School of Hard Knocks? Surveying the Landscape of Higher Ed Credits

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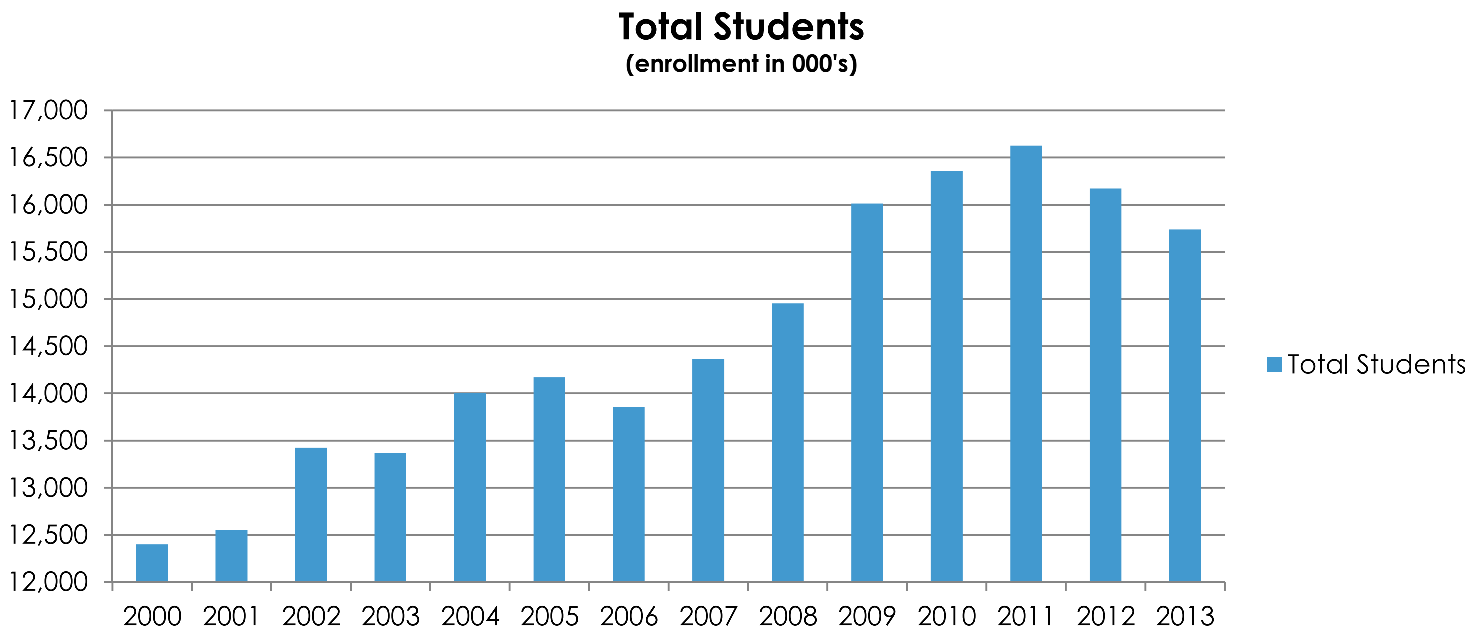
Agenda

- Secular trends
- The general landscape of education credits – defining characteristics
- At-Risk Indicators
- Success Indicators
- Lessons from experience

Secular Trends

- Increased competition
  - Applicant pool downward/negative after years of steep rise

