthy schools—as evidenced in the chart below, their endowments are significantly smaller than the original cohort. Yet, for the new cohort, their endowment plays a vital role in maintaining financial stability. Moody's April 2024 report cited that "In many cases, small colleges are currently relying on elevated endowment draws to support operations and strategic initiatives".

Moreover, the new cohort consists of many schools that are already struggling financially. In its report, Moody's issued a weak financial outlook for small, regional schools due to unfavorable demographic trends and increased competition from state schools, among other challenges.[4] A significant portion of the new cohort aligns with Moody's 'at risk' profile: these schools enroll 45% fewer students than those in the original group, averaging just 2,381. They also tend to be far less selective, accepting between 32% and 57% of applicants, and primarily serve regional students.



Source: 2023 IPEDS Data



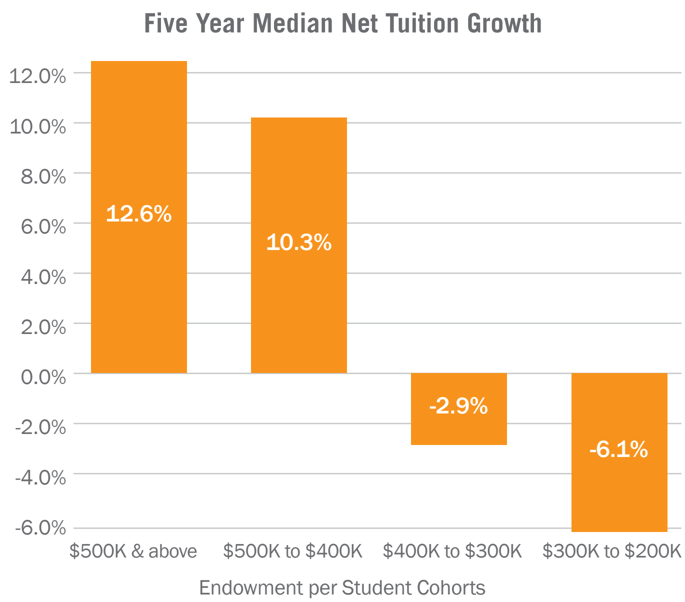
Source: 2023 IPEDS Data

Enrollment trends are exacerbating financial weakness, especially those with smaller endowments. The least-endowed segment, with an endowment per student between $200,000 and $300,000, has seen enrollment decline by 7.2% on average over the past five years.

3 *Using the 2023 IPEDS database we examined the impact the endowment tax would have on the approximately 160 schools. Since the IPEDS data does not include cash and other investments balances in its data, the number of schools impacted by the endowment tax will be much larger than those we reviewed. To make the cohorts more representative we have eliminated the data from the 8 research universities with enrollment over 10k and endowment > $2B.*

4 *Moody's Investor Services Sector-In-Depth Report "Small Institutions in Northeast and Midwest face credit stress as enrollment declines", April 22, 2024.*

Unsurprisingly, enrollment challenges have translated into declining net tuition growth. The least-endowed schools have seen a decrease in net tuition of 6.1% over a five-year period. The next largest cohort has seen net tuition decline by nearly 3%. Based on our analysis, 22 schools are struggling even more with a five-year decline in net tuition of 21.4% on average.



Source: 2023 IPEDS Data

The bottom line is that many of the institutions in this new cohort do not have the resources to fulfill their current student needs, let alone pay an endowment tax. Asking these schools to pay up to 21% tax on endowment income will directly impact their ability to provide financial aid, reducing access for students and further stressing enrollment.

WHAT IS THE RATIONALE FOR THE ENDOWMENT TAX?

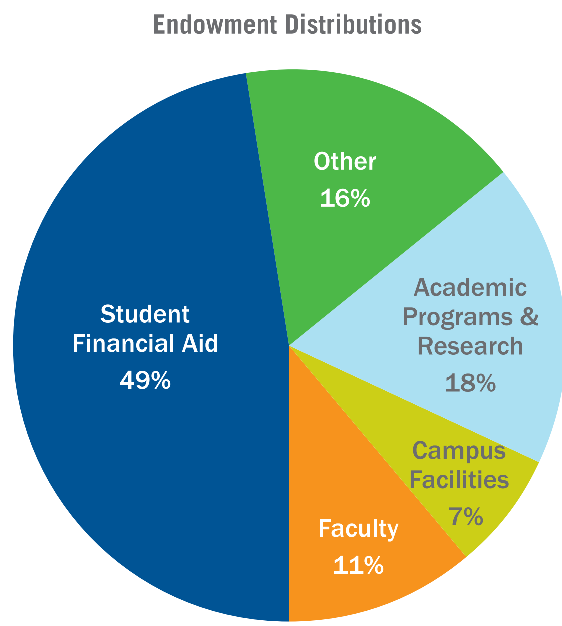
If the endowment tax has the potential to be so damaging, why would the government undertake such a measure? The argument for the endowment tax is based on two misconceptions.

1 We must "level the playing field" between endowed institutions and corporations by applying equal tax rates for endowments and corporations.

