Statement of
MaryFrances McCourt
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on behalf of the
National Association of College and University Business Officers
Before the
U.S. House of Representatives
Committee on Ways and Means
Subcommittee on Oversight
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Introduction

Thank you for inviting me today to testify at this hearing on the rising costs of higher education and tax policy. My name is MaryFrances McCourt and I am the Senior Vice President and Chief Financial Officer at Indiana University. I came to higher education 10 years ago, after 20 years as a corporate executive, the last 14 of which I spent in the technology industry (during its boom and decline). Today, I am here on behalf of NACUBO, the National Association of College and University Business Officers. NACUBO is a membership organization representing more than 2,100 public and private nonprofit colleges and universities across the country and around the world. Its primary membership is chief business officers.

Since 1974, NACUBO has sponsored, with partners, an annual endowment survey. The NACUBO-Commonfund Study of Endowments (NCSE) is the largest and longest-running survey series of higher education endowments in North America.

The most recent study gathered data from 832 U.S. colleges and universities for the 2014 NACUBO-Commonfund Study of Endowments® (NCSE). The institutions participating in this year's Study withdrew $21.2 billion from their endowments—providing financial access to education so today's students have the tools to build a strong future *and* supporting the overall research and public missions of their respective institutions.

I am eager to share with you today some background on how institutional leaders work collaboratively to take into consideration the institutional mission, vision, and programmatic needs when crafting college and university budgets. This necessitates an ability to work effectively with enrollment management, invest in student services, provide guidance relative to the endowment, assure that campus facilities are well maintained and meet the needs of educational, research and service programs, and manage debt. It also means facilitating the growth of undergraduate enrollment in degree-granting postsecondary institutions to enable economic growth in the United States and to ensure first generation and minority student enrollment is supported as well. Institutions of higher education are making significant investments in student persistence, completion, advising, career counseling, financial literacy, and other academic services to ensure student success.

The trustees who govern our institutions in furtherance of educational, research, and service missions, at the same time expect us to manage our operations based on sophisticated business principles and hold us accountable to performance metrics that align with corporate gold standards. These trustees are often successful business executives themselves.

Today, I also want to take this opportunity to illustrate the importance of endowments to colleges and universities. This hearing provides a welcome opportunity to make clear the fundamental guidelines that investment managers and boards of trustees must adhere to when managing endowments. These guidelines can be summarized in three words: perpetual, growing, and consistent.

Perpetual. Endowed funds represent an institution's promise to donors to use income and investment gains generated by their gifts to support an aspect of the university's mission into perpetuity. Donors who direct their gifts to endowments expect institutions to strike a balance between supporting current needs and ensuring the funds meet the needs of future generations, meeting the mission and needs of students and the campus community here and now as well as long into the future.

Growing. Investment managers are obligated to manage funds in such a way that financial gifts continue to grow over time—thus enabling withdrawals to keep pace with inflation while supporting other necessary investments in student support, research, etc. This fiduciary responsibility is articulated in a legally-binding agreement between the donor and the institution. These agreements and guidelines for distribution as well as prudent investment standards are also governed by uniform code—set in state law—across the county. Endowment investment policy statements are developed and approved by university foundation boards and investment professionals.

Consistent. As a chief financial officer, I seek low volatility over time in my operating budget to meet the consistent demands of fulfilling our mission as a public research institution. Indiana University relies on the endowment for a steady flow of operating revenue. Fundamentally, endowments are expected to provide stable funding to the university while creating inter-generational equity by balancing the current and future needs of the university. Mandating endowment payouts to fund a "flavor-of-the-month" would simply equate to poor financial management.

Balancing Budget and Tuition Demands

The single most challenging financial constraint we've faced in recent years at Indiana University is the fact that the state has not been able to appropriate adequate funds to keep up with inflation and enrollment growth. Revenue from tuition and fees now makes up more of our budget than state appropriations as a percentage of our operating revenue. The proportion of our budget from state appropriation and from tuition and fees has flipped since the mid-1980s.

However, we have managed to thrive. Historically low tuition increases are the "new normal" at IU. We have invested heavily in student success and affordability, with the reduction of student debt as a key focus. As chief financial officer, I have also been driving the business division to find operational efficiencies, with much success over the past several fiscal years.

