Secured Finance Network

Higher Education Under Pressure – Options for Struggling Institutions

By Mark Podgainy

Many higher education Trustees and executive leaders need to recognize that their communities must confront the early stages of a long-term restructuring. The upcoming transition is similar to the long-term restructuring process now being addressed by the retail and healthcare industries. The difficult landscape that colleges and universities must contend with didn't just materialize – it has been a long time in the making.

Background and Recent Developments

There are several significant underlying, long term trends that have led to today's difficult higher education environment:

- Affordability – over time, tuition and room and board costs have increased much faster than family income growth.Between 1989 and 2016, the cost of an undergraduate degree increased 8 times faster than wages for both public and private schools.[1]In 1980, the median household salary was seven times higher than the cost of a public college tuition, today it is only three times higher.[2]Those cost increases have forced students and their families to choose between not attending college or borrowing significant amounts.In a similar time frame, student debt at graduation has increased from $13,500 to $30,000 per student, after adjusting for inflation[3].Federal policies have made it easier for students to take on more student debt – prior to 1986, there was a limit of $10,000 in subsidized student loans, but since 1993 there has been no limit.[4]

- Declining public support levels – state government funding reductions, particularly since the Great Recession, have forced public schools to increase tuition to make up the shortfall.

- Changing demographics – though the share of the adult population enrolled in college has increased significantly over the last 40 years, the traditional college age population has leveled off. Between 2000 to 2017, the overall U.S. population increased by 15 percent, from 282 million to 325 million. The population of 18-24-year olds increased 13 percent between 2000 and 2010 (from 27.3 million to 30.8 million), but remained relatively constant between (30.7 million to 30.5 million, peaking at 31.5 million) from 2010 to 2017. During the same time period, the number of children under 17 years old has remained stagnant.[5]

- Migration patterns - people are moving from the Northeast and Midwest to sunbelt and southern states like Florida, Arizona, Texas, and Georgia.Geographic enrollment trends are following the

same patterns. Smaller, private colleges have typically drawn from within their region, and migration towards central and southern states are projected to cause a decrease in high school graduates from the northeast.U.S. census statistics from 2010 to 2018 show that the youth population dropped more than 10 percent in the New England states of Vermont, New Hampshire, and Connecticut.Meanwhile, New England, with over 250 colleges and universities, has disproportionately more four-year private non-profit colleges compared to the rest of the nation. Schools that draw from a wider geographic region, with high selectivity, strong matriculation and revenue diversity don't face the same vulnerabilities.[6]

- Increase in supply – the number of public and private non-profit four-year institutions increased from 1,830 in 2000 to 2,030 in 2019, an increase of 10.9%, while the number of private for-profit 4-year institutions increased from 210 to 300, an increase of 42.9%.[7]

The primary impact of the increased costs and demographic changes has been a decline in enrollment. Total enrollment in degree-granting post-secondary institutions peaked at 21 million in 2010 and has since declined to 19.6 million in 2018.[8] Given that schools benefited from ever-increasing pools of applicants for many years, adapting to the new reality has been difficult. To address these issues, colleges have deployed strategies intended to maintain or increase enrollment, including:

- Adding or expanding existing programs
- Investing in new facilities
- Upgrading and expanding student services
- Discounting and providing increased aid levels
- Adding internal staff and outside enrollment consultants

Recent issues have worsened the negative enrollment trend. For example, foreign student enrollment, which is typically more lucrative, has declined over the last few years due to federal government immigration policy changes. Similarly, the COVID-19 pandemic has accelerated related trends. For example, remote learning *via* online classes, which was growing prior to the COVID-19 pandemic, has picked up steam and further reduced institutional housing and food revenues. The pandemic has further strained state government budgets, accelerating the continuing decline of public support. As a result, colleges that were previously challenged are now scrambling to ensure their survival, or seeking a path to a soft landing.