This argument simply does not make sense. Donors establish endowments to support student financial aid, academic programs and research excellence. Corporations' objective is to maximize stockholder returns. These two goals could not be further apart and deserve vastly different tax treatment.

2 Large school endowments should pay the price for the rising cost of higher education and the student loan crisis.

The cost of education has escalated substantially, and the student loan crisis is real, but school endowments are not the problem; they are part of the solution. According to the 2024 NACUBO Study of Endowments, student financial aid is by far the greatest beneficiary of endowment distributions, comprising nearly 50% of annual spending. Schools with larger endowments tend to be even more generous with their financial aid.



Source: 2024 NACUBO Study of Endowments

CONCLUSION

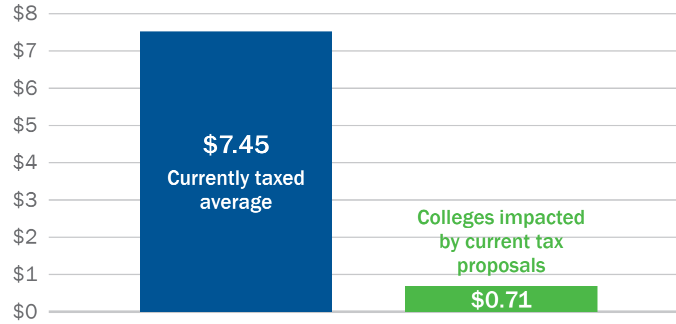
While we previously looked at the colleges impacted by the tax proposal in three bands, looking at the data collectively sums up the situation nicely. Together, on average these colleges have endowments that are 91% smaller than the schools currently taxed, are losing market share, and their primary revenue source is not growing.

The building of an endowment should be celebrated and encouraged, not discouraged. Endowment distributions reduce the cost of education and contribute to the well-being and advancement of society. Philanthropy is what has allowed our nation's higher education system to perpetuate and thrive. This, in turn, has allowed generations of students to thrive—and they should not have to bear the burden of the endowment tax.

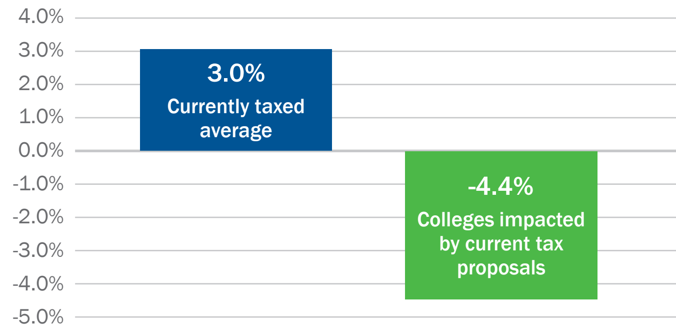
The schools being included in this tax proposal look nothing like the schools currently taxed. Many of these schools are already struggling financially due to enrollment shortfalls, inflation and increased competition. This makes their endowment even more meaningful to their financial sustainability. They cannot afford an additional tax burden.

Since 1988, Hirtle Callaghan has been serving as the Chief Investment Officer for nonprofits and families who rely on the growth of their assets to support important causes and communities. With each client in mind, we design and manage a customized investment program that reflects our best ideas across a global, diverse opportunity set. As of year-end 2024, we manage approximately $20 billion on behalf of our clients, including many colleges and universities.

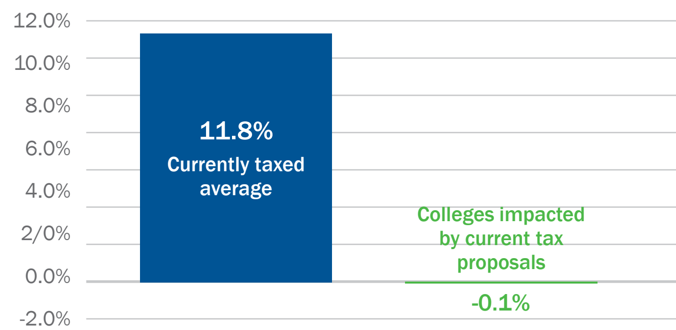
Average Endowment Market Value (billions)



Five Year Change in Enrollment



Five Year Change in Net Tuition



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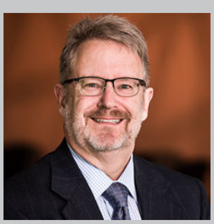

JOHN W. GRIFFITH, CPA / jgriffith@hirtlecallaghan.com

John is a Director and serves as an Endowment Specialist. He has over 35 years of nonprofit experience. John leads the firm's holistic planning process for institutions, working closely with investment committees to design customized investment programs that are fully aligned with their goals and risk tolerance. He also works directly with endowments on specific, client-driven projects. These projects help committees tackle key strategic issues, including spending policy, liquidity policy, debt ratios and covenants, capital campaigns, operating reserves and governance. From 2003 until 2014, he was the Chief Financial Officer and Treasurer of Bryn Mawr College. Prior to Bryn Mawr, John spent 15 years in various financial roles at the University of New Hampshire, and started his career at Coopers & Lybrand.