



February 22, 2008

Steven B. Sample

President and
Robert C. Packard
Professor

Senator Max Baucus
Chairman
Senator Charles E. Grassley
Ranking Member
Committee on Finance
United States Senate
Washington, D.C. 20510-6200

Dear Chairman Baucus and Ranking Member Grassley:

The University of Southern California is pleased to offer the enclosed response to the Senate Finance Committee's inquiry of January 25, 2008, concerning financial aid and the use of endowment funds.

The Role and Mission Statement of the University of Southern California states that the university's central mission is the development of human beings and society as a whole through the cultivation and enrichment of the human mind and spirit. This mission, so vital to our country in the 21st century, is accomplished mainly through teaching, research, artistic creation, professional practice, and selected forms of public service. Our mission also gives first priority to the education of our students, from undergraduates to professional graduate students to Ph.D. students to postdoctoral students.

USC has established a unique niche among America's "highly selective" private research universities. It is one of the largest private universities in the nation, educating more than 33,500 students each year, about half of whom are undergraduates. USC has dramatically improved the academic quality of its undergraduate student body over the past 15 years to the point that *U.S. News & World Report* now ranks its student selectivity in the company of Johns Hopkins University and the University of Chicago – and the USC community takes great pride that this has been accomplished *without* sacrificing access or diversity. USC enrolls more under-represented minority students (African American, Hispanic, and Native American) than most other private research universities in the country. It also enrolls a higher percentage of low-income students than any private research university in the country.

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USC's longtime commitment to access for low-income and under-represented minority students is made possible by the country's largest pool of financial aid, which includes income from endowment and a substantial annual allocation of unrestricted funds from the university's operating budget.

- 17.7 percent of the undergraduate population comes from low-income backgrounds.
- More than 9,000 undergraduate students receive student aid, a number larger than the total enrollment of many public and nearly all private universities.
- Graduation rates at USC are high, 85 percent after six years, and the graduation rates of low-income students are comparable to those of the student body in general.
- Tuition growth of 65 percent over the past 10 years was more than matched by an 80 percent growth in institutional grant funding. Institutional grant funding has grown by \$80 million over the past 10 years.
- USC has demonstrated a historic, unprecedented commitment to engaging its urban, predominantly working-class neighborhood. Just two examples:
 - The Neighborhood Academic Initiative, a tuition-free program for successful graduates of neighborhood high schools; and
 - The Good Neighbors Campaign, an annual university-wide fundraising drive to support the local neighborhoods. This year the campaign yielded more than \$1 million in donations from USC faculty and staff to neighborhood safety and education programs.
- USC has never had an early decision program, thereby encouraging students from all backgrounds to apply for admission.
- USC offers admission without regard to ability to pay.
- USC meets 100 percent of the demonstrated need of on-time financial aid applicants.

USC's past and present trustees, officers, faculty, and alumni have intended for USC's educational mission to be carried out in perpetuity, supported by an array of viable, long-term programs that teach existing knowledge while also spurring the creation of new understanding that can drive the national economy and the general prosperity. This commitment makes a research university such as USC distinctly different from for-profit entities, which are far more likely to reinvent or even jettison major portions of their enterprises in response to rapidly evolving market conditions. A mission that exists in perpetuity is served well by an endowment that can exist in perpetuity.

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Done well, a university education is never inexpensive, even at a public university with lower tuition; such an education requires an extraordinary commitment on the part of philanthropies, private industry, government agencies, and taxpayers, many of whom do not even have children of college age. Further, every student benefits from the use of the land, buildings, laboratories, libraries, endowed faculty positions, maintenance, and equipment that existed at USC before the student entered, and that were paid for by previous gifts. This reflects the reality that, in a nation such as ours, higher education is a cross-generational societal covenant.

Sound fiscal stewardship has undergirded USC's efforts to fulfill its mission since its founding in 1880. Although the USC community and the larger Southern California community have long aspired for the university to be as productive in meeting societal needs as any of the world's premier institutions, USC did not at the outset have some of the advantages of its older and wealthier peers, especially in the area of endowment. As such, the university's dramatic academic gains required an entrepreneurial and efficient approach.

USC's endowment has grown rapidly over the past few decades due to historic fundraising campaigns; yet if university endowments are adjusted for size, USC's endowment "per student" would still only be one-tenth that of Stanford, a university of comparable age, and one-twentieth that of Princeton, which is more than twice as old. Still, USC has managed to consistently pay out more than 5 percent of its endowment pool, often exceeding 6 percent and never falling below its floor of a 4 percent payout.

