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Vulnerable US Private Colleges at Risk from New Federal, State Actions

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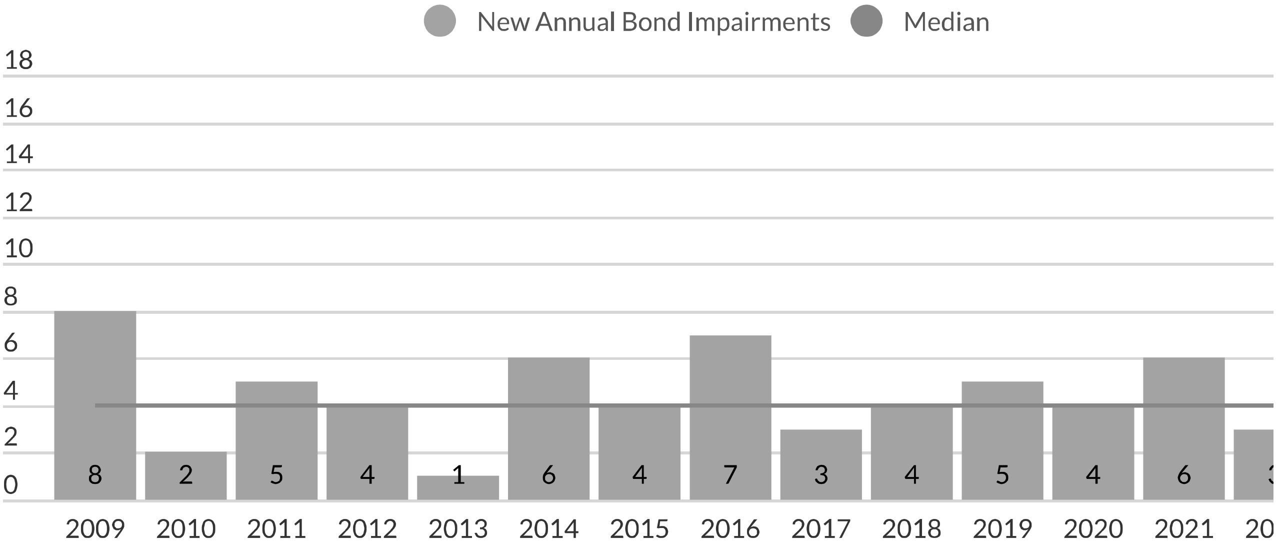
Fitch Ratings-Chicago/New York-06 March 2024: The credit or even viability of small U.S. private colleges serving sizable low-income and minority populations, many already financially vulnerable to operational and enrollment stress, is threatened by new hurdles posed by recent federal and state actions, Fitch Ratings says.

Recent federal financial aid processing delays, overtime pay proposals and merger/acquisition regulation, together with the U.S. Supreme Court's abolition of race-conscious admissions in 2023, place greater pressure on these colleges. State efforts to provide minimal-cost public college access to lower income residents also increases the acute competition faced by these institutions.

Financial stress in the higher education sector spiked during calendar year 2023 with a record high number of new impairments (payment and technical defaults) among the sector's bond issuers, according to Municipal Market Analytics. Fitch analysis shows that issuers with newly impaired debt in 2023 served very high percentages of minority and low-income students, averaging 55% non-White enrollment and 48% federal Pell Grant recipients among first-time undergraduates in fall 2022.

Higher Education Bond Impairments Spiked in 2023

Municipal Market Analytics Higher Education Sector New Bond Impairments by Year



Note: Impairments include payment and technical defaults
Source: Municipal Market Analytics, Fitch Ratings