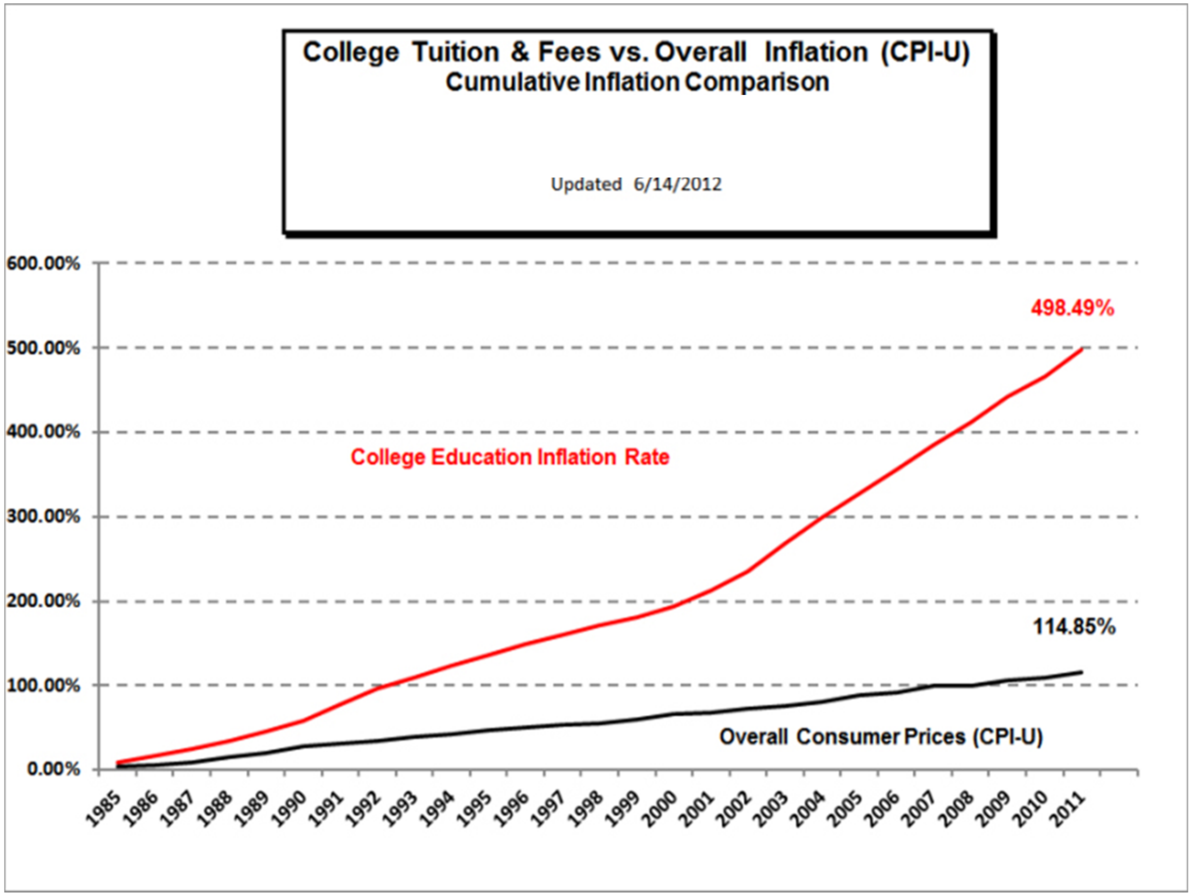


Between 2011 and 2013, 930,000 fewer students were enrolled in college nationwide.

Source: U.S. Bureau of Census

Secular Trends

- Costs increasing faster than inflation
  - CPI at 1.4%, higher education inflation rate at 3.3%



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Secular Trends

- General health, disruptions to business model
  - MOOCs
  - Distance learning
- Bottom line: Schools are selling a high priced product to fewer people with some low cost competitors entering the market

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Basic contours of the landscape

- Security features generally weaker – less differentiation in the capital stack
  - What is the difference between you and an unsecured creditor?
  - If you have a security package, is it functional?
- Covenant structures weaker – You can watch the train wreck from a distant hillside
- Very mission focused boards

Basic contours of the landscape

- Strategic partners hard to find
  - Mergers have occurred
  - Urban v. rural
- Accreditation – need for transparency but need to manage communication
- Department of Education (DOE)
  - Title IV eligibility
  - If the entity wants to survive bankruptcy is not an option
- AG scrutiny of charitable entities

Basic contours of the landscape

- Longer turnaround times
  - High costs may be embedded and harder to shed
  - Longer time frame for revenue growth
  - Strategic repositioning takes longer

Where do you place your bets?

- In a competitive and tough industry, how do you select winners and losers?
- What are the differentiators?
- Who is going to be at the head of the class five years from now? Ten?