But the last several years have been a demanding and uneasy time for us as well as the entire public and nonprofit higher education sector. The economic situation has improved somewhat, but it has not yet stabilized—leading to uncertainty about short- and long-term funding, and how to manage costs. Institutions, like IU, have taken action with a wide array of initiatives, from more internal consolidation to increased external collaboration.

We are past the point of acknowledging the "new normal" and most institutions are dealing with pressures to maintain their infrastructure (both human and physical) and invest in student success and welfare. Many institutions must invest in the research missions that drive U.S. innovation, while at the same time address extreme price sensitivities to tuition and consider student affordability. Indiana University is a notable representative for public higher education as we run a large complex university comprised of eight campuses that range from a large, flagship research institution to smaller regional campuses with significant non-traditional student populations.

Setting Tuition

As a corporate executive, before coming to Indiana University, a key area of focus for me was financial modeling and analysis. This experience has become invaluable in the tuition setting process. Tuition and fee increases emerge only after examining numerous financial models (at IU we typically look at approximately 50 different analyses) built on details that reflect campus- , school- , and unit- level sensitivities. Key inputs on these projections include:

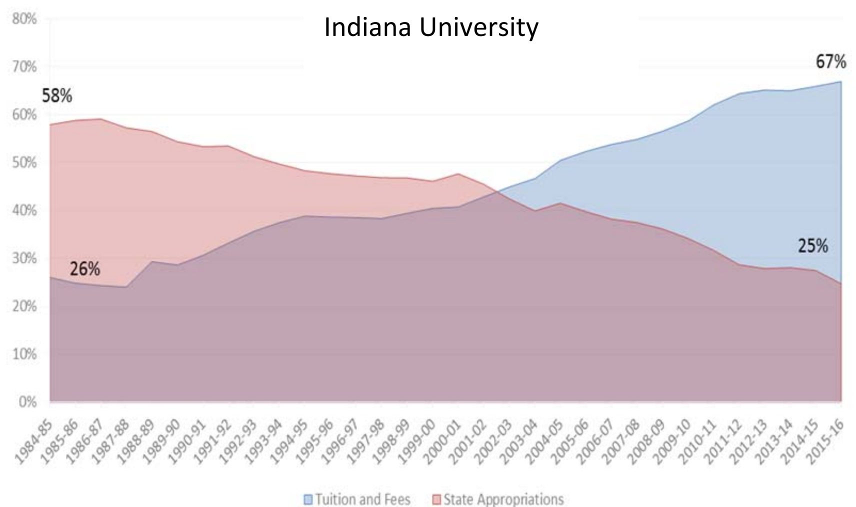
- Enrollment credit hours by school
- Healthcare and other employee benefit costs
- Investment in student initiatives (student welfare, completion, persistence and more)
- Compliance initiatives
- Technology investment

Many of these budget considerations can be projected at a remarkable level of accuracy. The key variables to estimating our operating budget model are tuition and fees and compensation increases. Several models are done to determine the appropriate balance of being able to offer our employees a minimal salary increase—the compensation pool has not increased more than 2 percent since I arrived at IU and we've had some years with no increase or a delayed increase— and keeping our tuition increases as low as possible in light of the pressures on students' ability to pay.

There have been many operational efficiency initiatives to decrease operating expenses and we have made significant strides here. But, this industry is marked by a cost structure based predominantly on labor. And a significant portion of that labor is semi-fixed with tenure-track faculty.