While there has been a great deal of discussion about how educational burdens are distributed, it should be noted that no student pays for the full cost of a USC undergraduate education. The costs of many aspects of the undergraduate experience are supported through a variety of means other than tuition or fees – so much so that even a full-tuition paying student covers only about 89 percent of his or her total educational cost, while the average USC student covers roughly 64 percent of his or her total instructional cost.

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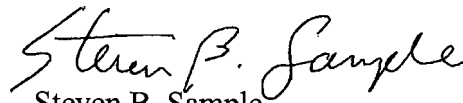
The USC community (the "Trojan Family," as we have called it for generations) is justifiably proud of our track record in managing limited resources in a way that opens up a world-class education to talented young men and women from every walk of life. USC's rapid rise in excellence and in reputation, unprecedented in modern times, has been linked to some degree to our success in growing our endowment; yet we remain largely dependent on the use of unrestricted operating revenue to meet both our short- and long-term objectives in building academic excellence and ensuring wide access to that excellence.

We believe our responses to the Committee's questions demonstrate our long-standing commitment to access for all societal groups; prudent management of our endowment to assure the sustainability of the university's mission for future generations; and a generous commitment of university resources to assist current students in paying for a USC education. We hope that congressional attention to these issues results in a larger national conversation among our citizenry, political leadership, and university faculty and administration about the future of higher education. The result can be a better understanding of the forces, issues, challenges, and opportunities that will drive our society's progress in coming years – as well as a re-energized commitment to the universities that are so inextricably tied to that progress.

This overview provides some background for the answers to the specific questions that the Senate Finance Committee poses. In addition, we have enclosed copies of our detailed Financial Report, which is also available on the web at <<http://www.usc.edu/private/factbook/USC.FR.2007.pdf>>. The University of Southern California has long provided perhaps the most informative annual financial reports of any peer private institution; past reports are also available on-line at <<http://www.usc.edu/about/ata glance>>.

Please do not hesitate to contact me directly, or Jennifer Grodsky in our Office of Federal Relations in Washington, D.C. at (202) 824-5860, if USC can provide you with further information.

Sincerely,


Steven B. Sample
President

Enclosures

Response from the University of Southern California

to the United States Senate Finance Committee inquiry into
university financial aid and endowment funding



February 25, 2008

Question 1:

Please provide the number of undergraduate and graduate students year-by-year for the last ten years.

As a highly selective, private research university, USC ranks among the largest in the country. Only Boston University and New York University are comparable in size.

USC intentionally maintains a large student population that is in the range of many major public universities, while simultaneously maintaining a smaller student to faculty ratio. One of the key aspects of the USC educational experience is the commitment to offering the full resources of a large university with the intimate community of a smaller college.

Figure 1. Student Population Fall 1997-Fall 2006¹

Academic Year	Undergraduate Students	Graduate Students
Fall 2006	16,449	15,689
Fall 2005	16,428	15,065
Fall 2004	16,272	14,877
Fall 2003	16,240	14,474
Fall 2002	16,021	13,752
Fall 2001	15,883	13,049
Fall 2000	15,571	12,721
Fall 1999	15,358	12,526
Fall 1998	15,218	12,476
Fall 1997	14,751	12,184

1. Does not include visiting students.

Question 2:

Please provide the total cost of undergraduate tuition (including all fees) – both sticker and average, mean and median – year-by-year for the last ten years. Please provide the amount of tuition assistance (not including loans or work study) that the university has provided to undergraduate students year-by-year for the last ten years. For the most recent year, please provide the percentage of students receiving university grants (for example 25 percent; 50 percent; 75 percent and 100 percent of tuition and fees). Please provide the average grant amount.

Undergraduate tuition and fees account for approximately 89 percent of the actual total cost of instruction. Room, board and miscellaneous expenses include the cost of living on campus as well as typical expenses including occasional travel home, entertainment, etc. In fall 2006, USC undergraduates paid an average of 68 percent of the total amount of tuition. This represents approximately 64 percent of the total cost of instruction.

