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Upping The Ante: Costs Of Luring Top Students Keeps The Outlook Negative On U.S. Not-For-Profit Higher Education Sector

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Standard & Poor's Ratings Services' 2015 outlook for the U.S. not-for-profit higher education sector remains negative as colleges and universities struggle to balance the demands of their expenditures while addressing student affordability and access. We believe this tug-of-war in an increasingly competitive market will continue to compress overall operating performance and put an additional strain on these institutions' financial resources, especially those whose credit characteristics are already at the cusp of a lower rating.

Higher Education: Essential Or Optional?

With the cost of attendance and the amount of student borrowing steadily increasing, the debate about whether higher education is truly essential for individual success has intensified during the past few years. Some argue that increasingly complex and technical careers have made an undergraduate degree mandatory and graduate study nearly essential, while others point to cases of college dropouts as self-made millionaires to suggest that college is unnecessary. We believe the issue is much more nuanced than the headlines would suggest.

Overview

- The 2015 outlook for the U.S. not-for-profit higher education sector is negative.
- Colleges and universities will struggle to balance their own rising costs with student affordability.
- As competition grows, management strength will be key to determining these institutions' success and credit quality

In our opinion, "higher education" is a term as broad as "transportation": The types of post-secondary institutions (technical schools, community colleges, specialty schools, research universities, etc.) are akin to various modes of transportation (cars, buses, bicycles, trains, walking, etc.). Just as a person may require transportation to get from home to work each day, we believe higher education is generally necessary for a person's long-term success and earning potential. However, to continue the analogy, if gas prices rise or the cost of insurance, automobiles, or parking becomes prohibitive, a person may opt to exchange their car for another mode of transportation. Similarly, should the cost-benefit ratio of one type of higher education become unattractive, a student may opt for a different type of college, degree, or career to meet their needs. For example, a cost-conscious student may choose to forego a smaller, more expensive liberal arts college for the more economical public university closer to home.

Consequently, while we believe the demand for higher education overall is sound and that the need for post-secondary education will increase over time, the viability of individual institutions will depend on how well they can demonstrate their value and respond to potential students' needs. This is especially important considering that for many colleges, competition has now expanded beyond the immediate peer group to include other types of institutions or modes of

education. It is our belief that colleges or universities that are unable to distinguish themselves in the market through their reputation or offerings will have to compete for students purely on price, which will weaken demand and possibly cut into their enrollment over time.

A buyer's market

This competitive landscape is beneficial to students but financially challenging for colleges. Although tuition continues to increase (but at a slower rate than historically), the cost of educating students also continues to rise: Institutions face an expensive contest to attract and retain the best students. Students have become more demanding. In lieu of dormitories with shared rooms and bathrooms down the hall, they are now asking for residence halls with private rooms and various amenities. And instead of basic gyms or swimming pools, many colleges are now building beautiful student recreation centers with the latest workout equipment, including upgrades such as climbing walls. Students and parents want increased student services, educational experiences, and facilities while expecting schools to keep the cost of attendance at a minimum. And as expenses continue to increase, institutions are finding it difficult to increase revenue at a commensurate pace as facility constraints, which limit enrollment growth and financial-aid demands, confine the potential for increased net tuition revenue.

Other expenses are mounting

In addition to the challenges with meeting their core mission to recruit, retain, educate, and graduate students, other ancillary demands -- including risk management and compliance requirements -- consume valuable time and resources and put additional operational and financial pressure on these institutions.

Risk management: Beyond the general risk management planning that most colleges and universities have been doing for the past several years, recent events have increased the focus on topics such as student safety and on-campus violence, National Collegiate Athletic Association (NCAA) violations, and cyber security.

Compliance and reporting: Increased reporting requirements from a variety of constituents, including state and federal governments, accrediting bodies, the NCAA, research funders, and bondholders, are necessitating substantial investments in tracking and reporting resources. While the institutions can use some of these data to better market themselves to students, make financial projections, or improve outcomes, most of it serves only to remain in compliance or reduce exposure to lawsuits.