Schools whose enrollment strategies have not borne fruit are saddled with additional problems. For example, if the "build and they will come" strategy didn't work, an institution now has higher fixed costs spread over fewer students. If programs were added but didn't attract enough students, leadership must address the increased labor costs. Larger schools are better able to reinvest in their programs, facilities and services, and are also better able to react to strategic and tactical missteps. Scale allows institutions to spread fixed costs and raise funds from a larger group of potential donors.

The ability to turnaround a struggling institution is a function of time and available resources. The more time an institution has and the more cash it has on-hand, the larger the number of potential options. For example, an institution that may not be able to meet its payroll next week has few options to survive. On the other hand, an institution that has two years of financial runway, assuming the same operating plan, has the ability to change its operating plan and to explore multiple strategic options, such as discontinuing academic programs, selling assets, and entering into a joint venture, among many others. Whether an institution is underperforming, stressed or distressed, there are options to improve its financial condition and fulfill its mission and obligations to its students and other stakeholders. Following are potential options that struggling institutions can consider

depending on the severity of their financial challenge, whether underperforming, stressed or distressed.

Options for Struggling Institutions

Underperforming Institutions

An underperforming institution may have flat or declining revenues and/or increasing costs that result in declining cash flow. While there may be no serious short or even mid-term financial implications, a failure to change course could ultimately result in financial stress or distress. The goal is to ensure the institution's long-term survival, or alternatively, ensure the long-term survival of its mission in some form.

At this stage, the institution has time to analyze the cash- generating ability of its programs and identify cost savings in its overhead structure, allowing it objectively to determine its core competencies, strengths, and weaknesses, and develop strategies and tactics to change direction. A typical analysis would encompass:

- Academic operations – assess whether program departments and groups pay for themselves, taking into account registrations, course scheduling, space and instructor utilization, and faculty/student ratios
- Enrollment and admissions – determine effectiveness of marketing strategies, taking into account yields, dropout rates, graduation rates, tuition levels and discounting practices, and fees charged
- Financial aid – review of compliance quality, maximization of resources and options
- Space utilization – in addition to academic, assess residential, administrative, and athletic space utilization
- Manpower – evaluate leadership, and non-academic and academic manpower, considering: union *vs*. non-union, tenured *vs*. non-tenured and adjunct *vs*. permanent staff
- Contracts and vendors – review existing relationships to identify excess costs, duplication, and outdated or redundant services
- Working capital management – assess accounts receivable, third party and financial aid collection, aid-issuance policies and procedures, and accounts payable management

With this analysis completed, an institution will have a solid understanding of its business, including:

- Core competencies
- Top earning programs/majors as well as those losing money
- Student contribution by segment
- Underutilized space
- Underutilized instructors and non-academic staff
- Excess costs, including services and vendors
- Sources of slow-moving accounts receivable and write-offs; vendors with flexible payment terms

This information provides input for setting strategic direction and developing action plans. Fortunately, an underperforming institution has time to consider options that are more time-consuming to evaluate and implement, usually requiring a one to three-year time frame. These options can include a joint venture, merger, or acquisition; co-branding; and cost-sharing (e.g., collective procurement, facilities, administrative services, IT, health services, and libraries), etc. There are also options that are more straightforward and less time-consuming to implement, such as discontinuing unprofitable programs or majors; reducing underutilized academic and non-academic staff; re-focusing recruitment efforts on the most profitable student segments; selling, leasing, or

repurposing underutilized space; and renegotiating costs and terms with vendors. However, institutions may need to maintain certain unprofitable elements during a transitional period, like underutilized space or faculty should they be important to a potential acquirer or merger partner.

