



Q&A with Earlham's Vice President for Financial Affairs, Dick Smith

Question: What are Earlham College's sources of revenue and how much of the daily operating budget do they fund?

Answer: For the College, student-driven income — tuition, room and board — accounts for 73% of Earlham's annual \$43 million operating revenue. However, income from past and present donor gifts is critically important and totals \$9 million — \$7.2 million from the unrestricted endowment and \$1.8 from current giving. Donor-generated income accounts for 19% of the operating budget.

Question: Some people say that the College's endowment is large enough already. Is this accurate?

Answer: While the endowment is large relative to those of many colleges, endowment income is still insufficient for some major needs — particularly financial. Last year, 2007-08, we distributed over \$17 million in College grant aid. Two million was funded directly from scholarships that are restricted by donors for financial aid, \$7.2 million came from the unrestricted endowment and \$500,000, from annual donor-restricted gifts. Even so, there is a short-fall of over \$5 million in financial aid that is not covered by donors or the endowment. And, while the College strives to make Earlham affordable for every student, the College still must package loans as part of financial aid for moderate- and high-need students.

Many people also forget that over 10% of the Earlham endowment is restricted for use by the Earlham School of Religion and is not available for support of the undergraduate College.

Question: How has Earlham's endowment performed over the last decade, especially considering recent national economic conditions?

Answer: For the past decade ending December 31, 2007, the Earlham endowment had an average annualized return of 10.4%. For the 2007 calendar year, the endowment earned 9.4% — a year in which the S&P 500 Stock Index returned 5.5% and the Lehman Bond Index returned 7.0%. Since 1986, the endowment has earned an annualized 11.1% on average.

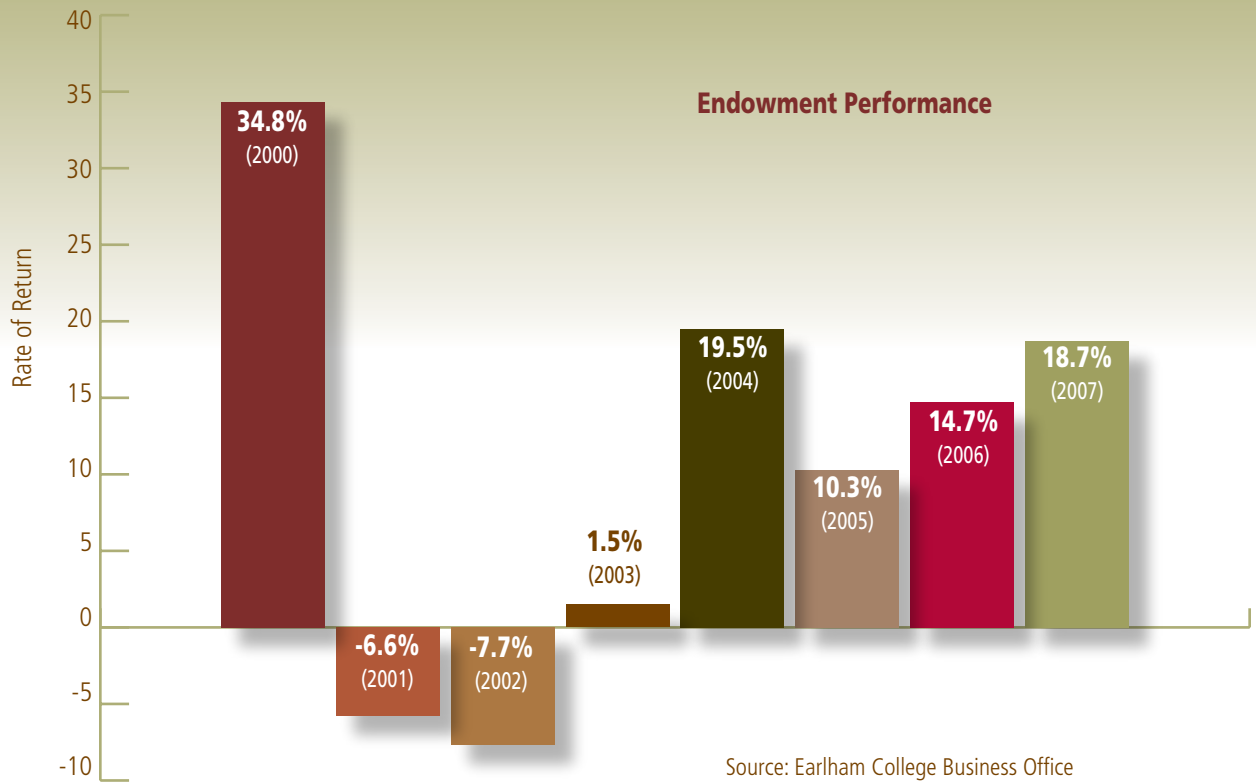
Question: How is the Earlham endowment invested?