Figure 2. Typical Undergraduate Budget Fall 1997-Fall 2006 ¹

Academic Year	Tuition and Fees	Room, Board and Misc.	Total Budget	Average Amount Paid	Average Paid as % Of Tuition
Fall 2006	\$33,892	\$10,190	\$44,082	\$22,899	68%
Fall 2005	\$32,008	\$9,610	\$41,618	\$21,630	68%
Fall 2004	\$30,512	\$9,063	\$39,575	\$20,762	68%
Fall 2003	\$28,692	\$8,632	\$37,324	\$19,581	68%
Fall 2002	\$26,956	\$8,512	\$35,468	\$18,206	68%
Fall 2001	\$25,533	\$8,128	\$33,661	\$17,108	67%
Fall 2000	\$24,123	\$7,610	\$31,733	\$16,215	67%
Fall 1999	\$22,636	\$7,282	\$29,918	\$15,076	67%
Fall 1998	\$21,374	\$6,978	\$28,352	\$14,304	67%
Fall 1997	\$20,480	\$6,748	\$27,228	\$13,681	67%

1. Average amount paid for tuition and fees. Student living arrangements and costs vary widely.

USC’s commitment to access is demonstrated in the tremendous rise in the average amount of USC aid provided to undergraduate students. In fall 1997, USC was providing approximately \$100.3 million to 9,462 undergraduate students. In fall 2006, we provided almost \$181 million to 9,715 undergraduate students. This represents an average-grant-per-student increase of more than 75 percent in the past ten years and an 80 percent increase in total aid provided from university funds.

Figure 3. University Aid to Undergraduate Students

Academic Year	University Aid to Undergraduate Students	# Students
Fall 2006	\$180,818,997	9,715
Fall 2005	\$170,496,639	9,850
Fall 2004	\$158,659,072	9,894
Fall 2003	\$147,968,205	9,910
Fall 2002	\$140,188,479	10,083
Fall 2001	\$133,818,174	10,078
Fall 2000	\$123,142,163	10,175
Fall 1999	\$116,102,426	10,075
Fall 1998	\$107,592,973	9,913
Fall 1997	\$100,288,908	9,462

Almost 60 percent of USC undergraduate students receive some form of university aid. This represents over 9,000 students – more than the total undergraduate population of most highly selective private research universities.

Figure 4. Percentage of Students Receiving Aid and Average Grant Amount, Fall 2006

Academic Year	Undergraduate Students				Graduate Students			
	Total # Students	# Students on Aid	% Students on Aid	Avg. Grant Amount	Total # Students	# Students on Aid	% Students on Aid	Avg. Grant Amount
Fall 2006	16,449	9,715	59.1%	\$18,612	15,689	6,379	40.7%	\$24,471

Question 3:

Please explain your university’s financial aid policy. How do you inform students and parents of that policy? What outreach efforts does your university take to recruit potential low-income students? How is low-income defined? What is the amount spent on these efforts?

All told, USC spent more than \$180 million on undergraduate financial aid in the 2006-07 academic year. These funds came from current operating revenue, from endowments (restricted and unrestricted), and from gifts (restricted and unrestricted). More than 70 percent of this money was used for need-based aid. This represents the country’s largest financial aid pool and provides a concrete demonstration of USC’s commitment to access and affordability.

Through the effective deployment of financial aid as well as other strategies, USC has created more diversity than almost any other private university – in terms of student backgrounds, income levels, interests and talents. This has been the result of a carefully constructed strategy for nurturing academic excellence with limited resources, often in ways that ran against the trend among USC’s peers. Unlike many of its peers, USC has been committed from its earliest days to admitting a significant number of transfer students, many of whom are among the most talented students from California’s many

junior colleges. Through this practice as well as other admission policies, we seek to make the academic experience of USC available to students who have grown up around our urban campus as well as to the top students from every corner of our nation and around the world. USC also has the largest international student population of any U.S. university.

USC is dedicated to helping all admitted students pay for a USC education. We are proud of our long-standing financial aid policy of meeting 100 percent of demonstrated financial need (as determined by USC's institutional methodology) for all eligible students. This need is met through a combination of state and federal grant, university grant, student self-help (such as work-study) and loans. The average amount of debt for USC undergraduates is only \$18,265 upon graduation.

Presently, a full 28 percent of all undergraduate tuition revenue (unrestricted operating funds) is set aside for undergraduate financial aid each year. These funds are fully expended on an annual basis. We believe the success of our efforts is demonstrated in our undergraduate population. We underscore that this is a commitment to access that we make from our unrestricted operating budget, in addition to the scholarships and financial aid provided from endowment income. This use of unrestricted money is necessary because, while USC has a relatively small per-capita endowment, it is committed to access for all qualified students.

USC's efforts to expand access to a university education include programs such as our innovative Neighborhood Academic Initiative (NAI), which turns college dreams into reality for low-income, under-represented, first-generation college-bound students and their families living in neighboring South Los Angeles. The NAI prepares such students for college through a rigorous six-year college preparatory program. Those who achieve a competitive grade point average and SAT score are offered a full scholarship to USC. In the 16 years since the program's inception, hundreds of students have been served by NAI. Many have gone on to graduate school and to successful careers, and many have mentored younger generations of inner-city students.