Indicators of success

- Two-pronged analysis
  - Which ones are most likely to cash flow
  - Prospects in distress – turnaround and liquidation

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At-Risk Indicators

Note: numerical levels are illustrative from Martin-Samels study – you need to determine the thresholds

- Financial
  - Tuition discount is more than 35%.
  - Tuition dependency is more than 85%.
  - Debt service is more than 10% of the annual operating budget.
  - Less than a 1 to 3 ratio between the endowment and the operating budget.
  - Student default rate is above 5%.

The at-risk indicators were extracted from the Martin, J., Samels, J.E. & Associates publication "Turnaround: Leading stressed colleges and universities to excellence".

At-Risk Indicators

- Financial
  - Average tuition increase is greater than 8% for 5 years.
  - Deferred maintenance at least 40% unfunded.
  - Short-term bridge financing required in the final quarter of each fiscal year.
  - Less than 10% of the operating budget is dedicated to technology.
  - Average annual alumni gift is less than $75.
  - Amount of unrestricted assets

At-Risk Indicators

- Enrollment
  - Institutional enrollment is 1000 students or lower.
  - Conversion yield is 20% behind that of primary competitors.
  - Student retention is more than 10% behind that of primary competitors.

At-Risk Indicators

- Administration and Faculty
  - The majority of faculty do not hold terminal degrees.
  - Average age of full time faculty is 58 or higher.
  - The leadership team averages fewer than 3 years or more than 12 years of service at the institution.
  - High ratio of tenured faculty to non-tenured faculty

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At-Risk Indicators

- Academics
  - No complete online program has been developed.
  - No new degree or certificate program has been developed for at least 2 years.
  - Academic governance and curriculum development systems require more than one year to approve a new degree program.

Risk Factors

• Geographic Isolation

"We are 30 minutes from a Starbucks"
- **James F. Jones Jr.**, President, Sweet Briar College

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The Rich Get Richer – the balance sheet advantage

- Investable assets are a huge differentiator and the gap will only widen
- Moody's Research Report - *Financially Leading Universities Poised to Further Widen Balance Sheet Advantage*, April 16, 2015
- Moody's analyzed the 40 leading public and private universities – these financial leaders shared key attributes

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The Rich Get Richer

- Less liquid, more aggressive investments lead to higher, though more volatile returns
- Receive 59% of the philanthropic support and have 33% of the total wealth
- Have strong cash flow from more diversified operations – less tuition dependency
  - The median private institution derived 75% of its revenue from student related charges; the financial leaders – 15%
  - The median public university derived 46% of its revenue from student related charges; the financial leaders – 30%

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The Rich Get Richer

- The financial advantages are ongoing advantages that will likely grow
- More investable assets enable the leaders to ride out the budgetary issues
- They can pursue opportunities - program growth, star professors, coveted students, build new facilities - more quickly than their less well-heeled competitors

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Metrics that Matter

- There are lots of metrics to follow to understand the business
- If cash is king, what is the endowment per student?
- Selectivity – the common app facilitates multiple applications, and many schools aggressively court applicants, which boosts selectivity percentages
- But matriculation leads to revenue. Where is that trending?

Metrics that Matter

- What is the 6 year graduation rate?
- What is the debt at graduation?
- What is the discount rate?
  - And not just the average but for the freshman class?
- What story can you glean about their market position?

The Power of Big Data

- Enrollment strength is key to survival
- The high cost of college greatly increases the pressure for colleges to deliver value
- There is data that helps establish value – that parents can troll and you can too.
- Visit www.payscale.com/college-roi to compare return on investment, defined as the expected increase in lifetime earnings as a result of a degree from a particular institution as compared with the cost of the degree.
- ROI can be determined either with or without the benefit of financial aid

The Power of Big Data

- The best value in higher education today?

Rank	School Name	20 Year Net ROI	Total 4 Year Cost	Graduation Rate	Typical Years to Graduate	Average Loan Amount
1	Harvey Mudd College (Private)	$985,300	$237,700	91%	4 Years	$21,920
2	California Institute of Technology (Caltech) (Private)	$901,400	$221,600	93%	4 Years	$22,160
3	Stevens Institute of Technology (Private)	$841,000	$232,000	79%	5 Years	$44,000
4	Colorado School of Mines (In-State)	$831,000	$112,000	70%	5 Years	$30,480
5	Babson College (Private)	$812,800	$230,200	91%	4 Years	$31,880
34	Harvard University (Private)	$646,100	$227,000	97%	4 Years	$25,080

The Power of Big Data

- Sorting by the effect of financial aid, who is number one?

