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THE HIGHER EDUCATION HIGHWAY

HEEDING YOUR WARNING LIGHTS

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"Weak governance and weak management play a key role, particularly in this disruptive period when colleges face mounting demands to control costs, improve quality, and adapt to new academic models."

-Moody's investor service analyst Susan Fitzgerald on why her firm downgrades colleges

INTRODUCTION

A funny thing happened to Sweet Briar College (SBC) on the higher education highway: It ran out of gas.

For the past six years, the women's college, which was founded in 1901, struggled on almost every front, including declining yield, enrollments, endowment value, and net tuition. Its only rising metric, unfortunately, was its student discount rate, which increased from 48.9% in 2009-10 to 61.9% in 2014-15. This fed an out-of-control death spiral that lead to the college's decision to shut its doors. While this decision has since been reversed, the jury is still out on whether SBC will survive.

The University of Maine System (UMS) is not too far behind SBC. Across its seven campuses, its enrollments have fallen by double digits in the past decade, with a projected budget deficit of $90 million by 2019-2020. Six of the seven colleges started the 2015 fiscal year in the red, and administrators have looked at selling real estate, according to the Wall Street Journal.

SBC and UMS are not alone in the breakdown lane on the higher education highway. The sad truth is that hundreds of colleges are also seeing the "low fuel" warning light appear on their financial dashboards, each hoping that a gas station is just ahead.

The trends and warning signs are clear:

- **Decaying financials.** According to a 2013 survey conducted by *Inside Higher Education* and Gallup, 60% of college chief financial officers feel that a significant number of higher education institutions are facing an "existential financial crisis." The regulators agree: Between 2009 and 2013, the number of colleges' credit ratings that Moody's Investor Services has downgraded outpaced upgrades by nearly five to one, according to *The Chronicle of Higher Education*. On top of all this, the National Association of College and University Business Officers reports that the average discount rate went up 6.3% in 2013-14. In this period, discounts rose faster than tuition; for every one dollar rise in tuition, on average, net tuition went up only 20 cents.

- **Enrollments are shrinking.** Enrollment goals are more out of reach than ever before. 46% of admissions directors reported being “very concerned” about meeting their numbers, and another 30% were “moderately concerned.” Results from the National Association for College Admissions Counseling’s annual survey indicate that, in recent years, nearly one half of all responding institutions did not meet their enrollment goals by the traditional May 1 deadline. As the student population of adult learners remains flat and the number of institutions offering degrees to adult learners continues to rise, colleges are experiencing more competition for these students.

- **A growing number of schools are closing their doors.** The number of private four-year colleges that have closed or been acquired has doubled from about five per year before 2008 to about 10 per year since, according to a 2013 Vanderbilt University study. Today, many private colleges face deep financial uncertainty if they fail to meet their enrollment goals. Higher education is in the midst of a transformation. The question for every stakeholder at every school is what steps you need to take today to ensure that you survive and thrive in the future. Answering this question has to start with an honest assessment of where you are and, more importantly, how you got there.

WHERE DO YOU STAND?

Below, Eduventures has identified seven key metrics, or “warning lights,” that together serve as a valuable dashboard for institutional leaders seeking meaningful indicators. Based on their institution’s performance in these categories, leaders can assess which stage of health, or “mile marker” it falls under and, ultimately, identify a defensible path to navigate forward.

ENROLLMENT TRENDS

“Bringing in your class” is more than just hitting your numbers in any given year. It requires insight into three- to five-year trends by major, geography, socioeconomic status, cost per enrollment, and yield from the top to the bottom of your enrollment funnel. Has your degree of selectivity gone up or down, intentionally or unintentionally, over the past five years?

Key question: Have you met your (new and total) enrollment goals in each of the past five years?

RETENTION AND COMPLETION RATES

While no institution can (or should) expect to achieve 100% retention, it should strive for first-year retention rates in excess of 80% to 85%. Institutions with first-year retention rates lower than 60% are doing a disservice to students and trending toward very problematic fiscal uncertainty.

Alongside retention, time to completion is also a major factor for prospective students (to say nothing of state and federal lawmakers), as more time and credits equal higher costs for families. Students must be afforded the right courses at the right time to ensure a four-year completion rate above 60%, a five-year completion rate above 70%, and a six-year completion rate above 80%.

While part-time and adult learners are on a different completion timeline, it behooves institutions serving these student populations to strive for a high undergraduate degree completion rate (exceeding 70%) in less than four years of part-time study.

Key questions: What is your retention rate for traditional and adult learners? What is your completion rate for traditional and adult learners?