USC enrolls more under-represented minority students (African American, Hispanic and Native American) than most other private research universities in the country (3,190 as of fall 2007). Moreover, USC enrolls 17.7 percent low-income students (defined as Pell eligible). For purposes of comparison, according to the *Journal of Blacks in Higher Education* (Autumn 2007), Stanford University enrolls 12.6 percent of Pell eligible students; Harvard enrolls 11.9 percent; Duke enrolls 9.6 percent; and the University of Pennsylvania enrolls 8.8 percent. Most importantly, low-income students at USC graduate at rates comparable to the overall undergraduate population.

We have achieved these results through a combination of aggressive national recruitment strategies and targeted outreach to low-income and under-represented populations. USC visits over 750 high schools across the country each year. We hold more than 30 information receptions across the country each fall and an identical number of admitted student receptions each spring. The focus of all of these programs is to make prospective or admitted students and their families aware of the academic opportunities available at USC and our policy of meeting 100 percent of demonstrated need. In addition, USC engages in one of the nation's largest outreach programs to college-bound high school juniors and under-represented, college-bound high school seniors. These students are the foundation of our national recruiting efforts. We are also a participant in

the College Board Access Project, designed to identify best practices in the recruitment of low-income students.

The recruitment of low-income students is fully integrated into our overall national recruitment efforts. Therefore, it is not possible to dis-aggregate the amount of financial or human resources devoted to the recruitment, admission, enrollment and aid of these students.

Question 4:

Who determines when tuition increases are necessary? What is the process for making this decision? Does the full Board of Trustees vote on tuition increases? Are students, parents and the public provided an opportunity to comment on tuition increases prior to final decisions being made? What role does your university endowment play in providing financial assistance to students?

As part of the annual budget planning process, the tuition rate is reviewed, and a ceiling on any proposed tuition increase is presented to the Finance Committee of the university's Board of Trustees. The tuition increase is proposed by the university's Provost and Senior Vice President of Academic Affairs, and it is the result of careful consideration of a number of external and internal factors. External factors include inflationary increases borne by the university, such as increases in insurance or utility rates. Consideration is also given to how inflation affects the costs incurred by the families who are paying the tuition bills. Internal factors include plans for buildings and student-related capital projects (such as a new Student Campus Center and new Student Health Center, soon under construction), as well as the cost of instruction and instructional support, technology and infrastructure. As a private university, USC does not receive per-capita enrollment funding from state government and therefore relies heavily on tuition as a source of funding for financial aid, particularly for undergraduate students, and for operating expenses.

The President determines the new tuition rate, taking account of the ceiling set by the Trustees, and the new tuition rate is announced in the spring. Detailed information on tuition rates and all fees is sent out to current and prospective students.

Nearly a quarter of the expenses funded by endowment income relate to student aid and scholarships, meeting our commitment to access to the university for all qualified students from all backgrounds. Another quarter of the endowment income supports a top-quality faculty to teach the students, and about half of the income supports other aspects of the campus and educational experience, which frees up additional unrestricted revenue to support student aid.

Question 5:

Please explain how your university's endowment is managed and the role of the Board of Directors. What are your university's endowment payout and investment policies? What is the mission of your university's endowment? When was the last time that the university's endowment policy was reviewed? When will it next be reviewed?

The USC endowment pool is a pooled fund comprised of a variety of gifts, trusts, endowments, and other funds donated to the university. These pooled investments have been commingled in a unitized pool for purposes of investment. As of June 30, 2007, the pooled investments stood at a value of \$3.4 billion.

The Investment Committee of the Board of Trustees establishes the policies, objectives, and guidelines of the endowment pool and is responsible for assuring compliance with all investment policies. The Investment Committee is comprised of no fewer than five members of the Board of Trustees in addition to the ex-officio members. The Senior Vice President for Finance and CFO, the Senior Vice President for Administration, the Treasurer, and the University Budget Director attend meetings of the Committee and may participate in discussions but do not vote. The Investment Committee, meeting as frequently as necessary, reviews investment performance and activity, determines the asset allocations as well as the suitability of various asset categories and makes any such investments or changes in asset deployment as deemed necessary to attain the investment objectives. The Investment Committee reports regularly to the Finance Committee. The asset allocation and investment policy is reviewed at least annually and was last reviewed on February 13, 2008.