The following example is illustrative. A small liberal arts college with declining enrollment whose nursing program is its largest cash-generating program and core competency, has significant underutilized academic space, and is in an area which has several other liberal arts colleges, might consider the following:

- Merger – one of the nearby institutions could provide most of the liberal arts majors and programs, except for the nursing curriculum, with the subject college offering the nursing curriculum.The schools could potentially consolidate on one campus.
- Administrative cost sharing – centrally administer costs such as payroll, accounting, risk management, benefits, purchasing, campus safety, health services
- Co-branding – joint market to drive enrollment to both institutions
- Archive academic programs – discontinue programs that don't contribute to overhead
- Reconfigure the footprint - maximize existing space, and sell or lease excess space

For each option, monthly cash flow forecasts should be developed along with sensitivity analyses that measure the impact of different scenarios. Given today's rapidly changing environment, creating sensitivity analyses to inform contingency planning is critical. Most importantly, institutions should be striving to do the right thing for their students, whether via a transaction or a soft landing.

Stressed Institutions

A financially stressed institution, which has enough liquidity to operate, is likely either to trigger a default of a lender or bondholder payment or covenant, or has already done so. The goal is for this institution to survive in some form, likely in combination or affiliation with another institution(s), or to engineer a soft landing which enables the institution to fulfill its obligations. Financially stressed institutions typically have the time to complete the rigorous analysis required to plan a future. The first step is to more aggressively manage working capital and cash flow to lengthen the survival runway. Further steps to be considered may include:

- Sell (or sell/lease back) assets
- Obtain incremental financing
- Increase drawdowns on the endowment
- Raise additional contributions
- Negotiate a forbearance with the lenders
- Improve working capital management
- Implement hiring freezes, pay cuts and layoffs

Distressed Institutions

A financially distressed institution is likely insolvent, is unable to meet its debts as they come due, and has negative cash flow. It has entered payment and/or covenant default, is stretching vendor payments, and is scrambling to bring in cash as quickly as possible. The institution's goal is to buy enough time to ensure a soft landing, which most likely will include closure, but could be executed *via* a transaction (merger, acquisition, etc.) if there is enough time. In this context, the Board and leadership team should be considering the following options:

- Lender forbearance – by working with its lenders to obtain a forbearance agreement, an institution is buying time to execute a short-term (3-6 month) or mid-term (12-month) plan.Requisites for negotiating an agreement usually include delivering to the lender a regularly updated short-term (13-week) cash flow forecast; a mid-term (12-month) cash flow forecast; and a business plan. Taking these steps, and retaining an independent financial advisor specializing in restructuring, will enable an institution to earn its lender's confidence and show that its leadership is competent.

- Bridge financing – financially strapped institutions may need additional funding in order to get to a transaction (e.g., acquisition, sale of assets), which can be obtained through the incumbent lending group, third-party lenders, or sometimes through donors.

- Working capital management – by focusing on collecting past-due accounts, providing incentives for early payment where possible, and complying with the Department of Education's documentation requirements, institutions can improve short-term collections and extend the financial runway.Similarly, institutions can also improve cash flow by delaying and/or restructuring vendor payments so that weekly payments reflect what must be paid to keep the lights on.For many finance departments, being in a position of "juggling payments" and micromanaging payment priorities and vendor communications is unchartered territory, but crisis management professionals can guide the team or even take over this role.

- Acquisition or merger – while the acquisition of, or merger with, a distressed institution may be unlikely given the time it takes for execution (due diligence, planning, closing), it could be possible to execute in a truncated time frame, depending on how attractive the institution's assets are (e.g., coveted programs, valuable real estate, well-known brand, etc.), as motivated buyers/partners can move quickly.

- Sale of assets – sale, or a sale-leaseback, of assets can generate cash and extend the financial runway or can pay off debt that is pressuring the institution.

- Declaration of financial exigency – this action enables institutions with contract provisions requiring notice of financial condition to lay off tenured faculty members under American Association of University Professors guidelines.There are implementation risks, but given that staffing accounts for a significant, if not a majority, portion of a school's expenses, the flexibility gained can have a significant positive impact on cash flow.