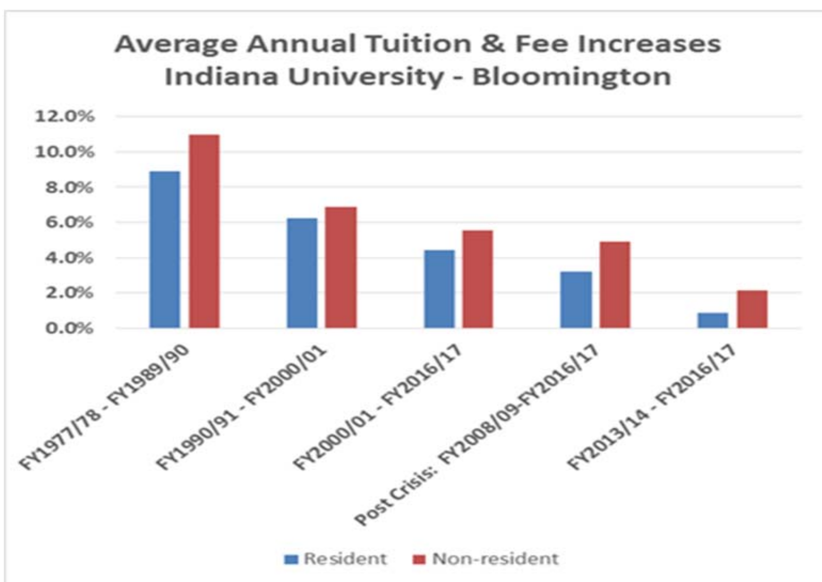
The Role of State Appropriations

At Indiana University, the share of the General Education budget funded by state appropriations versus that of tuition and student fees has reversed since the mid-1980s and the state appropriation per student full-time equivalent (FTE) dramatically declined. This is a trend with state-operating appropriations for public higher education we are seeing across the nation.



As state appropriations decline, institutions of higher education have hard choices. Institutions can raise tuition to preserve quality; decrease spending despite effects on student learning, retention, and graduation rates, and compliance, safety, and other programming; limit admission slots; cut employee benefits; etc. Increasing productivity by increasing class size/ professor throughput at the cost of quality is not an optimal option.

Institutions of higher education in the United States have also been impacted by extensive federal compliance requirements. There has been significant additive investment in compliance related to research, tax (employee, student, private use, Build America Bonds, etc.), data security, student safety (weather, active shooter, student welfare, and other emergency preparedness), revenue processing, etc. Many institutions of higher education have now established dedicated compliance offices.



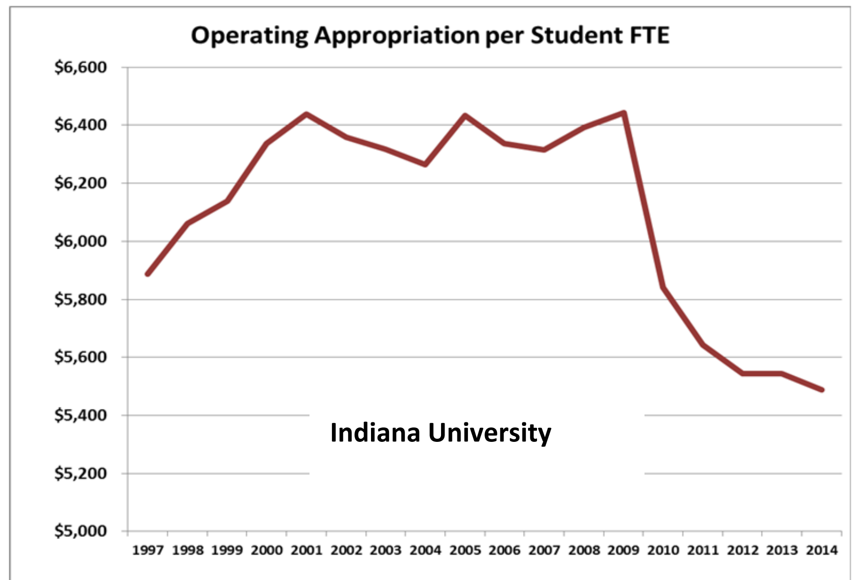
What are we doing to help students?

Undergraduate enrollment in degree-granting postsecondary institutions has grown more than 50 percent since 1990, and the proportions of first generation and minority students are growing as well. Colleges and universities are making significant investments in student persistence,

completion, advising, career counseling, financial literacy, and other academic services to ensure student success.