The mission of USC's endowment is to provide a stable foundation for long-term excellence in educational and research activities. The greater the endowment, the greater the ability of USC's decentralized network of professional schools, academic centers and research institutes to withstand temporary economic stresses and maintain a critical mass of talent and infrastructure. This is a challenge that is unique to non-profit research universities. Our response to this challenge stems from the use of a model that has served the educational, cultural and technological interests of the United States extraordinarily well since World War II, allowing the nation to remain the center of innovation amidst unprecedented global competition.

The university has a responsibility to the donors of endowment funds to maintain the principal of the gift in perpetuity relative to the value of the gift when the donation was made. In addition, the principle of intergenerational equity that guides the management of a university endowment ensures that future generations of students and faculty receive at least the same level of support from an institution's endowment as the current generation enjoys. Endowment pool assets should be invested to maximize the likelihood of achieving the minimum total annual rate of return necessary to support the programs and activities funded by the endowment and sufficient to preserve endowment purchasing power while maintaining reasonable and prudent levels of risk.

The endowment payout is determined each year by the Board of Trustees. The long-term goal is to generate a stable payout and to preserve the purchasing power of future payouts. The spending rate (payout per unit divided by the 12-quarter moving average of the endowment pool unit price, as of December 31 of the previous year) will range between four percent and six percent.

Question 6:

Please provide the year-by-year net growth of the university’s endowment for the last ten years (in both percentage and dollars). What is the amount of donations the endowment has received year-by-year for the last ten years? Please provide the percentage of investment in each asset class (equity, fixed income, hedge funds, private equity, venture capital, etc.) and the amount invested outside the United States.

When USC President Norman Topping and the university’s trustees began 50 years ago to set USC on a course toward becoming a top national research university, USC’s endowment was a mere \$3 million. That figure grew to \$470 million by the time that James Zumberge left the presidency in 1991. Since then, under the leadership of current President Steven B. Sample, an energetic fundraising approach and prudent, diversified investment strategies have built the endowment up to \$3.7 billion. The response to Question 9 will detail how nearly a quarter of the endowment income directly funds student aid, while the remainder strengthens the quality of the overall academic experience for the students.

Figure 5: Endowment Growth, 1997-2007

<u>Fiscal Year</u> <u>End</u>	<u>Market Value (\$)</u> <u>(in thousands)</u>	<u>Year to Year</u> <u>Growth (\$)</u>	<u>Year to Year</u> <u>Growth (%)</u>
6/30/97	1,204,672	-	-
6/30/98	1,432,786	228,114	19%
6/30/99	1,589,833	157,047	11%
6/30/00	2,152,589	562,756	35%
6/30/01	2,086,245	-66,344	-3%
6/30/02	2,130,977	44,732	2%
6/30/03	2,113,666	-17,311	-1%
6/30/04	2,399,960	286,294	14%
6/30/05	2,746,051	346,091	14%
6/30/06	3,065,935	319,884	12%
6/30/07	3,715,272	649,337	21%

Figure 6 (see next page) demonstrates a significant point: While USC’s endowment is larger than endowments of most of the United States’ 4,000 colleges and universities, it is substantially smaller than those of most of the peers with whom USC competes for students, faculty and research grants, particularly measured by the crucial “endowment per student” which provides a sense of the magnitude of expense of education that must be borne by other sources of revenue.

Figure 6: Endowment comparison per student

Institution	June 30, 2007 Endowment ¹ (in thousands)	Student Enrollment ²	Endowment per Student
Princeton University	15,787,200	7,145	\$2,209,545
Yale University	22,530,200	11,358	1,983,641
Harvard University	34,634,906	20,042	1,728,116
Stanford University	17,164,836	14,890	1,152,776
Massachusetts Institute of Technology	9,980,410	10,220	976,557
California Institute of Technology	1,860,052	2,086	891,684
Duke University	5,910,280	12,824	460,876
University of Chicago	6,204,189	13,750	451,214
Emory University	5,561,743	12,338	450,782
Washington University	5,567,843	13,527	411,610
Northwestern University	6,503,292	18,506	351,415
Brown University	2,780,798	8,025	346,517
Vanderbilt University	3,487,500	11,847	294,378
Columbia University	7,149,803	24,644	290,123
University of Pennsylvania	6,635,187	23,980	276,697
Cornell University	5,424,733	20,638	262,852
University of Rochester	1,726,318	8,698	198,473
Case Western Reserve University	1,841,234	9,844	187,041
Johns Hopkins University	2,800,377	19,708	142,093
University of Southern California	3,715,272	31,508	117,915
Carnegie Mellon University	1,115,740	10,402	107,262
Tulane University	1,009,129	10,509	96,025
New York University	2,161,800	38,391	56,310
Syracuse University	1,086,143	19,802	54,850
Boston University	1,101,386	29,341	37,537

1. 2007 NACUBO Endowment Study (Public NES tables)
2. Data available from university websites

The university's investment policy is to use a multiple asset class approach to investing. Because investments within asset classes may perform differently under similar market conditions, diversification across asset classes helps reduce volatility. The upward movement of one asset class may help offset the downward movement of another as economic and financial market environments change over time.