Management is key

As the higher education sector continues to evolve and face new and intensifying challenges, we believe institutions with astute and nimble leadership will be best positioned to successfully navigate this changing landscape. We expect to see a growing number of leadership changes due to both the aging of current senior leadership teams and strategic initiatives that may require different expertise and skills than an institution's current management possesses.

Hot topics for the coming year

Beyond the more general issues we discussed above, we believe the following could be increasingly important credit factors for many institutions:

- Liquidity strategies;
- Increasing capital pressures, and how to fund them;

- Enterprise risk management;
- Outsourcing, including privatized housing and public private partnership (P3) arrangements;
- Leadership transitions;
- Managing shrinking health care margins and increased expenses related to the Affordable Care Act;
- Tracking and reporting data for institutional use and compliance requirements;
- Focus on optimizing overall debt profile composition instead of increasing debt overall; and
- Driving net tuition revenue growth through better use of financial-aid dollars rather than tuition increases.

Rating Changes Skewed Negative Last Year

Rating changes

Table 1

History Of Higher Education Rating Changes

	2014*	2013	2012	2011	2010	2009	2008	2007	2006
Upgrades	7	12	12	26	26	19	23	14	27
Downgrades	30**	19	16	17	4	7	5	5	8
Totals	37	31	28	43	30	26	28	19	35
Downgrade to upgrade ratio	4.3 to 1	1.6 to 1	1.3 to 1	0.7 to 1	0.2 to 1	0.4 to 1	0.2 to 1	0.4 to 1	0.3 to 1

* As of Dec. 31, 2014. ** includes multiple downgrades for University of Puerto Rico, NC Board of Governors Pooled Bonds, Thomas M Cooley Law School, University of Northern Iowa, and Thomas Jefferson School of Law.

While the absolute number of rating changes in 2014 was on par with that of 2013, the ratio of downgrades to upgrades increased for the fourth consecutive year. Even when excluding the multiple downgrades for University of Puerto Rico, North Carolina Board of Governors, Thomas Cooley Law School, and Thomas Jefferson School of Law, downgrades still outpaced upgrades at a record pace.

Outlook revisions

Table 2

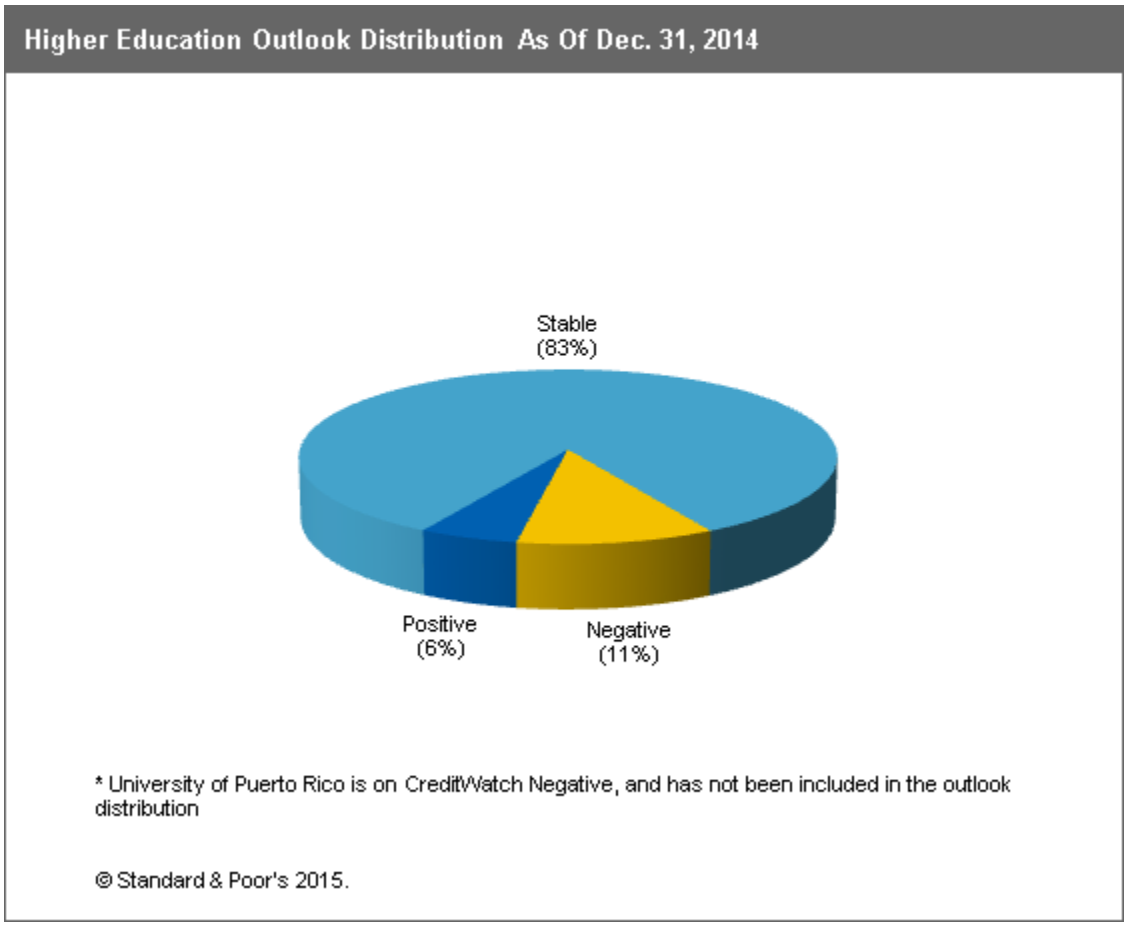
History Of Outlook Revisions Since The Great Recession

