

Capped Costs, Increasing Pressures: The Impact of Indirect Rate Limits on Institutional Finances

Indirect cost rates, also known as facilities and administrative (F&A) rates, are a critical yet often overlooked element of federally funded research. These rates help higher education institutions recover the real and growing costs of supporting research infrastructure expenses—including lab maintenance, compliance oversight, and grant administration—that cannot be directly attributed to a single project. As research demands and regulatory requirements have increased, so too have the associated indirect costs. Through complex negotiations with the federal government, institutions have secured rates to reflect these realities, some more than 60 percent. However, recent efforts by federal agencies to drastically cap indirect cost rates at 15 percent threaten to impose severe financial strain on research institutions, particularly those without substantial endowments or diversified funding sources. This brief examines how potential funding reductions may impact institutions' financial stability, research capacity, and, ultimately, the United States' global leadership position in science and innovation as legal challenges to these caps continue.

WHAT ARE INDIRECT COST RATES?

Higher education institutions apply indirect cost rates to federally sponsored research projects—for example, projects funded through grants or contracts—to reimburse that institution for the overhead costs associated with supporting that research. Indirect costs are not easily attributable to a specific project and are grouped into two categories:

- **Facilities**, which includes buildings and equipment depreciation; operation and maintenance (utilities, janitorial services, etc.); and library expenses.
- **Administrative**, which includes general administration (HR, payroll, purchasing); departmental administration; project administration; and compliance costs (institutional review boards, conflict of interest management, etc.).

HISTORY

Prior to World War II, federally funded research was nearly nonexistent. During the war, the Office of Scientific Research and Development (OSRD) invested heavily in the development of new technologies to support the war effort. University researchers made significant advances in the sciences, medicine, and engineering, and faculty-led research expanded into other federal agencies as well. However, both the federal government and higher education institutions recognized the need for institutional infrastructure and their respective costs, so federal agencies began reimbursing these costs through grants and contracts. From 1958 to 1963, Congress increased the flat rate of 8 percent to 20 percent, which Congress made a statutory limit. In the years after the war, higher education institutions and the federal government continued cost reimbursement conversations. In 1958, the Bureau of the Budget—later, renamed the Office of Management and Budget (OMB)—issued federal guidelines for determining indirect costs.

Over the years, there have been many revisions to these guidelines.¹ OMB fixed the *administrative* cost reimbursement rate at 26 percent in the 1990s; however, each institution negotiates its own *facilities* cost rate with the federal government,² and as a result, each institution has a different overall indirect cost rate, some of which are more than 60 percent.³

Notably, universities are the second-leading funder of academic research and development behind the federal government, and the inflation-adjusted dollars that universities spend on research have increased over the years, faster than any other sector. Much of the increased costs for research are due to increased compliance—an administrative indirect cost. Yet, the administrative indirect cost rate cap that universities can charge has remained flat for more than two decades and is lower than other entities' caps. For instance, federal and industrial laboratories have a slightly higher rate at 33 percent and 36 percent, respectively. Additionally, the federal government does not pay profit to universities for research, making the cost of research at universities a good value. Note that higher education institutions are subject to compliance requirements and strict oversight that do not apply to other sectors.⁴

WHAT HAPPENS WHEN INDIRECT COSTS ARE NOT REIMBURSED?

Higher education institutions often absorb unreimbursed indirect costs. A university may absorb these costs for a number of reasons, which include:

- **Developing Strategy.** The institution may want to gain access to prestigious or high-impact research opportunities, maintain or build strategic partnerships, support junior faculty or disciplines with fewer funding options, or consider the underfunded grant as a steppingstone to future funding.
- **Maintaining Competitiveness.** If peer institutions are willing to accept lower indirect cost rates, a university may do the same to remain competitive in procuring grants or attracting top researchers.
- **Supporting the University's Research Mission.** Even if indirect costs are not fully recovered, they may fund the difference to advance knowledge and innovation, contribute to societal goals, or support faculty development and student involvement in research.

- **Protecting Infrastructure and Programs.** By absorbing unpaid costs, universities can keep labs running, retain research staff, or avoid gaps in long-term projects that would otherwise lose momentum.

Federally funded research does not just occur at large research universities. Smaller regional universities and private colleges and community colleges with research programs receive research grants. In comparison to larger universities that access funding through endowments and philanthropic networks, these smaller institutions typically are resource-limited, with fewer funding channels to supplement overhead costs. Therefore, they will likely feel the impact of indirect cost rate caps more severely.⁵

When the federal government does not reimburse costs, systems or institutions often require a formal waiver process prior to receiving a grant. Through this process, the institution justifies the deviation from the expected indirect rate, reviews the resulting financial impact, and ensures that the institution can support the project without full support of indirect costs.⁶ Additionally, some states, such as California, allow state-appropriated funds allocated to universities' general funds to recover unreimbursed federal indirect costs;⁷ however, some states, such as South Dakota, disallow state funding or tuition dollars to be used to cover indirect costs.⁸ The latter is more common than the former.