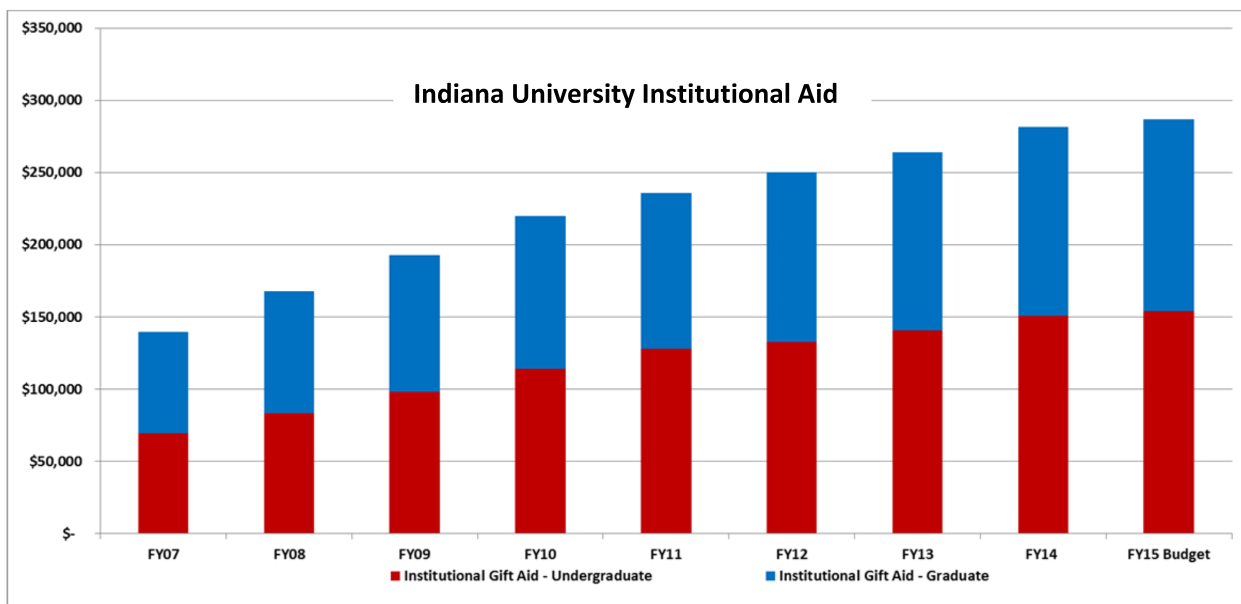
Indiana University has several initiatives directed at student affordability that are representative of initiatives across higher education:

- **Tuition increases are at historical lows.** Note that in each of the time periods noted above, beginning in the late 1970s (as far back as we have captured this data), average tuition and fee increases for both resident and non-resident undergraduates has declined.



- **Institutional aid** at Indiana University has doubled for both undergraduate and graduate students since fiscal year 2007 with the total fiscal year 2015 budget close to $300 million. Resident undergradate aid has tripled during this timeframe.

- Indiana University has also put **student financial literacy** front and center with targeted investment, programming, and enhanced business processes to educate students on debt optimization and loan default aversion. Results have been notable with total debt for graduate and undergraduate students **down $82.5 million, or 16.2 percent over the past three years**. Student loan defaults have also had material decreases across all campuses. A key focus of our financial literacy education is the reduction of "lifestyle" borrowing to minimize the overall cost of college.



Additionally, at Indiana University, **administrative costs have decreased as a percent of student fees**, even with the investment in compliance and technology. Average absolute salary levels across all significant income tiers are higher for faculty than for staff and the number of faculty in higher income tiers greatly surpasses the number of staff.