STUDENT AND FAMILY DEBT

Student loan debt stands at $1.1 trillion, exceeding total credit card debt in the United States, and nearly 20% of borrowers are in default. The average debt load is now $28,400 and half of borrowers say their student loans are increasing their risk of defaulting on other bills. Rising student and family debt is bad for borrowers, colleges, and the national economy. Average student debt should be trending downwards, as should institutions' tuition discounts.

The key here is an institution's ability to reduce the average student-loan debt incurred by its graduates. For some high-tuition institutions, the goal should be to fall below the national average. For lower tuition institutions, the goal should be to reduce the total amount of student debt, year over year. For example, Purdue University President Mitchell Daniels promotes the fact that his institution has reduced student loan debt by 18% since 2012, an accomplishment well received by Indiana state policy makers and parents.

Key questions: What is your average student debt at graduation? Are you reducing this amount year over year?

INSTITUTIONAL FINANCIAL HEALTH

Many factors contribute to an institution's overall financial health, including its debt service and trends related to external funding (public and private), discount rate, and net tuition.

According to Jeff Selingo, debt taken on by colleges has nearly doubled since 2000 to more than $300 billion. Like students and families, a college can only borrow so much before lenders become scarce and interest rates too high, credit ratings drop, or growing student fees, on top of tuition, become an enrollment liability.

Expenses leading to higher debt include increasing operating costs and depreciation expenses associated with new facilities, deferred maintenance, higher employee healthcare costs (especially retirees), and pension-related obligations. These are all relative factors that require comparison against your peer institutions. Your institution's overall debt as a percentage of its total operating budget is another key metric for measuring its financial health.

Likewise, nearly all states are facing very difficult economic conditions, including an unprecedented amount of debt ($1.5-$4 trillion of unfunded pension retirement liabilities) that will continue to force lawmakers to make tough decisions on K-20 appropriations for years to come. Overall, state appropriations for higher education have been decreasing annually for a number of years. For example, educational appropriations per student were down 13.3% nationally between 2009 and 2014, according to the State Higher Education Executive Officers Association. Compensating for flat to lower appropriations and reduced revenue from private sources (foundations, etc.) will weigh heavily on an institution's ability to maintain a healthy balance sheet and defend its credit rating.

By the same token, net tuition revenue (a key variable for credit rating agencies) should be going up year over year. In its "2015 Outlook–US Higher Education," Moody's projected net tuition growth will be the weakest in more than a decade, at 2% overall for fiscal year 2015, with "a growing number of universities experiencing acute pressure."

Due to external funding reductions, for the first time, students attending four-year colleges and universities now pay half or more of the full institutional cost to provide their education, on average. This represents an 18% to 22% increase at public four-year institutions over the decade. Central to a healthy balance sheet is an institution's ability to increase its net tuition rate, year over year.

Institutions with discount rates greater than 20% are at risk, and those with discount rates greater than 30% are operating an unsustainable model.

Taking all the aforementioned financial factors into account, institutions must seek new and diverse revenue streams to strengthen their cash positions, better manage and monetize their assets, and adequately fund annual capital expenditures in order to maintain financial sustainability in the turbulent and global economic challenges to come in the next three to five years.

Key questions: What is institutional debt as a percent of operating budget? What is the trajectory of your discount rate? What is your net tuition? Have you reduced your external funding?

ENDOWMENT PER STUDENT

About 75% of North American colleges reported putting a higher percentage of their endowments into their 2014 operating budgets than they did in 2013, according to the National Association of College and University Business Officers. A strong stock market, fueled by low short-term interest rates, has resulted in impressive returns in recent years; however, over the past 10 years, college endowment funds have seen an average return of 7.1%, which is slightly below the average long-term growth targets most universities need to meet.

Naturally, the goal is to grow your endowment (particularly unrestricted funds) through a realistic development strategy while lowering the percentage removed to cover your annual operating expenses. The key here is an institution's ability to grow its endowment per student, year over year. For some high-tuition institutions, the goal should be to exceed the national average per student for private institutions ($72,000) or for public institutions ($7500).

Key questions: What is your endowment per student? Has your endowment per student gone up each of the past five years?

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PERCEIVED VALUE

Perceived value is by far the most complex, most arbitrary, most subjective, and yet perhaps most important variable to the long-term health of an institution. While the top 150-200 colleges have strong enough brands to carry them through the tough economic times ahead, the vast majority of institutions must address the perceived value of each degree program among prospective students, parents, employers, and graduate programs.

Criteria include but are not limited to: college rankings, the quality of the faculty, the condition of the physical plant, graduate job placement rates (related to major), alumni earnings, innovative curriculum, and multiple speed-to-degree options.

Key question: What is your perceived value as an institution, as assessed by prospective students and their parents, faculty and staff, school counselors, and employers?