The endowment pool is currently invested in the following asset classes:

Domestic & International Equity – USC hires managers who invest in large, mid, small, and micro capitalization stocks domiciled in the U.S and in developed and emerging market countries. Core, value, growth, fundamental, and quantitative investment approaches are utilized.

Fixed Income – USC hires managers who invest in investment grade U.S. securities (treasuries, agencies, corporates, mortgages, asset-backed, etc.), non-

investment grade U.S. securities (high yield), international bonds, and emerging market bonds.

Distressed Obligation - USC hires managers who invest in debt obligations of U.S. and non-U.S. companies that are potentially or actually insolvent due to a wide range of economic and operating factors or are trading at 1000 basis points or more over Treasury securities of similar maturity. The managers may utilize an active for control or non-control strategy (investment strategies which actively influence the restructuring process) or a trading or passive strategy (strategies which do not influence the restructuring process).

Hedge Fund – USC hires managers who utilize one or more of the following strategies in and outside the U.S.: relative value (convertible arbitrage, equity market neutral/statistical arbitrage, fixed income arbitrage), event driven (high yield/distressed, special situations, risk/merger arbitrage), equity long/short, global macro, managed futures, in addition to other diverse strategies.

Natural Resources – USC hires natural resource managers who invest in and outside the U.S in oil and natural gas-related companies and properties, as well as investments in power-related sub-industries and timber.

Private Equity/Venture Capital – USC hires private equity and venture capital managers who invest in and outside the U.S. Venture capital managers make investments in start-up and early-stage, high-growth private companies. Private equity managers make investments in companies (most with positive cash flow or profit) through acquisitions, leveraged buyouts, management buyouts, recapitalizations, reorganizations, privatizations, restructurings and spin-offs.

Real Estate – USC hires real estate managers who invest in companies and properties in and outside the U.S. and who are diversified by property type (residential, industrial, office, retail) and geographic location. Public real estate managers invest in REITs (real estate investment trusts) and private real estate managers invest in properties utilizing a value-added or opportunistic investment strategy.

Question 7:

Please explain how you determine what is considered part of the university endowment. In other words, how is your endowment defined? Are there other long term investments that are not included in the endowment as reported to NACUBO? If so, what are they and what are their values?

The funds to establish an endowment are based on the original principal amount of the gift invested in perpetuity providing an annual return that will support expenses associated with the purpose of the endowment. The principal types of endowment are:

True Endowment: This can be created only at the request of the donor. The donor specifically states that the original principal amount of the gift is to be invested in perpetuity and only the income is to be used according to the restrictions set forth by the donor gift.

Quasi-Endowment, also known as Funds Functioning as Endowment: This is created by investing unrestricted or restricted gifts as though they were endowment and using only the income in accordance with the original restrictions of the gift. The ability to create quasi-endowment rests with the governing board of the institution. The USC Board of Trustees has authorized deans to make this decision regarding the use of their gifts.

Term Endowment: This can be created only at the request of the donor. The donor specifically states that the original principal amount of the gift is to be invested for a specific period of time or until the occurrence of a specific event. Only the income is to be used in accordance with the restrictions set forth by the donor. After the restrictions on the original principal amount have lapsed, the fund, along with any gain or loss, is transferred in accordance with the donor's stipulations.

USC has \$330,164,000 in life income and annuity funds that are not included in the endowment.

Question 8:

What has been the cost of management of the endowment year-by-year for the last 10 years?

The university's Treasurer's Office hires external investment managers to manage the assets of the endowment pool. USC does not own a management company. For the past 10 years, the cost of managing the endowment as measured by an expense ratio has been between 28 and 77 basis points. This expense ratio includes the cost for the university staff, external investment management fees, custodian costs and all other miscellaneous expenses associated with managing the endowment. It does not include any fees paid to alternative investment managers that have a management fee/incentive fee structure as this number is not quantifiable. If USC employs a fund of funds manager, it does not include an estimate for the fees paid to the underlying managers, but it does include the fee paid to the fund of funds manager.