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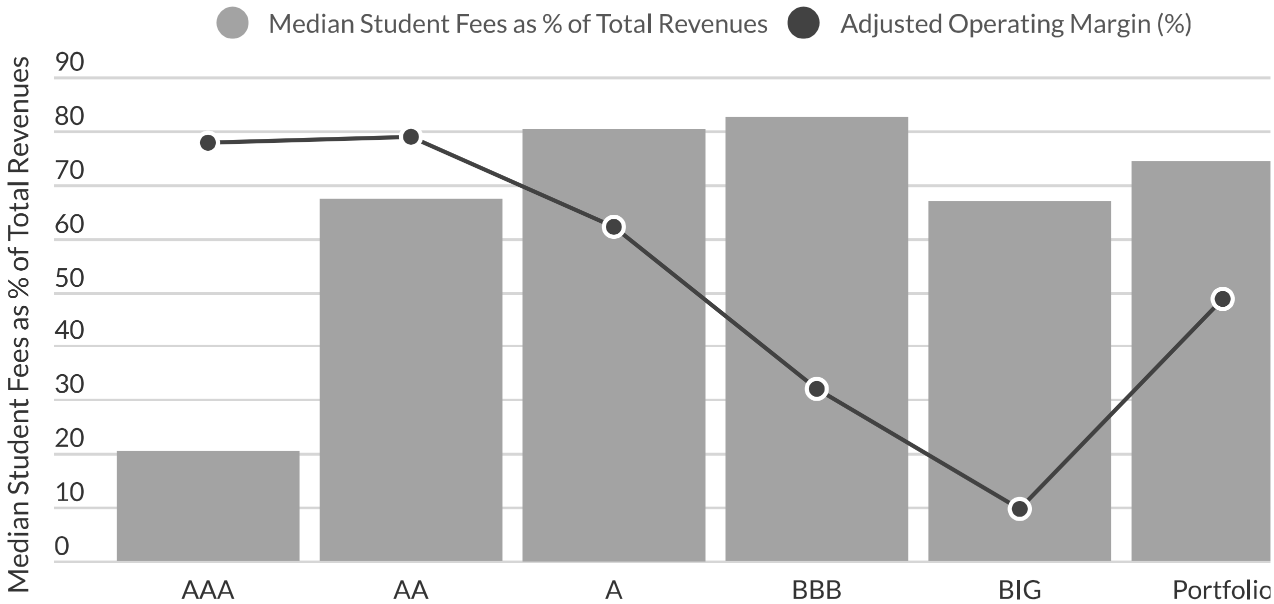
The U.S. Department of Education (DOE)'s delayed processing of Free Application for Federal Student Aid (FAFSA) data for the fall 2024 enrollment cycle is the latest blow to colleges that rely heavily on low-income and minority enrollment. The delay is forcing most colleges to postpone sending financial aid packages to students until late March or April at the earliest. This puts colleges at risk of losing admitted students to competitors with lower sticker prices or to colleges that can afford to commit financial aid or merit funds to students before knowing FAFSA results. In turn, deposit rates are down as some students postpone college decisions pending receipt of their aid offers, while some may consider foregoing college altogether. For colleges that are almost solely dependent on student-generated revenues, this enrollment uncertainty is wreaking havoc on their already tight budget planning for the upcoming fiscal year.

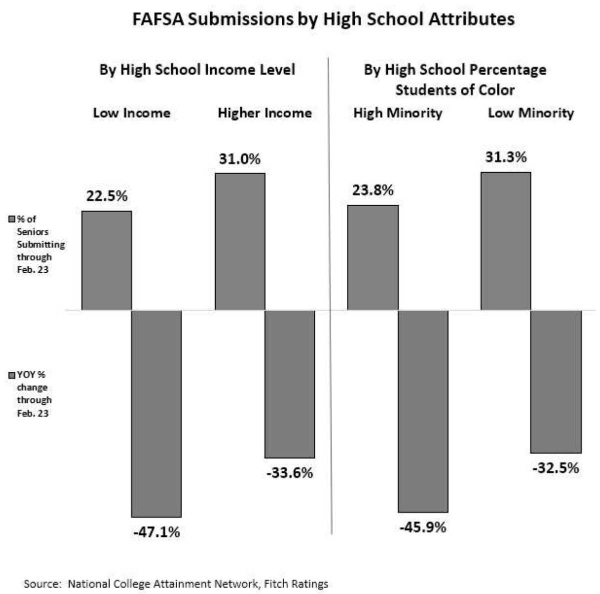
Private University Median Student Fee Dependence

Fiscal 2023



BIG - below investment grade
Source: Fitch Ratings

Technical snafus and separate delays in rolling out new streamlined FAFSA forms to students have caused year-to-date FAFSA completion rates to plummet, which is especially foreboding for minority- and low-income- serving colleges. A dramatic 38% fewer high school students completed FAFSAs through February 23, 2024, compared with the same time last year, according to National College Attainment Network, with even steeper drops from minority and low-income student groups.



Fitch anticipated FAFSA-related risks in our 2024 Higher Education Outlook. FAFSA fallout will be felt unevenly within the sector and may be muted at academically-selective schools, lower-cost institutions, colleges with unique niches, or colleges that effectively managed students' expectations. For colleges that suffer enrollment losses, even marginal, one-time disruptions in producing a robust incoming freshman class will dampen finances for several years.

Other new federal rules also pose challenges. Overtime pay may soon be required for salaried employees earning less than about $55,000 annually, up from the current $35,568 threshold. For colleges already managing extremely tight or deficit operations, any additional mandated costs will compound budgetary stress.

Separately, DOE implemented new procedures in mid-2023 for colleges seeking merger or acquisition approvals. Industry experts estimate that at least an additional year is now needed to obtain DOE change-in-control approvals. The availability of sufficient operating liquidity may ultimately dictate whether institutions can remain viable through this extended approval process, or will be forced to close.

In addition to federal actions, many states are restructuring public education systems to improve their viability and accessibility. For instance, Pennsylvania is considering limiting tuition at certain public colleges to $1,000 for lower-income residents. Such types of state efforts may pose further risks to enrollment at small, private regional institutions, unless public subsidies can also be used at private institutions (such as in Pennsylvania and Iowa currently).

Related Research:
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Success of Smaller Colleges' Enrollment Strategies Not Guaranteed
Fiscal 2022 Median Ratios for U.S. Not-for-Profit Private Colleges and Universities (Credit Gap is Widening)

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