Figure 2. The higher education highway scorecard

WARNING LIGHTS	GREEN (3 POINTS)	YELLOW (2 POINTS)	RED (1 POINT)	SCORE
ENROLLMENT TRENDS (past five years)	Meeting enrollment goals is not an issue	Struggle to meet enrollment goals each year	Enrollment goals not met past three to five years	
RETENTION & COMPLETION RATES	>80% >75%	50%-80% 50%-75%	<50% <50%	
STUDENT DEBT				
Reduction Rate	>20%	10%-20%	<10%	
Average Total	<$20,000	$20,000-$30,000	>$30,000	
FINANCIAL HEALTH				
Institutional Debt	Decreasing	Flat	Increasing	
Discount Rate	<20%	20%-40%	>40%	
Net Tuition	Increasing	Flat	Decreasing	
External Funding Reduction	5%	5%-8%	>8%	
ENDOWMENT PER STUDENT				
Private Institutions	>$200,000	$50,000-$200,000	<$50,000	
Public Institutions	>$25,000	$7,500-$25,000	<$7,500	
Growth Trend	>15%	8%-15%	<8%	
PERCEIVED VALUE	High	Moderate	Low	
TOTAL SCORE	—	—	—	

NOTE: For categories with several metrics, score each metric separately and record the average in the "score" column. Calculate institutional debt as a percent of the total institutional operating budget.

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INTERPRET YOUR SCORE

MILE MARKER 1:
FULL TANK INSTITUTIONS (16-18 POINTS) – WELL ENDOWED/ENROLLMENT IS NOT AN ISSUE

Less than 100 schools have endowments that exceed $1 billion. These are the highest rated national universities and liberal arts colleges. We do believe that these schools need to pay attention to the transformation that is happening in higher education and make sure to stay on the technology learning curve while being careful not to preserve unsustainable practices. Nonetheless, they have the capital and the reputations to continue to thrive well into the foreseeable future. Their biggest risk is complacency.

MILE MARKER 2:
THREE-QUARTER TANK INSTITUTIONS (15-17 POINTS) – SECURE

Enrollment-driven schools that are highly desirable are therefore secure in attracting and retaining the necessary number of students to be financially secure. However, an institution's overall perceived value or brand will not cover under-performing degree programs. Individual academic programs will need to stand on their own merit or risk dragging the entire institution to a lower stage and higher mile marker.

MILE MARKER 3:
HALF TANK INSTITUTIONS (12-14 POINTS) – ON-THE-EDGE

These institutions are missing enrollment goals and struggling financially, but are not yet in a full blown crisis. They have the ability to streamline operations in order to develop sustainable operating models. For these institutions, degree program differentiation is paramount and price matters. Each and every academic program must be aligned with the competencies that students and employers desire. Outdated curriculum and administrative inefficiencies are major liabilities and must be addressed.

MILE MARKER 4:
QUARTER TANK INSTITUTIONS (9-11 POINTS) – NOT ORGANICALLY SUSTAINABLE

It is too late to simply streamline operations. Declining enrollments and escalating costs are putting viability in question. A reasonable option is to seek third-party partnerships that allow institutions to differentiate themselves in the market.

MILE MARKER 5:
RUNNING ON FUMES (6-9 POINTS) – SURVIVAL IS IN QUESTION

Streamlining operations and strategic partnerships cannot happen fast enough. A significant infusion of capital will be required to maintain payroll, as regional accreditation and bond rating agencies will question the financial stability of these institutions.

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CONCLUSION

The Eduventures scorecard is meant to be neither prescriptive nor all-inclusive. It is merely meant to serve as a warning light that suggests to institutional stakeholders that greater attention must be paid and alternative strategies must be discussed and instituted before the situation becomes worse.

No single metric will cause an institution to move from one mile marker to the next. Colleges can, in fact, weather multiple yellow (and even one or two red) lights. The real question is, "For how long?"

What mile marker defines your institution? Unless you can place yourself with confidence, you will not be focused on taking the right next steps. Simply holding out hope that a solution will find you is not enough. Hope is not a strategy.
You have an opportunity to secure your future based on your current set of circumstances. Each mile marker has its own risks and uncertainties, but if you take the appropriate steps, you can improve your chances for a sustainable future.

In subsequent reports, we will offer recommendations to colleges at or nearing mile marker three, four or five. We focus on these schools because they have to act now with a sense of urgency.

ABOUT EDUVENTURES

Eduventures is the leading reseach and advisory firm focused exclusively on analyzing the forces that are transforming higher education. Our forward-looking research, based on proprietary market data, supports both strategic and operational decision-making.

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