Stanford University Endowment FAQ

What is the value of Stanford's current endowment?

As of the last audited statement for Aug. 31, 2014, Stanford's endowment was valued at $21.4 billion. This includes the value of Stanford's income generating endowed lands (such as the Stanford Research Park), in addition to traditionally invested funds. The endowed lands were valued at roughly $3 billion and the invested funds were valued at $18.3 billion. Each year, Stanford reports on its endowment in the university's annual report, available online at Stanford's Bondholder Information website.

What exactly is the Stanford endowment?

Stanford's endowment consists of gift funds set aside and invested to support the university's teaching and research missions in perpetuity. Part of what makes the management of endowments so challenging to explain is the notion of perpetuity. Endowments are designed to last forever. They are essentially trust funds for current and future students and faculty, including those who may not even be born for decades – if not centuries – to come.

When Stanford receives an endowment gift, it places the gift into an endowed fund. The university benefits from more than 7,000 endowed university funds, the vast majority of which are restricted. That means that donors have designated these gifts for specific purposes, for instance, financial aid for students with demonstrated need or funding for a faculty position in a particular field. "Restricted" means that a gift designated by a donor for one thing, say, the construction of a building, cannot by law be suddenly switched to fund something else, such as financial aid, even if an urgent need arises.

Each year, a small portion of the endowed fund is used to support the designated purpose of the fund. This is known as the endowment "payout." In a typical year, the investment returns exceed the payout, and the remainder of the returns are reinvested in the endowment to maintain its value over time. This reinvestment ensures that in future years the fund's payout can still support the same purpose, even after inflation.

What role does the endowment play in university financing?

Each year, the Board of Trustees approves a payout for the endowment. The target payout rate is 5.5 percent, but the actual payout is "smoothed" to account for market volatility. In 2014, the payout was 5.3 percent of the September 1, 2014, value of the endowment. In 2015, it is projected to be 5 percent.

These funds provide an essential source of income, as does sponsored research, student income and health care services. In 2014-15, endowment payout exceeded tuition and accounted for 21 percent of the university's sources of funds, or about $1 billion. After sponsored research it was the largest source of income for the university.

To put that into context, Stanford is a $5 billion enterprise. So taken to its extreme, if Stanford were to fund its teaching and research mission solely from its endowment and take in no new revenues, it would last just four years.

But that could never happen because, again, only the relatively small payout can be used from an endowed fund, and moreover, most of the endowment is restricted as to its use. In other words, Stanford must use gifts for the purpose designated by the donor. Approximately 29 percent of the endowment payout supports specified

instruction and research activities, 23 percent is restricted to student aid, 19 percent must be used for faculty salaries and support, and 6 percent is designated for libraries and other uses. The remaining 22 percent is unrestricted, but this income is also used to cover expenses incurred in carrying out the university's teaching and research mission, including additional student financial aid and salaries of essential faculty and staff.

How is the endowment used to reduce tuition?

Every dollar spent from the endowment to support the university is a dollar that does not have to be raised via tuition, whether it is spent on financial aid, on a faculty member's salary, or to support student health services or the registrar's office. Private universities like Stanford, which do not receive the state support that public universities do, rely heavily on endowment income to fill the gap between tuition and the actual cost of a university education. At Stanford, for instance, full undergraduate tuition covers less than 60 percent of the actual cost of the education and services a student receives. Gifts and endowment pay the rest. So even a student paying the full price of tuition is not paying the full cost of his or her education.

Endowment income reduces the tuition price for all students. But Stanford also has one of the most generous financial aid programs in the country, further reducing the cost for students with financial need. Stanford's undergraduate financial aid budget has more than doubled since 2007 and the university's financial aid program has recently been expanded. Parents with average resources and family income of $125,000 or less pay no Stanford tuition, and those with income of $65,000 or less pay no tuition, room or board. The average net price of Stanford tuition, room and board, once financial aid is considered, has actually gone down 4 percent over the past decade, adjusted for inflation. Approximately 50 percent of Stanford undergraduates receive need-based scholarships, and the average aid per student is over $37,000 per year.

What does the term "intergenerational equity" mean in terms of endowments?

Endowment spending at Stanford – and elsewhere – is done with the ultimate goal of intergenerational equity. In other words, the endowment should provide the same benefit for future students as it does for students today. So, the endowment's investment returns must, on average, both keep up with inflation and cover the current payout. If they do not, then Stanford will steadily spend down the endowment and shortchange students of the future. Stanford's target payout rate has been carefully chosen to achieve intergenerational equity.

Why not spend more of the endowment?

Again, a university's endowment is more of a trust fund than it is a checkbook. Trust funds have long-term horizons that, essentially, must last as long as the institution does.

If the university were to spend down the endowment by choosing a higher payout rate, it would not only cheat future students, it would also violate the wishes of the original donors. Donors give endowment gifts in order to support a designated purpose in perpetuity. Consider an endowment fund that today pays the full salary of a professor. In order to cover the full salary in 20 years, the fund must grow to keep up with inflation. If it does not, then the shortfall must be charged to tuition, thereby hurting future students and violating the original intent of the donor. This would be the inevitable result of spending the endowment at an unsustainable rate.

