Key Questions

What Does the Future Look Like for Higher Education?

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The college experience of the past might never look the same, and the divide between the haves and have-nots may only grow wider as a result.

Last week, we addressed the critical back-to-school season, highlighting its significance to our economy and society. Our conclusion: Experimentation, adaptability, and innovation -– hallmarks of our educational system -– are needed now more than ever.

This week, we delve deeper into the unique challenges facing higher education today. We believe that until a vaccine emerges and is commercially available, the college experience that many have known might never look the same. Further, many of the disruptive forces that have gained prominence in recent years are poised to intensify, and the divide between the haves and haves-not may only grow wider as a result.

There are approximately 4,000 post-secondary institutions in the US, split roughly between 1,600 public and 2,400 private institutions (including both non-profit and for-profit organizations). From the early 1970s through 2010, the growth of the number of schools was stable, typically rising or falling no more than 1% per year. Since then, however, the number of institutions of higher learning has fallen, with last year witnessing a decrease of 6.3% year/year, the most significant drop-off ever.

The decline in the number of institutions has been led by for-profit organizations. These institutions have been halved since 2012, as many have called their business practices into question. However, the number of both “traditional” public and private institutions has also declined. A record number of non-profit private institutions closed their doors in 2019.

School closures are rising amid declining enrollment: Over the past eight years, college enrollment nationwide has fallen about 11%, with all segments facing similar pressures. As one college administrator stated: “We’re in a crisis right now, and it’s a complicated one.”

Such a statement is all the more profound when one realizes it was made in December 2019, well before COVID-19 swept onto the scene. A mere seven months ago, unfavorable demographics, elevated tuition costs, and a strong economy — many defer college and head straight to work in a healthy economy — were cited as factors for weakening enrollment trends.

Since then, challenges facing higher education have only intensified as COVID-19 forced many schools to go online-only or postpone classes entirely. Academic programs are shuttering, athletics are being completely rethought (some sports suspended indefinitely), and costs to facilitate safe housing and classroom conditions are soaring.

Smaller private liberal-arts schools, many of which lack large endowments and receive little government support, are likely to suffer the most.

Accordingly, mergers could ensue, and closures could continue to climb.

Public institutions, on the other hand, may see in-state enrollments rise. But some might also experience pressures as out-of-state, and higher-paying students may opt to stay closer to home. Similarly, travel restrictions and changes in US foreign diplomacy may cause enrollment of international students also to fall. Such declines will disproportionately impact revenues as international students are more likely to pay full tuition.

Hyper-aware of this challenging backdrop, fixed income analysts such as my colleague Mike Sroda, will be focused on the liquidity/financial resources of each institution being underwritten. Mike will also likely analyze the amount of unrestricted/spendable reserves relative to debt or operating expenses to gauge how well a school is positioned. Operating and debt metrics are also important. Each of these metrics will vary significantly from school to school, as the management of some institutions are better than others.

Moreover, some positive attributes remain. First, the value of a college degree is still substantial, in our view. Career advancement and social mobility have been and will continue to be dependent on education.

Secondly, though not all, many institutions still have access to the capital markets where they can find low borrowing rates and off-balance-sheet financing via public/private partnerships to enhance their liquidity profiles. Similarly, fundraising and capital campaigns will provide additional support, but here too, we think there will be significant disparities amongst institutions.

Over the longer term, however, demographic challenges are expected to persist with projected declines in US high-school graduates. Online offerings will likely grow and perhaps even accelerate due to COVID-19.

Given these strong headwinds, investors choosing to invest in higher education municipal debt should be super-selective, in our opinion. Moreover, they should be aware of potential knock-on effects such as opportunities linked to student housing and companies highly dependent on the education sector.

As Mike reminded me recently: “Security selection will be key, so do your homework.”

For more information, please contact your Key Private Bank Advisor.