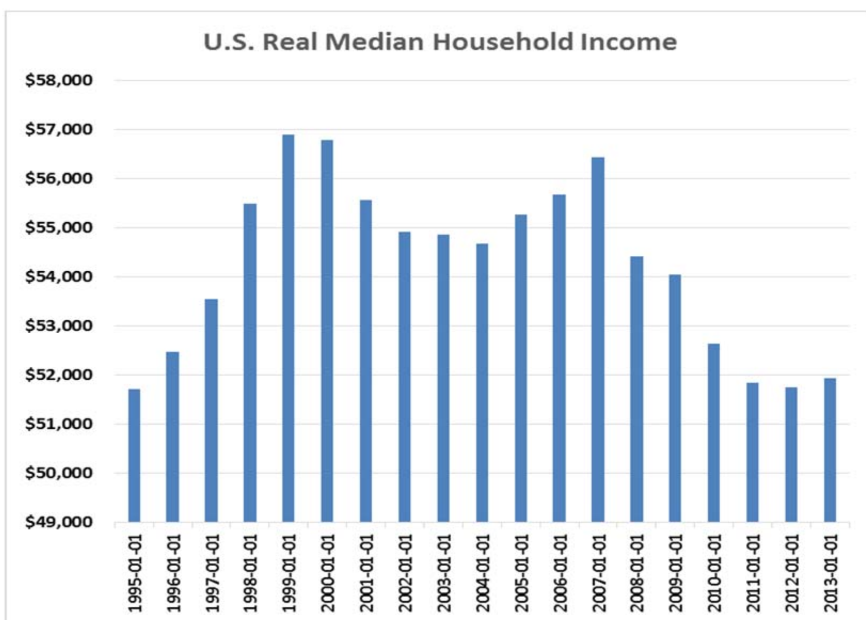
<u>What is impacting student affordability?</u>

The cost of college and students' ability to pay has gained the national spotlight in the aftermath of the 2008 financial crisis. Headlines tend to isolate and simplify the problem as rising tuition leading to student debt. But student affordability issues are the result of many macro- and microeconomic issues.

As Robert Archibald and David Feldman highlight in *Why Does College Cost So Much?* one must consider higher education costs within the broader economy. In practice at IU, this means that we look at every line of our income statement and balance sheet to optimize any factor for which we are responsible while examining all factors outside our purview to help students navigate their future.

In addition to the shift in cost from state subsidy to the student, there are several other factors contributing to student affordability. It is important to consider the ways in which students and families finance an education. Financing options can include current income, savings, home equity, student debt (other types of debt), grants, and scholarships.

Affordability has been significantly impacted since the early 2000s as real family income has remained stagnant. U.S. real median household income has hovered around $52,000 since 1995.



Family net worth has been impacted by stock market volatility as well. From 2001-2012, the Standard& Poor's Index ended calendar year 2012 only slightly higher than it started calendar year 2001. This would have impacted family college funding from savings as well as donor giving to support the endowment.

<u>Where are we now?</u>

Institutions of higher education across the nation have adjusted their business models post-financial crisis. Student affordability has been negatively impacted by both macro- and micro-economic forces. Institutions have put significant "skin in the game" with historically low tuition increases, significant investment in institutional aid, reduction in cost through operational efficiency initiatives, and investment in programming for student welfare and success. Attention to accessibility has never been higher and the focus on persistence/ completion has never been greater.

What role do endowments play?

It is important to note that as state subsidies have declined and pricing pressure has grown, philanthropy has gained significant importance. Philanthropy is a major factor in IU's ability to increase accessibility to our institution over the past decade.

A key societal benefit of universities is to inspire knowledge breakthroughs and provide access to education. Endowments offer donors the opportunity to support these societal needs in perpetuity. Through endowments, our donors provide students and faculty the means to change the world for the better through education, research, and public service. In many cases, universities conduct research and provide financial support to researchers that would not typically be funded by private industry or government funding, but might not be possible without donors' gifts.

At IU we also invest for the long-term; part of our strategic financial planning includes oversight and prudent management of our endowment. Endowed funds, established contractually with donors, represent the institution's promise to donors to use income and investment gains generated by their gifts to support an aspect of our university's mission.

What is an endowment?

An endowment is a collection of funds provided by donors to secure long-term institutional strategic goals. Most endowments are comprised of hundreds, or even thousands, of individual funds that range in size from less than $10,000 to more than $1 million—there are approximately 8,000 at Indiana University. Endowment funds are created with legally-binding agreements between donors and institutions.

Charitable giving directed toward endowments are part of a very successful formula the government has in place to leverage private investment in the American college and university sector, where our institutions use those resources to ensure they continue to be are viewed as the finest educational institutions in the world.

Most individual funds have a specific, donor-directed purpose (e.g., research, financial aid, public service) and these funds represent the institution's promise to donors to use income and investment gains generated by their gifts to support an aspect of the university's mission, usually **into perpetuity**.