Rank	School Name	20 Year Net ROI	Total 4 Year Cost	Graduation Rate	Typical Years to Graduate	Average Loan Amount	% Grant Money Received
1	Harvey Mudd College (Private)	$1,104,500	$237,700	91%	4 Years	$21,920	71.0%
2	California Institute of Technology (Caltech) (Private)	$1,029,700	$221,600	93%	4 Years	$22,160	54.0%
3	Stanford University (Private)	$966,900	$233,300	96%	4 Years	$29,880	53.0%
4	Stevens Institute of Technology (Private)	$948,300	$232,000	79%	5 Years	$44,000	97.0%
5	Babson College (Private)	$946,500	$230,200	91%	4 Years	$31,880	45.0%
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14	Harvard University (Private)	$812,100	$227,000	97%	4 Years	$25,080	58.0%

- What does that tell you?

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The Power of Big Data

- You can also sort by 6 year graduation rate
- And by average debt at graduation
- Again, what story is being told by the data re: enrollment?

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The Power of Big Data

- Brookings Institution recently revealed the results of their attempt to measure colleges by economic payout.
- Ranking based on "Value-added" percentage.
  - Value-added in this calculation is the difference between actual and estimated salary (of a graduate from a similar college). A zero value-added measure means the school’s students earn the average for students like them at similar types of colleges.

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The Power of Big Data

Four-Year or Higher Colleges With the Highest Value-Added With Respect to Mid-Career Earnings

	Value-added	Predicted	Actual	Metropolitan area
California Institute of Technology	49%	$77,129	$126,200	Los Angeles-Long Beach-Anaheim, CA
Colgate University	46%	$79,774	$126,600	Syracuse, NY
Massachusetts Institute of Technology	45%	$82,439	$128,800	Boston-Cambridge-Newton, MA-NH
Rose-Hulman Institute of Technology	44%	$73,628	$114,100	Terre Haute, IN
Carleton College	43%	$76,236	$117,700	Faribault-Northfield, MN
Washington and Lee University	42%	$81,281	$124,300	Lexington, VA
SUNY Maritime College	42%	$79,637	$121,700	New York-Newark-Jersey City, NY-NJ-PA
Clarkson University	42%	$72,583	$110,700	Ogdensburg-Massena, NY
Manhattan College	42%	$72,701	$110,800	New York-Newark-Jersey City, NY-NJ-PA
Stanford University	41%	$83,864	$126,400	San Jose-Sunnyvale-Santa Clara, CA
Harvey Mudd College	40%	$89,466	$133,800	Los Angeles-Long Beach-Anaheim, CA
Rice University	40%	$80,379	$119,900	Houston-The Woodlands-Sugar Land, TX
Marietta College	39%	$62,795	$93,100	Marietta, OH
Virginia Military Institute	38%	$78,444	$115,000	Lexington, VA
Polytechnic Institute of New York University	37%	$76,245	$110,400	New York-Newark-Jersey City, NY-NJ-PA
Worcester Polytechnic Institute	37%	$76,688	$110,500	Worcester, MA-CT
St Mary's University	36%	$64,500	$92,500	San Antonio-New Braunfels, TX
Stevens Institute of Technology	36%	$82,827	$118,700	New York-Newark-Jersey City, NY-NJ-PA
Bradley University	35%	$67,307	$95,500	Peoria, IL
Georgia Institute of Technology-Main Campus	34%	$79,195	$111,700	Atlanta-Sandy Springs-Roswell, GA
Average of all four-year and higher colleges	9%	$68,790	$75,900	

Value-added in this calculation is the difference between actual and predicted earnings in log values. A zero value-added measure means the school's students earn the average for students like them at similar types of colleges.

Source: Brookings, "Beyond College Rankings, A Value-Added Approach to Assessing Two- and Four-Year Schools".

The Power of Big Data

- The National Association for College Admission Counseling (NACAC) annual College Openings Update is a voluntary update of roughly 1,300 U.S. NACAC member four-year colleges (leaving about 1,000 U.S. four-year colleges unaccounted). The initial deadline is May 5, and additional colleges and universities typically join the list after the initial deadline.
- This update can provide you with an additional set of warning signs as the colleges might not have made their Fall enrollment acceptance projections.