	2014*	2013	2012	2011	2010
Positive	24	17	20	25	16
Negative	30	33	14	13	28
Total	54	50	34	38	44

* As of Dec. 31, 2014.

A slightly different picture emerges when looking at outlook revisions, however. Although 2014 was a high-water mark in terms of the number of outlook revisions, the ratio of negative to positive revisions improved from 2013 levels, to 1.25 from 1.9. The current number of institutions with negative outlooks (11%) is still more than double that of institutions with positive outlooks (5%), while 84% of all rated institutions have stable outlooks. Though negative and positive outlooks each increased in 2014 (from 9% and 4% in 2013, respectively), we expect outlook revisions to be modestly more positive in fiscal 2015 given the robust endowment returns for fiscal 2014, better-than-expected operating margins, and moderate debt issuance.

Chart 1



The road ahead

As we look at the rating changes and outlook distributions for 2014, a few interesting patterns emerge:

- The outlooks on all four rated standalone law schools are negative, and a fifth such school (Thomas Jefferson School of Law) defaulted in 2014.
- Other notable ratings with negative outlooks include those on five Illinois public universities (Western Illinois University [WIU], Eastern Illinois University [EIU], Illinois State University [ISU], Governors State University, and Northeastern Illinois University [NEIU]), a handful of private colleges and universities in Pennsylvania and New York, and one 'AAA' rated institution (Washington University).
- A full 19 of the 49 ratings with negative outlooks are private universities in the 'BBB' rating category.
- Ratings with positive outlooks are evenly split between public and private universities and include three specialty schools (Wisconsin Medical College, New York Chiropractic College, and California College of the Arts).
- Two states (Alabama and Kentucky) also demonstrate that public universities can have mixed credit quality despite receiving support, and that the larger, comprehensive flagship schools tend to outperform smaller, regional public universities. In Alabama, the University of Alabama is rated 'AA-/Positive', while Alabama State University is rated 'BBB+/Negative'. In Kentucky, the University of Kentucky is rated 'AA-/Positive', while Northern Kentucky University and Western Kentucky University are rated 'A+/Negative'.

