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Struggling to Stay Afloat

By JEFFREY J. SELINGO

STUDENTS piling on debt to go to college might attract all the attention, but colleges have been on a borrowing spree as well, nearly doubling the amount of debt they've taken on in the last decade to fix aging campuses, keep up with competitors and lure students with lavish amenities.

In January, Moody's Investors Service put a [negative outlook](#) on the entire higher education sector, even at major research universities, which had been spared in previous forecasts. And that came after a year in which the agency downgraded the credit ratings of 22 colleges, including [Alabama A&M](#), [Wellesley College](#) and [Morehouse College](#). At the same time, [Standard & Poor's Ratings Service](#) downgraded 13 institutions, including Amherst College, Tulane University and Yeshiva University. Combined, both agencies upgraded only eight colleges in 2012.

Bond ratings aren't scoured like the U.S. News and World Report rankings. But if you're a parent preparing to start the college search with your son or daughter, the negative financial outlook raises plenty of questions to ask the college tour guide: Will outdated buildings be renovated? Will more part-time instructors replace retiring professors? Will classes get bigger or will students end up in partly online courses? Will the school even be in business by the time your child graduates in four years?

"There is a major problem in that the industry has an inability to grow revenue in a way they have for the last 20 years," says John C. Nelson, managing director of the higher education and health care practice at Moody's, which examines the finances of more than 500 colleges and universities that issue bonds through public markets.

A handful of colleges have closed, merged or been bought by for-profit colleges in recent years — mostly small, tuition-dependent private colleges, which remain at most risk. While few financial experts foresee mass closings in the years ahead, only 500 or so of the 4,000-plus colleges and universities in the United States seem to have stable enough finances to be truly safe. The remaining colleges, where a vast majority of Americans attend, can no longer hold off the technological, demographic and economic forces quickly bearing down on them.

One-third of all colleges and universities in the United States face financial statements significantly weaker than before the recession and, according to an [analysis released last](#)

July, are on an unsustainable fiscal path. Another quarter find themselves at serious risk of joining them.

“Expenses are growing at such a pace that colleges don’t have the cash or the revenue to cover them for much longer,” says Jeff Denneen, head of the higher education practice at Bain & Company, the global consulting firm that, along with the private-equity firm Sterling Partners, performed the analysis. “A growing number of colleges are in real financial trouble.”

Other forecasts are equally pessimistic. The number of higher education institutions on a Department of Education watch list, for instance, has grown by more than a third since 2007 to include institutions like Long Island University and Pace University.

“We’re seeing prolonged, serious stress,” says Karen Kedem, an analyst at Moody’s. What is significant about the negative outlook is that Moody’s typically rates only colleges and universities with strong balance sheets to begin with.

Reading a college’s bond-rating report is like reading a person’s credit report: it is a financial checkup that gives insight into strengths and weaknesses that you will never find in any college guidebook, but probably should.

Take this line from a [Moody’s report when it downgraded Drew University](#) in New Jersey in 2012: “The rating is based on persistent operating deficits and thin cash-flow driven by a decline in enrollment and net tuition per student coupled with rising debt service payments and transition of several key members of university leadership.”

Translation: the private college is operating in a hole (though, Moody’s also notes, it’s helped by having an endowment); it is discounting tuition too much, and it is not attracting enough students, especially those who will pay more in tuition.

Michael Groener, Drew’s vice president of finance and business affairs, who arrived on campus last fall, says the financial decline is largely the result of discounting the \$42,000 sticker price too often and too much — sometimes by 50 percent. “That is pushing it about as far as we can go,” Mr. Groener says. In the years ahead, he says, Drew needs to bolster revenue through other means, mostly fund-raising, and look more closely at expenses by prioritizing what really matters in a good liberal-arts education.

In recent years, net tuition revenue — what’s left after grant aid is subtracted — has either been flat or falling at 73 percent of colleges. But most colleges and universities, particularly private ones, lack the market power to raise their prices significantly in a down economy. Business and law schools are no longer the cash cows they once were for their parent institutions. Meanwhile, employees expect raises and other costs continue to rise.

“This is a perfect storm, where you have a number of challenges at the same time over a long period of time,” says Ms. Kedem, the Moody’s analyst.

For public universities, the big challenge is that states are getting out of the business of higher education. In 1987, states kicked in about three quarters of what public colleges spent on education; now they contribute about half. The rest has to come from tuition.

By some measures, state taxpayer support for higher education hasn’t been this low since 1965, when there were 16 million fewer students in the system. As a result, public colleges have joined with cash-strapped private colleges on the hunt for more students who can pay full freight. That has led many schools to recruit foreign students and caused public colleges to look across state lines for students, who pay about twice as much as their in-state counterparts.

But the pool of students able to pay higher prices shows signs of running dry. The economic crisis has left the median American family with no more wealth than it had in the early 1990s. Experts predict a drop in the number of affluent, well-prepared high school graduates — the type that every college is after. One analysis conducted by a small private college in the Northeast found that of the 4.3 million 18-year-olds in 2009, only 996 had above-average SAT scores, family incomes over \$200,000 a year, and had indicated that they wanted to attend a small, private college in the mid-Atlantic or Northeast regions. Of course, hundreds of colleges are going after those same students.

Despite evidence to the contrary, some colleges still think the tough times are a temporary inconvenience — that eventually they will again be able to pass on their additional costs to students or get more money from the state and federal governments. But the most informed and realistic of higher education leaders realize they are now living in a new normal.

The collapse of higher education’s business model has been predicted many times before. Yet more colleges have opened their doors than closed them in the past 50 years. Perhaps the continued financial struggles indicate that there are just too many colleges for the marketplace — or at least too many that, with their climbing walls, lazy rivers and five-star dormitories, look too much alike in the battle for prestige, and have lost sense of their mission. A thinning of the ranks might be long overdue.

Just because we believe that colleges are a public trust and shouldn’t fail doesn’t mean they won’t.

Jeffrey J. Selingo is editor at large at The Chronicle of Higher Education. This essay is adapted from “College (Un)Bound: The Future of Higher Education and What It Means for Students,” to be published May 7 by New Harvest.