Institution Name	State/Country	Freshmen	Transfer	Institutional Control	Enrollment	Financial Aid	Housing	
Aberystwyth University	United Kingdom	Yes	No	Public	5,000-9,999	Yes	Yes	Contact Info
Adams State University	CO	Yes	Yes	Public	1,000-4,999	Yes	Yes	Contact Info
Aims Community College	CO	Yes	Yes	Public	5,000-9,999	Yes	No	Contact Info
Alabama A&M University	AL	Yes	Yes	Public	5,000-9,999	Yes	Yes	Contact Info
Alfred State -- State University of New York	NY	Yes	Yes	Public	1,000-4,999	Yes	Yes	Contact Info
Alma College	MI	Yes	Yes	Private	1,000-4,999	Yes	Yes	Contact Info
Angelo State University	TX	Yes	Yes	Public	5,000-9,999	Yes	Yes	Contact Info
Ashland University	OH	Yes	Yes	Private	5,000-9,999	Yes	Yes	Contact Info

Website link to data: http://www.nacacnet.org/research/research-data/College-Openings/Pages/College-Openings-Results.aspx

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When trouble hits

- Turnaround
  - Strategic transactions
- Liquidation

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Situations are unique

- If you've seen one, you've seen one
- Case Studies
  - Thomas Jefferson School of Law
  - Stillman College
  - Sweet Briar College
  - Louisiana State University

Thomas Jefferson School of Law

- Declining enrollment at fourth tier law school; debt load not sustainable
- TJSL wanted to continue operations – bankruptcy not an option
- Bondholders able to negotiate a recapitalization
- Sale/leaseback structure gave bondholders control of the key physical asset
- Trade some flexibility on timing and cost of exit for control over asset, interim cash flow, a deficiency note and share of upside in strategic transaction
- Desirable asset in San Diego with access to housing and parking creates floor on value

Stillman College

- HBCU with declining enrollment
- Refusal to engage consultant after coverage ratio defaults in 2009 and 2010
- Protracted efforts made to negotiate terms of turnaround
  - Enrollment assessment
  - Financial advisor
- Bondholders able to negotiate tender offer
  - Par plus premium and accrued and unpaid interest

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Current Situations – Sweet Briar College

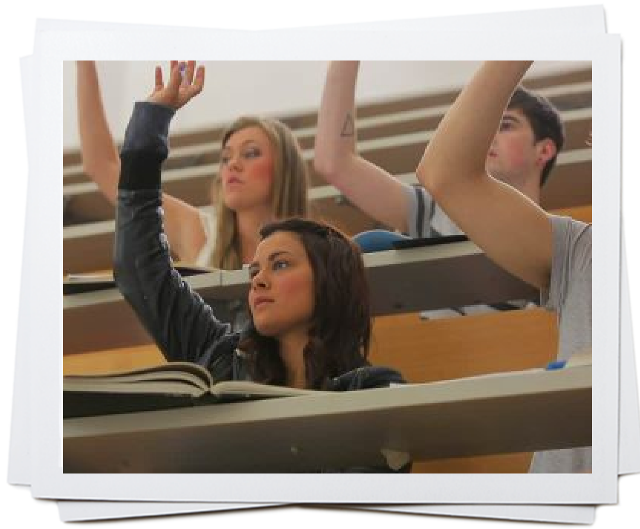
- Private all women's college in Virginia
- Deteriorating enrollment trends
- High fixed costs
- Increasing number of applications but declining yield led to higher tuition discounts
- Estimated $94 million endowment
- Abrupt closure
- Battle of the constituencies

Current Situations – Louisiana State University

- "Financial exigency": allows termination of faculty and employees before the end of their contract term
- <u>Not</u> an alternative to bankruptcy

Conclusion

- Success is about placing good bets
- Figure out the differentiators and then stay on top of them to monitor health
- If management will talk with you, find out their approach to navigating a challenging environment
- If trouble hits, jump in as early as you can to maximize outcomes
- Formulate and implement strategic turnaround if possible
- Get best team of professionals to maximize return…..you're going to need them



Questions?