Rating distribution for 2014

Chart 2

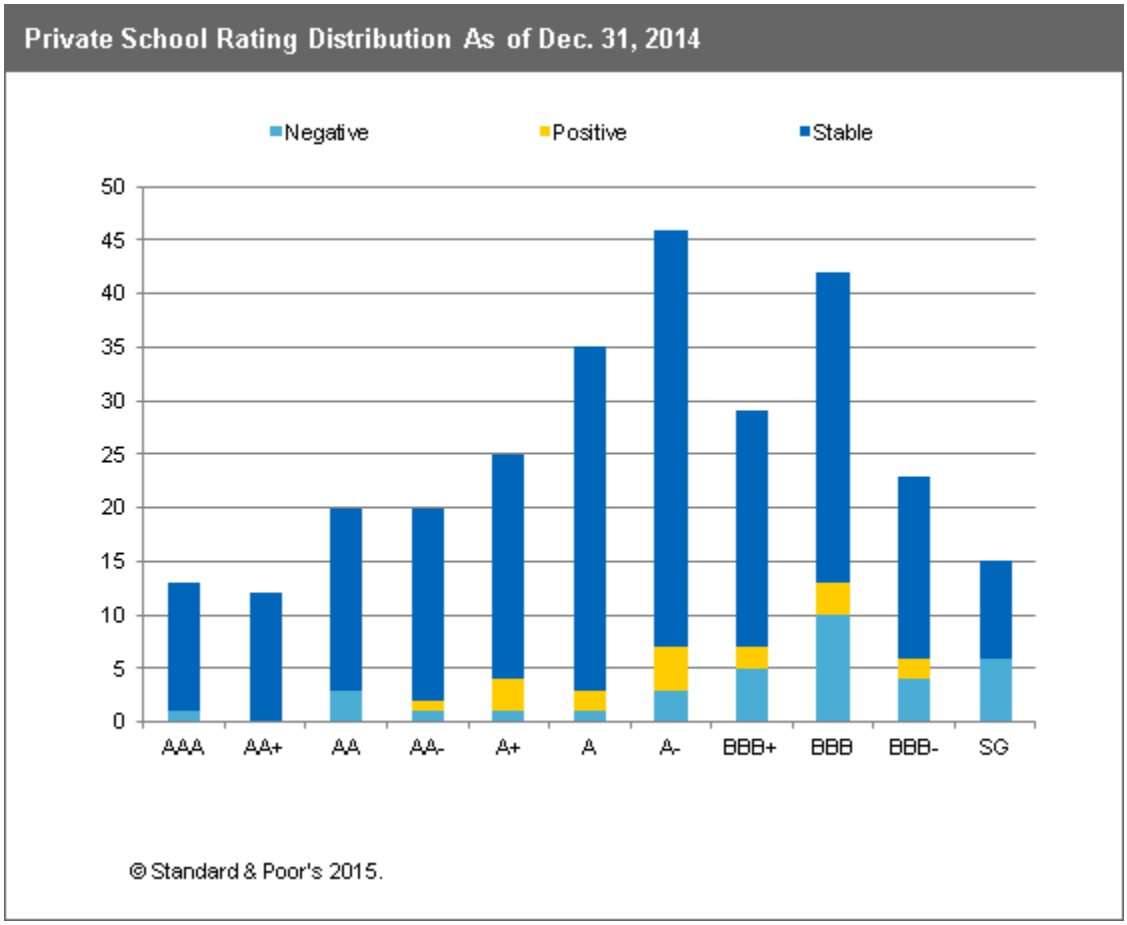
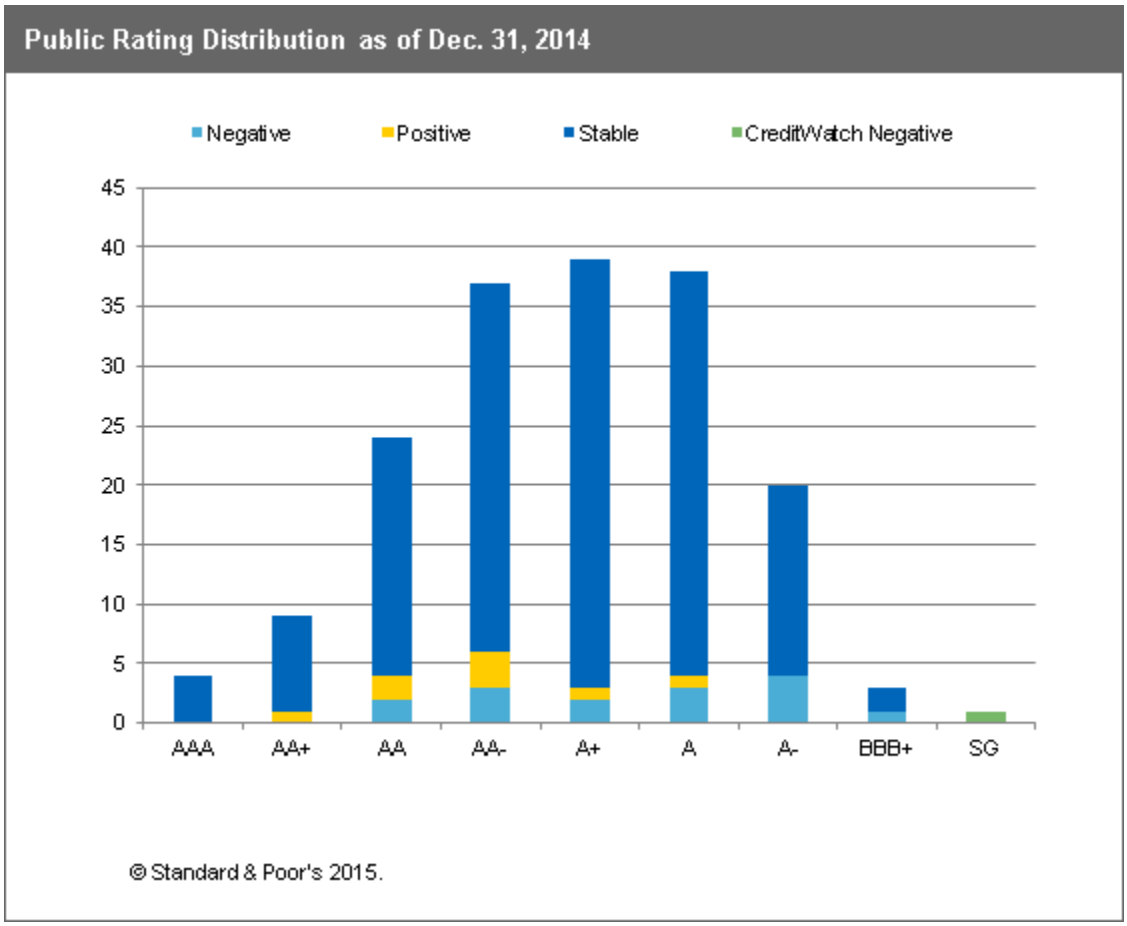