RECENT EVENTS

Along with the new administration and drastic and far-reaching funding cuts, the National Institutes of Health (NIH), U.S. Department of Energy (DOE), and, most recently, the National Science Foundation (NSF) announced implementing caps on indirect cost rates at 15 percent for grants made to higher education institutions.^{9,10,11} The capping of indirect cost rates risks reducing research capacity, delaying scientific advancements, and diminishing the United States' leadership position in global innovation. Many institutions have initiated hiring freezes, paused research projects, and considered reducing graduate student admissions due to anticipated budget constraints. These developments underscore the critical role that indirect cost reimbursements play in sustaining the research infrastructure of universities. The reduction in funding threatens not only current research activities but also the long-term viability of institutions' research missions. Examples of impacted institutions include:

- **University of Massachusetts.** There are currently more than 500 NIH grants across the UMass system, totaling \$248 million, with more than \$80 million directed toward indirect costs. At UMass Amherst, NIH funding accounts for 18 percent (\$44.8 million) of the FY24 research budget, with \$13.1 million allocated to indirect costs. The proposed indirect cost rate cap will have a deep impact and result in a loss of as much as \$10 million and, as the university's vice chair of research and engagement noted, will reduce "support and opportunities for research and training in biomedical engineering, chemical engineering, civil engineering, electrical engineering, mechanical engineering, agriculture, biology, public health and health sciences, mathematics, chemistry, psychology and other programs."¹²
- **University at Buffalo.** The university estimates that the 15 percent cap will result in a loss of at least \$47 million over the next three to five years, jeopardizing its ability to conduct lifesaving medical research. The university noted, "NIH-funded research at UB is focused on a wide range of vital lifesaving projects, including developing new treatments for multiple sclerosis,

improving health outcomes for cancer patients receiving chemotherapy, saving the lives of newborns during neonatal resuscitation, developing new methods to detect potential brain aneurysms, and investigating the major causes of disease and death in women.¹³

- **Duke University.** Facing a reduction from its current 61 percent indirect cost rate, Duke has implemented hiring freezes and postponed expansion projects, decreased the number of PhD students admitted, decreased funding for current students, and postponed capital projects.¹⁴
- **Medical College of Wisconsin.** The Medical College highlights that the cap would have immediate and long-term consequences, directly impacting the timeline for developing treatments and cures for various diseases.¹⁵
- **Baylor College of Medicine and MD Anderson Cancer Center.** These Houston-based institutions could lose tens of millions of dollars, affecting overhead costs, like support staff and lab space, and hampering their research capabilities.¹⁶

A coalition of universities and higher education associations filed lawsuits against both the NIH and DOE policies.¹⁷ As of this writing, a permanent injunction has been placed against the NIH rate cap, which the administration is appealing.¹⁸ A temporary injunction is currently in place against the DOE rate cap.¹⁹ In addition, legal challenges are expected against the recent NSF policies.²⁰ As legal proceedings continue, the research community remains vigilant, advocating for policies that support the full cost of conducting federally funded research and maintain the nation's competitive edge in science and technology.

HOW DO WE PREPARE FOR THE WORST?

Despite the legal challenges and injunctions, higher education institutions are taking measures to minimize hardships resulting from the potential forthcoming indirect rate caps. They have begun implementing staffing adjustments, such as instituting hiring freezes, eliminating vacant positions, and offering voluntary buyouts.^{21,22}

Additionally, institutions have been encouraged to limit their exposure to cuts in federally funded research by diversifying funding sources—such as private industry and philanthropic organizations—reexamining grant budgets to reallocate eligible indirect costs as direct costs, and pursuing internal strategies, such as using endowment income or launching fundraising campaigns to support research infrastructure.²³

CONCLUSION

Indirect cost rates are central to sustaining research across American higher education. These reimbursements help cover the essential infrastructure that makes research possible, including maintaining labs, managing compliance, and administering grants. Proposals from some federal agencies to cap these rates at 15 percent risk weakening the very foundation that supports innovation. Institutions across the country, especially smaller colleges without large endowments or diverse funding streams, are already feeling the strain.

In the meantime, many universities are having to make compromises that adversely affect faculty, including hiring freezes, reduced research activity, and cuts to graduate programs. It is important

to understand that as the legal challenges continue, underfunding the full cost of research does not just hurt institutions, but it also slows progress, limits advancements, and puts America's leadership in science and technology at risk.

Note

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