Question 9:

What is the payout (both in dollar and percentage) from the endowment year-by-year for the last ten years? What is the targeted payout (in percentage) from the endowment year-by-year for the last ten years? If either the actual and/or targeted payout is below 5 percent, please explain how this meets the needs of the current student body. If there is a material variation between actual and targeted, please explain. What were the top 10 major expenditures from the endowment last year?

The university uses a spending rule for its pooled endowment in order to maximize the current and long-term investments in the endowment pool. The spending rule calls for an annual distribution of no more than 105 percent of the prior year's payout, with a minimum of 4 percent and a maximum of 6 percent of the average market value for the previous 12 calendar quarters. Over the years, exceptions to this policy have been approved either due to budget constraints or market performance. The payout amount has never fallen below the floor of 4 percent, but exceptions have been approved to exceed the 6 percent ceiling.

Figure 7: USC's Endowment Distribution Rates

Fiscal Year	Average of Previous 12 Calendar Qtrs	Payout per Share	Payout as % of Average Market Value
1987-88	\$140.99	\$8.46	6.00%
1988-89	\$159.75	\$8.88	5.56%
1989-90	\$171.79	\$9.32	5.43%
1990-91	\$179.75	\$10.79	6.00%
1991-92	\$182.73	\$10.28	5.63%
1992-93	\$192.35	\$12.82	6.67%
1993-94	\$200.24	\$12.82	6.40%
1994-95	\$217.93	\$12.82	5.88%
1995-96	\$227.50	\$12.82	5.64%
1996-97	\$240.11	\$13.05	5.44%
1997-98	\$254.36	\$13.27	5.22%
1998-99	\$284.49	\$14.22	5.00%
1999-00	\$318.27	\$15.91	5.00%
2000-01	\$353.95	\$19.47	5.50%
2001-02	\$418.59	\$22.31	5.33%
2002-03	\$457.70	\$22.88	5.00%
2003-04	\$467.95	\$22.88	4.89%
2004-05	\$436.36	\$22.88	5.24%
2005-06	\$437.99	\$23.57	5.38%
2006-07	\$475.64	\$24.28	5.10%

Like most other universities, USC has adopted policies that aim for consistent equity over generations. This helps ensure that succeeding generations of students and faculty enjoy the same level of support from the endowment. The resulting financial stability is crucial to the educational and research missions of USC and other colleges and universities; unlike most for-profit entities that adjust their activities rapidly in response to market conditions, university activities are primarily long-term and not easily changed without a loss in quality.

USC operates through a relatively decentralized budget process, where the deans of the College of Letters, Arts and Sciences and the professional schools are empowered to make decisions to use their resources, including endowment income, to best meet their teaching and research missions. The top priorities for such expenditures are as follows:

About 23 percent of the expenses funded by endowment income directly relate to student aid and scholarships, meeting our commitment to enabling access to the university for all qualified students from all backgrounds. Much of that student aid is targeted to undergraduate students, enabling them to pursue USC's unique curriculum that encourages "breadth with depth" (the ability for a student to focus in depth on two or more widely separated academic disciplines, so that she gains more breadth than a

specialist would and more depth than a generalist would), and to take advantage of the opportunities to participate in a meaningful, hands-on way in cutting-edge research.

Roughly 24 percent of the expenses funded by endowment income are related to compensation and research support for a world-class faculty that we expect to transmit existing knowledge while discovering new intellectual, cultural and technological frontiers. Again, these funds directly serve the teaching and research missions of the university. For example, our innovative undergraduate core curriculum is taught entirely by tenure and tenure-track faculty, many of whom receive financial support from endowment funds. In some cases, the endowment income allows researchers to purchase equipment necessary to produce research in the basic and applied sciences with societal impact, and that work often includes undergraduate students and almost always involves our Ph.D. and other graduate students.

One illustration of the relationship between the undergraduate academic experience and endowed professorships involves a faculty endowment fund established by David and Dana Dornsife. Their generosity allowed USC to recruit Professors Antonio and Hanna Damasio, two eminent neuroscientists who are leading a new USC institute devoted to the study of the brain and human creativity. At the Brain and Creativity Institute, one undergraduate student has been investigating what happens in the brain during spiritual experiences that can occur in religious as well as secular settings. He is examining whether the variety of such experiences involves a common pattern of brain activity independent of any particular belief. To further explore this issue, he is testing the response of individuals to musical experiences while an fMRI scanner measures their brain activity. This undergraduate student is only one of several who work with the Damasios, and only one of many who work with our other top researchers who hold endowed chairs and professorships. Such a richly rewarding approach to research increasingly reflects the undergraduate experience that USC promotes—and it is made possible by endowment.