Chart 3



Despite the rating and outlook changes during 2014, our rating distribution remains roughly consistent with that of 2013, with public university ratings in a bell curve distribution with a median rating of 'A+', and private university ratings more evenly distributed, with a median rating of 'A'. For both public and private universities, most of the negative outlooks can be found at the lower end of the rating distribution. Thomas Jefferson School of Law defaulted on its debt in the fall of 2014, the first private university default in nearly 12 years. Our lowest-rated university is currently Franklin Pierce University in New Hampshire, at 'CCC/Negative'.

General Economic Outlook

Table 3

Standard & Poor's Economic Outlook As of November 2014

	-- 2014 --			-- 2015 --		-- Percent change --							
	Q2	Q3e	Q4e	Q1e	Q2e	2009	2010	2011	2012	2013	2014e	2015e	2016e
Real GDP	4.59	3.24	2.80	2.98	2.90	(2.78)	2.53	1.60	2.32	2.22	2.21	3.02	2.70
Federal Govt. Purchases, $2009	(0.89)	(0.23)	(0.55)	(0.84)	(0.84)	5.67	4.35	(2.69)	(1.78)	(5.69)	(2.66)	(0.70)	(0.80)

Table 3

Standard & Poor's Economic Outlook As of November 2014 (cont.)													
CPI	3.03	1.10	0.52	1.67	1.98	(0.32)	1.64	3.14	2.07	1.46	1.72	1.55	1.55
Unemployment Rate	6.23	6.07	5.96	5.93	5.84	9.28	9.63	8.93	8.07	7.35	6.23	5.82	5.69
S&P 500 Index	1,900.37	1,975.95	1,983.03	2,006.61	2,038.38	946.73	1,139.31	1,268.89	1,379.56	1,642.51	1,923.41	2,046.87	2,106.77

(1) Quarterly Percent Change represents annualized growth rate; Annual percent change represents average annual growth rate from a year ago. (2) Quarterly levels represent average during the quarter; Annual levels represent average levels during the year. (3) Quartlery levels of Housing Starts and Unit Sales of Light Vehicles are in annualized millions.