I'd like to highlight just two of our endowed funds at Indiana University:

- Jesse and Beulah Cox gifted IU with more than $92 million dollars for a scholarship endowment that currently provides 100 Indiana residents access to an IU education. Jesse Cox learned what hard work meant as a child working on a farm and came to believe that, "Accumulated knowledge is the greatest key to a future of happiness." Thus, he directed his wealth to this public purpose through the establishment of this gift.

- Another gift, established in 1990, the Wells Scholars Program has launched the careers of 557 students who have, for example, gone on to be the first concertmaster of the Berlin Philharmonic, a Native American rights attorney, an endowed professor at Yale, a member of the Committee on Homeland Security, a Foreign Affairs Officer, and a pediatric researcher studying youth violence.

Uniform state law provides fundamental rules for the investment of funds held by charitable institutions and the expenditure of funds donated as "endowments." Those rules support two general principles:

- Assets would be invested prudently in diversified investments that sought growth as well as income, and
- Appreciation of assets could prudently be spent for the purposes of any endowment fund held by a charitable institution.

In other words, endowment managers are obligated to support current students, but balance asset management goals to ensure there is support for tomorrow's students. These two principles have been the twin guide stars of asset management for endowments since the Uniform Management of Institutional Funds Act (UMIFA) became the law of the land in nearly all U.S. jurisdictions. The Uniform Law Commission approved the Uniform Prudent Management of Institutional Funds Act (UPMIFA) in 2006 and recommended it for enactment by the legislatures of the various states. UPMIFA is designed to replace the existing UMIFA, which was approved by NCCUSL in 1972, and has since been enacted in 49 states.

What is a spending rate?

The "effective spending rate" is the share of the endowment value withdrawn for spending on financial aid and other purposes (spending dollars divided by the endowment value). The spending rate is determined by institutions' trustees, typically an investment subcommittee of a college or university's board of trustees. About 26 percent of the largest 2014 NCSE endowments spent 5 percent or more.

The most recent NCSE study found that, from FY04 to FY14, the average spending rate fell from 4.9 percent to 4.4 percent. However, percentages can be deceiving. **Total dollar withdrawals increased from $360.6 million to $620.2 million** and the overall average spending from endowments **nearly doubled** from $11.4 million to $26.3 million.