Finally, a significant portion of endowment income funds acquisitions for our library; these acquisitions are not just traditional books and journals, but also include an emerging digital collection that will allow our library to lead in the creation of the University Library of the 21st century. Again, these library resources contribute directly to our teaching and research objectives, and our library resources and digital collections also support researchers from across the nation and the world.

Question 10:

How much of the endowment is subject to permanent spending restrictions or limitations set by the original donor? Of the portion subject to permanent limitations, what percentage is restricted for need-based scholarships? What portion is restricted for undergraduate financial aid? Please provide the top five types of restrictions on the endowment by category. What percentage of the endowment is subject to significant limitations placed on it due to a decision by the board (or a subcommittee of the board) or a college or university official – such as a set-aside for a specific program? Please provide the investment return to the endowment year-by-year for the last ten years.

Approximately 68 percent of USC's endowment is subject to permanent spending restrictions set by the donor. It would be extremely burdensome to analyze the funds subject to permanent spending restrictions to calculate the percentage restricted for need-based scholarships for undergraduate financial aid. As we noted earlier, however, more

than 70 percent of our substantial financial aid pool, which includes funds from endowment income, is provided to students with need.

The top areas involving restrictions on the use of endowment are:

- Institutional support – 51 percent
- Chairs/professorships – 24 percent
- Student scholarships – 23 percent
- Operations & maintenance – 2 percent

Roughly 32 percent of the endowment is subject to significant limitations placed on it due to a decision by the board, subcommittee or university officials. When an academic unit within USC receives a significant gift or bequest toward a particular academic program, the unit enjoys a quick influx of cash to that program. However, because such an infusion most likely cannot be sustained over time and may result in counterproductive spurts of growth and decline, a dean may request that the gift be treated as endowment. Designating funds as “quasi-endowment” generally has been an effective way to advance the university’s academic mission over the long term.

Endowments and restricted gifts designated by donors for financial aid make an important difference in the lives of our students. For example, the Rose Hills Foundation made a \$1.84 million multi-year gift to provide support to undergraduate students from Southern California who are studying science and/or engineering. In fall 2006, more than \$400,000 was awarded from this fund to undergraduate students with financial need. Eighty-one needy students from USC’s neighborhood in Los Angeles received over \$400,000 in aid from USC’s Norman Topping Student Aid Fund. This fund was established by USC undergraduate students to provide aid to needy students from our local area. These are just a few examples of the many students supported through the generosity of students, alumni and friends of the university.

Figure 8: Annual Returns on Pooled Endowment

<u>Fiscal Year End</u>	<u>Market value (\$)</u> <u>(in millions)</u>	<u>Total Annual</u> <u>Return (%)</u>
6/30/98	1,101	19.74
6/30/99	1,248	10.13
6/30/00	1,794	40.42
6/30/01	1,704	-3.84
6/30/02	1,809	-7.22
6/30/03	1,768	1.46
6/30/04	2,002	16.86
6/30/05	2,334	17.80
6/30/06	2,627	14.16
6/30/07	3,407	20.17

Question 11:

Please explain the fee arrangement for investment advisors. How is the fee and compensation measured and determined? What is the process to review reasonableness of the fee and compensation and what comparables are used? Who reviews and approves the fee? Who pays the fee (the endowment, general funds)? Please explain what relationship, if any, exists between endowment size and/or growth and the compensation given to the college or university president and the endowment manager. Please list what endowment-related bonuses, if any, either the college or university president or the investment manager has received year-by-year for the last ten years.

Fees paid to the endowment's investment managers, all of whom are external, are usually measured as a percentage of assets under management. In a few cases, there is an incentive fee arrangement. Most of the alternative asset managers are paid a management fee and also receive a percentage of the profits (carried interest). For the non-alternative managers, fees are compared to other managers from a database provided by USC's consultant, Cambridge Associates. Fees paid to the alternative managers are compared against managers in the same asset class and same quartile of performance. For example, USC would be willing to pay a higher fee to a consistently top quartile venture capital manager. Net of fee performance numbers are also used as part of the decision-making process to hire a new manager and are compared versus the appropriate peer group. The fee arrangement for any new manager is presented to the Investment Committee of the Board of Trustees for approval after review by the Treasurer's Office. No one at the university receives a bonus specifically tied to the performance of the endowment. Endowment growth and performance may be used as one of many qualitative measures when determining the bonus of certain university employees.

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