The same is true for an endowed scholarship or any other endowment fund. To fully support the intended purpose, now and into the future, the fund must grow to keep up with inflation. If all the investment returns are spent, and none reinvested, the support will shrink in real terms and future students will have to make up the difference.

Once again, Stanford's target payout rate of 5.5 percent has been carefully chosen, given historical investment returns and historical inflation rates. Higher education inflation has typically averaged between 4 and 4.5 percent, and Stanford's investment returns have averaged around 10 percent. If 4.5 percent must be reinvested in an endowment fund to keep up with inflation and the average investment return is 10 percent, then the remaining 5.5 percent is what can be responsibly spent from the endowment fund to cover current expenses. Spending at a substantially higher rate would eventually deplete the endowment.

How does Stanford manage its endowment?
The Stanford Management Company (SMC) was established in 1991 to manage Stanford's financial assets, including its endowment. SMC is a division of the university with oversight by a board of directors appointed by the university's Board of Trustees. SMC's board of directors includes investment professionals, the university president, the university chief financial officer, members of the Board of Trustees and SMC's chief executive officer.

The Stanford Management Company is responsible for managing what is called the Merged Pool on behalf of the university. The Merged Pool includes most of the university's endowment and expendable funds, as well as capital reserves from Stanford Health Care and Lucile Packard Children's Hospital – approximately $25.3 billion in total assets. For the 10 years ending June 30, 2014, the Merged Pool achieved an annualized rate of return of 9.9 percent.

SMC strives to balance risk and return objectives by investing in an equity-oriented, global investment portfolio that is well diversified by both asset class and geography. Portfolio management is disciplined and focused on long-term goals. Individual investment decisions are largely implemented by external investment firms and managers with whom SMC works.

Changes in total endowment value from year to year result from investment gains and losses plus endowment gifts and other funds transferred into the endowment, less the annual payout for university operations. The annual reports of the Stanford Management Company can be viewed online at Stanford's Bondholder Information website.

How does Stanford respond to the criticism that more of the endowment payout should be spent on financial aid for students and less on the financial professionals who manage endowment funds?
SMC carefully chooses external investment firms and managers based on their ability to generate the best returns net of fees. What this means is that, in the judgment of SMC, lower management fees could be achieved only by reducing total investment returns *after* management fees are deducted from the results. This in turn would lead to less, not more, endowment dollars available to support financial aid and other teaching and research expenses.

Suppose, for example, SMC chose to reduce external management fees at the cost of decreasing the net investment returns on the endowment by even one half of one percent. At the current size of the endowment, this would reduce the annual returns by approximately $100 million. That would be $100 million that would not be available for university expenses, including financial aid, and would require either cuts in aid and other expenditures, or an increase in tuition.

Large university endowments have achieved their historically high investment returns largely by selecting the highest quality funds and managers for each asset class in their portfolios. These are the same funds and managers

used by some of the most sophisticated private investors. If comparable results could be obtained while paying lower management fees, both endowments and private investors would certainly do so.

Stanford has one of the most generous financial aid programs in the nation, in large part because of the wise investment of the Stanford endowment over more than a century. Seventy-seven percent of graduates left Stanford debt-free last year. The median debt for the remaining 23 percent was $14,000.

How does market volatility affect Stanford financially?

The university takes a long-term view in managing its resources and employs specific measures to protect the budget from year-to-year extremes.

To mitigate year-to-year volatility in endowment returns, the university uses a diversified approach to investments. The Merged Pool is a diversified portfolio of actively managed public and private equity, absolute return, natural resources and real estate assets.

In addition, the trustees apply a "smoothing" formula, explained above, to buffer the annual budget. In periods of unusually high returns, for instance, the smoothing formula reduces the actual payout rate. In down markets, smoothing increases the payout rate. In either case, year-to-year fluctuations in the dollars available for the university budget are minimized.

But even smoothing cannot protect any college or university, including Stanford, from downturns such as that experienced in 2008. The financial downturn of 2008 affected Stanford profoundly, resulting in endowment losses, staff layoffs and reductions in our educational programs. There have been years in the university's history when the endowment lost money. In 2008, for instance, the endowment was valued at $17.2 billion. By 2010, it had dropped to $12.6 billion. Critics of university endowments often ignore the fact that endowments go down as well as up, depending on the market.

How long must a university endowment last?

Universities are unique institutions that must anticipate time horizons very different from individuals or businesses. This year, Stanford will celebrate its 125th anniversary. But we are a relatively young university: Harvard will soon have its 380th anniversary, while Oxford recently celebrated 800 years of continuous operation. At Cambridge University, Stephen Hawking held the same endowed faculty position, the Lucasian Professorship, that Isaac Newton held 300 years before him.

These time scales are hard to grasp, much less plan for. But the university's Board of Trustees has a fiduciary responsibility to ensure that its most reliable source of revenue – the endowment – will continue to make the education it provides students and the research it provides society both possible and affordable.

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