We believe general economic trends only moderately influence the higher education sector because college attendance for most students is a long-term goal that families prepare for and plan on for years. That said, economic forces certainly affect the type of institution selected, the length of time to graduation, the amount of student debt, and the ability to pay for tuition. And for part-time or nontraditional students in particular, it can influence their ability and willingness to attend college at all.

We project that the consumer price index will rise 1.7% in 2015, which will moderate expense growth and revenue projections for the sector. (See "U.S. State And Local Government Credit Conditions Forecast: Economic Growth Is Tinged By Questions Of Sustainability", published Oct. 15, 2014, on RatingsDirect.) We also expect investments to continue to appreciate, as measured by the S&P 500 index. This is important for the higher education sector, given its reliance on investment earnings and endowment appreciation. Because many institutions use a 5% annual endowment draw, investment returns would need to exceed 6.4% (5% draw plus 1.4% inflation) to preserve sustainable investment levels.

Also in 2015, we expect federal government spending to decrease by 0.7%, which may hurt research grant and contract awards and could also affect Pell Grant program awards.

Our projections also indicate that the national unemployment rate will improve to 5.8%. College enrollment typically runs countercyclical to the economy because some people return to school after a job loss or to retrain. However, after multiple years of high unemployment, most of these students have now graduated and are unlikely to enroll for another degree. We believe an improved employment rate would help the sector because working students or families of students would be better able to afford tuition.

Table 4

List Of Rating Or Outlook Actions In 2014							
		-- Rating change --		-- Outlook change --			
Organization	**State**	**To**	**From**	**To**	**From**	**Action**	**Date**
Loyola University	LA	A	AA+	Stable	Stable	Rating lowered from 'AA+'	January
University of Chicago	IL	AA	AA	Negative	Stable	Rating affirmed; outlook revised from stable	January
University of Puerto Rico	PR	BBB-	BBB-	Watch Neg	Negative	Rating affirmed	January
Ferris State University Board of Trustees	MI	A	A	Positive	Stable	Rating affirmed; outlook revised from stable	January
Polytechnic Institute of New York University	NY	AA-	BBB-	Stable	CW Positive	Rating raised from 'BBB-'; outlook revised from Watch Positive	January