- Teach-out – a Teach-out is a planned transition of students from a closing institution (or one that is eliminating programs or majors) to one or more "receiving" institutions located nearby or online.In this arrangement, the receiving institution agrees to accept all credits earned by transitioning students toward a reasonably similar degree and is willing to award the degree in approximately the same amount of time the student would have needed at the closing institution.Institutions must be in close touch with the various regulatory groups (accreditors, licensing boards, etc.) because Teach-out plans need to be submitted for approval and receiving institutions must meet certain criteria to be authorized to participate in a Teach-out plan.

- Bankruptcy – filing for bankruptcy protection prior to resolving student Teach-out obligations is essentially a hard landing.An institution that files a bankruptcy petition loses its eligibility to participate in programs authorized under the Higher Education Act of 1965, precluding the ability to restructure.However, depending on an institution's facts and circumstances, a bankruptcy filing could be beneficial in effecting a wind-down, and could be used in conjunction with other actions.

- Liquidation – similar to bankruptcy, an institution’s liquidation is essentially a hard landing, and may be considered in conjunction with some of the actions above.An institution will work with legal and financial advisors to monetize its assets to maximize recoveries for its creditors.

Summary

If there are clouds on the horizon, an institution must start planning for its future as early as possible. In many cases, consolidation of some kind provides the best opportunity for underperforming or stressed institutions to fulfill their missions and obligations, given today’s education landscape.

Taking steps to extend the decision-making and plan-execution timeline is critical. Trustees and leadership teams who have never experienced working though these situations should take comfort in knowing that outside professionals can be brought in to help analyze, recommend, and support implementation strategies to navigate through these difficult and very unfamiliar times. Inaction must be avoided at all costs.

[1] Source: Educationdata.org
[2] College Board
[3] Source: Educationdata.org
[4] Historical Federal Student Loan Limits (savingforcollege.com)
[5]Source: National Center For Education Statistics
[6] Sources: Education Next, Spring 2021, vol. 21 no. 2; GlobeSt.com, ”Private Colleges To Take Sharpest Hit From Coronavirus Enrollment Declines”, by Dan Packel, July 26, 2020
[7] Source: National Center for Education Statistics – Number of postsecondary institutions over time - Number of degree-granting institutions with first-year undergraduates, by level and control of institution: Academic years 2000-01, 2012-13 and 2018-19.
[8] Source: National Center for Education Statistics – Total fall enrollment in degree-granting postsecondary institutions, by attendance status, sex of student, and control of institution, 2019.

About the Author

Mark D. Podgainy, CTP, is a managing director in the New York office of Getzler Henrich with more than 20 years of experience working with healthy, underperforming and distressed middle market businesses, both as an advisor and as a member of the management team. He provides operations restructuring, business plan analysis, performance improvement, cash and vendor management, bankruptcy consulting and interim management services. He also works with law firms on forensic and litigation support assignments in bankruptcy cases. His clients have included business owners, boards of directors, private equity firms, lenders, creditors’ committees and law

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Mark has extensive experience in successfully guiding middle market companies through workout and restructuring processes, both in court and out of court, throughout the country. He has served as CRO, interim CFO, treasurer or financial advisor in a variety of companies and situations. Outcomes have included successful reorganizations, enterprise and asset sales, wind downs and liquidations. In each situation, he has been able to address thorny financial, legal, organizational and governance issues to maximize recoveries for the parties-in-interest.

Mark has an MBA from Columbia University and a bachelor's degree from Cornell University's School of Hotel Administration. He is currently a board member of Neighborhood Housing Services of New York City, Inc., a non-profit that revitalizes underserved neighborhoods; the NYC Chapter of the Turnaround Management Association; and of 520 West 19th Street Condo Association. He is a Certified Turnaround Professional, a member of the American Bankruptcy Institute, the Turnaround Management Association, and the Cornell Hotel Society and has written frequently on mergers and acquisitions, real estate and related topics for numerous industry trade publications.