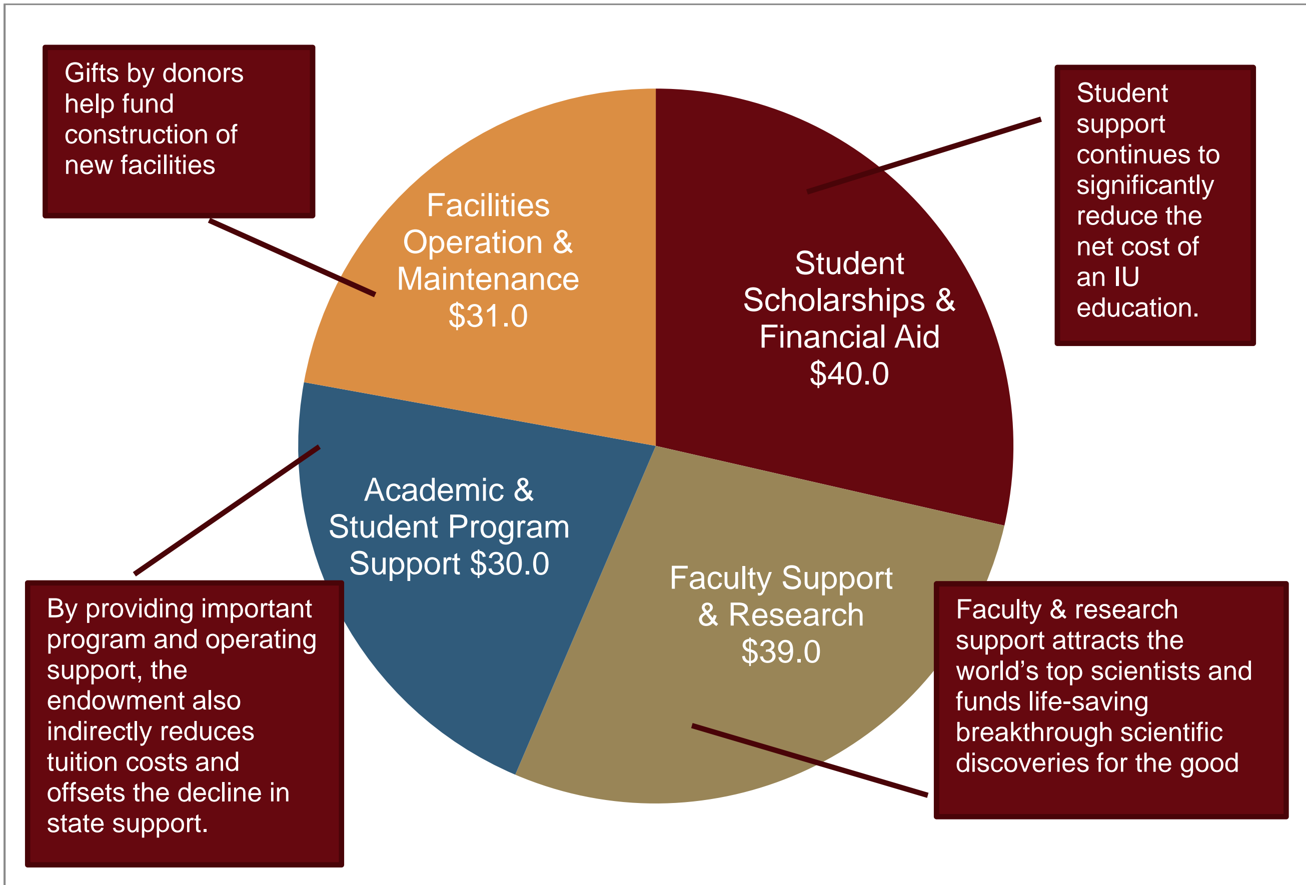
What are endowment withdrawals used for?

Most endowment spending is restricted to donor-directed purposes. **At Indiana University, unrestricted private funding support less than .1 percent of IU's annual operating budget.** Unrestricted endowment payouts at Indiana University recently supported emergency scholarships, expanding international outreach of the university and creating global opportunities for students and other priorities of the university president and board of trustees such as career support services and financial literacy programs.

The NCSE found that, in FY14, colleges received $7.7 billion in new financial contributions to their endowments. Of those new gifts, 90 percent were restricted for a specific purpose by the donors.

The chart below describes the breakdown, by purpose area, of IU's FY2014 endowment withdrawal. Student scholarships and financial aid are a significant—and growing—area of interest for our donors. The 2014 Voluntary Support of Education Survey, conducted by the Council for Aid to Education found that 43 percent of new gifts that were restricted were dedicated to student aid. It is important to note, however, that endowment spending on other operational areas relieves tuition pressure. In other words, covering institutional expenses with endowment payouts eases pressure to increase tuition revenue.

The Indiana University Foundation, in FY 2014, provided more than $140 million in philanthropic support (endowment and general accounts)
**amounts in millions*



Challenges Facing Institutions

Institutions across the country are facing numerous challenges: increased student expectations, rising labor costs, a growing variety of instructional delivery systems, and more stringent government regulations. These and many other forces are reshaping higher education.

Ten-year average annual endowment returns remain below the NCSE institutions' average long-term target rate of 7.4 percent (median target return rate is 7.9 percent). Moody's Investors Service continues to have a negative outlook for certain U.S. higher education sectors, due to declining revenue and falling enrollment. Standard & Poor's Rating Services also issued a negative outlook for nonprofit higher education for 2015. Student enrollments are expected to decline over at least the next decade, according to the Western Interstate Commission for Higher Education. And about half the states still spend less on higher education programs than prior to the Great Recession (2015 Grapevine report).

The way institutions respond today to each of these pressures will determine their financial condition not only now but also in the future. We take very seriously the responsibility we have in continuing to deliver on the public purpose of higher education. As economic, demographic, geographic, and cultural forces continue reshaping financial conditions, we are using the financial tools we have available to us to the best of our abilities to deliver on our missions and uphold expectations of all of our stakeholders.