Table 4

List Of Rating Or Outlook Actions In 2014 (cont.)							
University of Nebraska System	NE	AA	AA	Positive	Stable	New sale; rating affirmed; outlook revised from stable	January
Eastern Illinois University	IL	A-	A-	Negative	Stable	Rating affirmed; outlook revised from stable	February
Cedar Crest College	PA	BB+	BBB-	Stable	Negative	Rating lowered from 'BBB-'; outlook revised from negative	February
New York Institute of Technology	NY	BBB+	BBB+	Negative	Stable	Rating affirmed; outlook revised from stable	February
University of North Carolina at Charlotte	NC	AA-	AA-	Negative	Stable	New sale;rating affirmed; outlook revised from stable	February
University of the Sacred Heart	PR	BBB	BBB	Negative	Stable	Rating affirmed; outlook revised from stable	February
University of Puerto Rico	PR	BB+	BBB-	Watch Neg	Watch Neg	Rating lowered from 'BBB-'	February
University of Kentucky	KY	AA-	AA-	Postive	Stable	Rating affirmed; outlook revised from stable	February
Colorado College	CO	AA-	AA-	Postive	Stable	Rating affirmed; outlook revised from stable	March
The Board of Governors of the University of North Carolina (2005A)	NC	A	A+	Stable	Watch Neg	Rating downgrade	March
University of Puerto Rico	PR	BB+	BB+	Negative	Watch Neg	Rating affirmed; positive outlook revision	March
Delaware State University	DE	A	A+	Stable	Stable	Rating lowered	April
Illinois State University	IL	A+	A+	Negative	Stable	New sale: rating affirmed; negative outlook revision	April
Judson College	AL	BB+	BB+	Negative	Stable	Rating affirmed; negative outlook revision	April
Mercyhurst University	PA	BBB	BBB	Negative	Stable	Rating affirmed; negative outlook revision	April
University of Scranton	PA	A	A	Negative	Stable	Rating affirmed; negative outlook revision	April
Georgetown University	DC	A-	A-	Stable	Negative	Rating affirmed; positive outlook revision	April
Mount St Marys University	MD	BB+	BB+	Stable	Negative	Rating affirmed; positive outlook revision	April
MCPHS University	MA	A+	A	Positive	Positive	Rating raised	April
Texas Lutheran University	TX	BBB	BBB	Negative	Stable	New sale: rating affirmed; negative outlook revision	May
University of Kansas	KS	AA	AA	Negative	Stable	New sale: rating affirmed; negative outlook revision	May
Pittsburg State University	KS	A-	A	Stable	Stable	Rating lowered	May
Vermont State College	VT	A	A+	Negative	Stable	Rating lowered	May
Regent University	VA	BBB	BBB+	Negative	Negative	Rating lowered	May
Thomas M Cooley Law School	MI	BBB-	BBB	Negative	Negative	Rating lowered	May
Butler University	IN	BBB+	BBB+	Positive	Stable	Rating affirmed; positive outlook revision	May
Winston-Salem State University	NC	A-	A	Stable	Stable	Rating lowered	May
University of North Carolina at Greensboro	NC	A	A+	Stable	Negative	New sale; rating lowered	May

Table 4

List Of Rating Or Outlook Actions In 2014 (cont.)							
Albany Law School	NY	BBB	BBB	Negative	Stable	Rating affirmed; negative outlook revision	June
Haverford College	PA	AA	AA	Negative	Stable	Rating affirmed; negative outlook revision	June
Merrimack College	MA	BBB-	BBB-	Negative	Stable	New sale: rating affirmed; negative outlook revision	June
New Mexico State University	NM	AA	AA	Negative	Stable	New sale: rating affirmed; negative outlook revision	June
Pacific Lutheran University	WA	BBB	BBB	Negative	Stable	Rating affirmed; negative outlook revision	June
Rider University	NJ	BBB+	BBB+	Negative	Stable	Negative outlook revision	June
University of Puerto Rico	PR	BB+	BB+	Watch Negative	Negative	Rating affirmed; placed on CreditWatch negative	June
Boston University	MA	A	A	Positive	Stable	Rating affirmed; positive outlook revision	June
Georgian Court University	NJ	BBB-	BBB	Stable	Negative	Rating lowered	June
Pennsylvania College of Technology	PA	A	A	Stable	Negative	Rating affirmed; positive outlook revision	June
University of Arizona	AZ	AA-	AA	Stable	Negative	New sale; rating lowered	June
Michigan State University	MI	AA+	AA	Stable	Positive	New sale; rating raised	June
Trustees of Boston University	MA	A	A	Positive	Stable	Rating affirmed; positive outlook revision	June
Texas State University System Board of Regents	TX	AA	AA-	Stable	Stable	Rating upgrade	June
Western Michigan University	MI	A	A	Stable	Negative	Rating affirmed; positive outlook revision	June
University of Pittsburgh	PA	AA+	AA	Stable	Positive	New sale; rating raised	June
Franklin Pierce University	NH	CCC	B	Negative	Stable	Rating lowered	July
New York Law School	NY	BBB	A-	Negative	Negative	Rating lowered	July
Washington University	MO	AAA	AAA	Negative	Stable	Rating affirmed; negative outlook revision	July
University of Toledo	OH	A	A+	Stable	Negative	Rating lowered	July
University of Puerto Rico	PR	BB	BB+	Negative	NM	Rating lowered removed from Watch Neg	July
Sacred Heart University	CT	BBB+	BBB	Stable	Positive	Rating raised	July
University of North Dakota	ND	AA-	A+	Stable	Positive	Rating raised	July
Florida Gulf Coast University Financing Corporation	FL	A-	A-	Negative	Stable	Rating affirmed; negative outlook revision	August
University of Northern Iowa	IA	A+	A+	Negative	Stable	Rating affirmed; negative outlook revision	August
The Board of Governors of the University of North Carolina (2006B)	NC	A-	A	Stable	Negative	Rating downgrade	August
Thomas M Cooley Law School	MI	BB+	BBB-	Negative	Negative	New sale; rating lowered	August
University of North Carolina at Pembroke	NC	A-	A	Stable	Negative	Rating lowered	August
Kean University	NJ	A-	A-	Stable	Negative	Rating affirmed; positive outlook revision	August
Meredith College	NC	BBB	BBB	Stable	Negative	Rating affirmed; positive outlook revision	August