Answer: From fairly simple beginnings in 1976 when there were three external managers — bonds, growth equities and value equities — in addition to Eli Lilly company stock, the investment mix has become more diversified and more return-oriented. As of December 31, 2007, 13.3% was invested in traditional bonds and cash, and 33.8%, in U.S. domestic equities. The remaining investments include a large concentration in international equities (19.3%), private equity partnerships (15.4%), and real estate and natural resource partnerships (7.4%) with the remainder in "hedge-fund"-type funds (10.7%).

Question: Earlham says that it cares about being a socially responsible investor. How does Earlham make this happen? What roles do students play?

Answer: Since 1971, the College has had a formal policy on socially responsible investing with a student-faculty-trustee committee that made recommendations on divestiture and that voted proxies on social issues. During 2006-07, a student-faculty-trustee committee wrote a new Socially Responsible Investment Policy Statement (available at www.earlham.edu/policies/investing.html). This past year, the new

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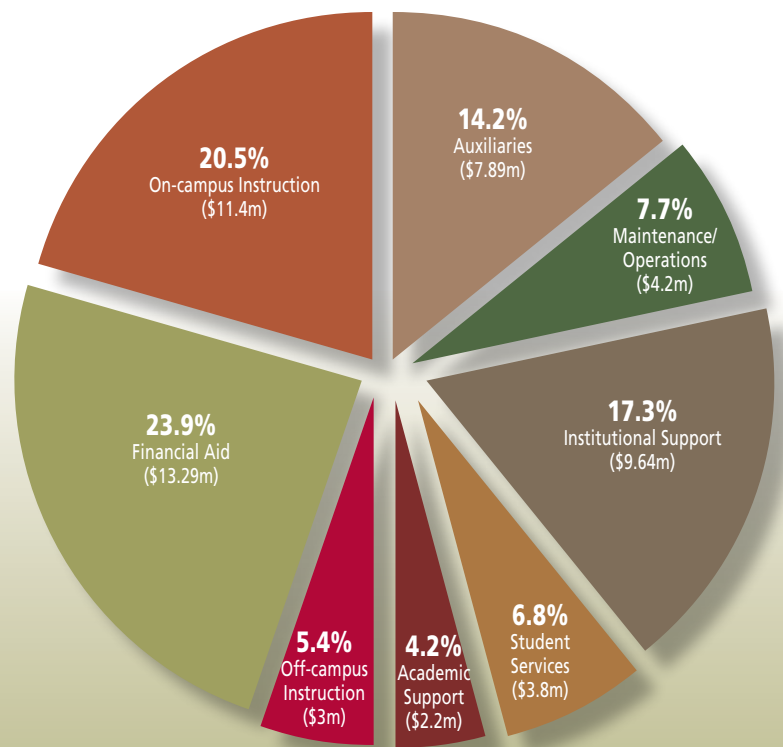


Socially Responsible Investment Advisory Committee (SRIAC) reviewed investment holdings, made recommendations on companies to be excluded and voted proxies on social issues. In addition, the Earlham endowment has made a commitment to support a new Energy Technology Partnership that invests in alternative energy companies and in improving energy efficiency.

Question: In these interesting and challenging financial markets, how exposed is the endowment to investments like subprime mortgages and credit default swaps?

Answer: Each of our two fixed-income managers invests in “core strategies” without much exposure specifically to subprime mortgages; however they do hold other mortgage-backed and asset-backed securities that have declined in price. The managers believe that those securities remain underpriced and will regain value as confidence in the credit markets improve. One of our short-term managers, the Commonfund, has restricted withdrawals but this restriction has not been a major burden. In general, the endowment has moved in the general direction of the market. Because of our overall diversification, we remain confident that there should not be any shortfalls unique to Earlham and its investments.

Operating Budget Expenses 2007



Source: Earlham College Business Office