Table 4

List Of Rating Or Outlook Actions In 2014 (cont.)							
Stevens Institute of Technology	NJ	BBB+	BBB+	Positive	Stable	Rating affirmed; positive outlook revision	August
West Virginia University	WV	A	A+	Stable	Stable	New sale; rating lowered	August
Valley City State University	ND	A-	A-	Stable	Negative	Rating affirmed; positive outlook revision	August
Eastern University	PA	BBB-	BBB-	Negative	Stable	Rating affirmed; negative outlook revision	September
Hawaii Pacific University	HI	BB+	BB+	Negative	Stable	Rating affirmed; negative outlook revision	September
Thomas Jefferson School of Law	CA	CC	B+	Watch Negative	Negative	Rating lowered	September
Wisconsin Medical College	WI	A+	A+	Positive	Stable	Rating affirmed; positive outlook revision	September
Dowling College	NY	B-	B	Negative	Negative	Rating lowered	October
University of Wyoming Trustees	WY	AA-	AA-	Stable	Postive	Rating affirmed; negative outlook revision	October
Rensselaer Polytechnic Institute	NY	A-	A-	Negative	Stable	Rating affirmed; negative outlook revision	October
Molloy College	NY	BBB	BBB+	Stable	Stable	Rating lowered	October
Duquesne University	PA	A-	A-	Positive	Stable	Rating affirmed; positive outlook revision	October
McDaniel College	MD	BBB+	BBB+	Stable	Negative	Rating affirmed; positive outlook revision	October
Thomas Jefferson School of Law	CA	D	CC	NM	NM	Rating lowered	November
California College of the Arts	CA	BBB-	BBB-	Positive	Stable	Rating affirmed; positive outlook revision	November
Iona College	NY	BBB	BBB	Stable	Negative	Rating affirmed; positive outlook revision	November
Rhodes College	TN	A+	A+	Positive	Stable	Rating affirmed; positive outlook revision	November
Delaware State University	DE	A-	A	Stable	Stable	Rating lowered	November
Baylor College of Medicine	TX	A-	A-	Positive	Stable	Rating affirmed; positive outlook revision	November
Southern New Hampshire University	NH	BBB	BBB	Positive	Stable	Rating affirmed; positive outlook revision	November
Sweet Briar College	VA	BBB	BBB	Negative	Stable	Rating affirmed; negative outlook revision	November
Alabama State University	AL	BBB+	A-	Negative	Negative	Rating lowered	December
University of Northern Iowa	IA	A	A+	Stable	Negative	Rating lowered	December
Transylvania University	KY	A+	A+	Negative	Stable	Rating affirmed; negative outlook revision	December
Wayne State University	MI	AA-	AA-	Negative	Stable	Rating affirmed; negative outlook revision	December
University of Puerto Rico	PR	BB	BB	CW Negative	Negative	Rating affirmed; placed on CreditWatch negative	December
Yeshiva University	NY	BBB	A	Negative	Stable	Rating lowered	December
Waynesburg University	PA	BBB	BBB+	Stable	Negative	Rating lowered	December

All things considered, we believe that despite the likely stronger national economy this year, the not-for-profit higher

education sector will likely see more negative rating actions than positive in 2015 as institutions attempt to keep tuition affordable while adding or improving amenities to draw and retain students. These institutions' ability to balance those factors in an increasingly competitive market will determine the direction of the ratings.

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