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Moody's Sees Stiff Challenges for Colleges—Especially Private Ones—in Next Year

By SCOTT CARLSON

A new annual-outlook report from Moody's Investors Service says that higher-education institutions are facing a range of challenges in the next year and a half. Although all colleges will face hardship, private colleges will be especially stressed compared with public colleges and community colleges.

Roger Goodman, a Moody's vice president and author of the report, said that this was the first negative outlook for all sectors of higher education since the credit-rating agency started publishing higher-education outlooks in the mid-1990s.

The outlook is consistent with trends that Moody's has been marking over the past year. Last January, Moody's released an outlook that said that the climate for colleges was stable, but that several factors, like lower investment returns and higher energy costs, could lead to problems for colleges (The Chronicle, January 25, 2008). In August, as the economy got significantly weaker, Moody's released an update that maintained a stable outlook, but cited more risks amid an eroding housing market and fund-raising climate (The Chronicle, August 1, 2008).

In those reports, Moody's noted that private colleges were especially vulnerable as families look for lower-cost alternatives among public colleges and community colleges, a point reiterated in this report.

The new report, "2009 U.S. Higher Education Outlook," says that colleges face risks in four crucial areas:

* The first is increasing pressure on tuition and financial aid, with declines in household income, investments, and home equity. Access to loans is also scarcer. However, Moody's considers college education to be "a nondiscretionary expense," which means that families will generally not postpone enrolling children in college.

* Second is loss in endowments, which will probably be the largest in recent decades—down perhaps as much as 35 percent since June. The report

says those losses will not necessarily lead to rating downgrades.

* Third, many colleges are facing pressure on liquidity. "Investments in hedge funds, private equity, and other private investment vehicles are generally proving even more illiquid than originally thought," the report says.

* Lastly, many colleges are exposed to volatility in variable-rate debt markets.

The short-term risks from these four challenges outweigh risks from longer-term challenges, like changing demographic trends, Mr. Goodman said.

Fortunately, colleges plan with long lead times, he added. "That is why there is so much in the report mentioning management and governance as being extremely critical for how colleges weather this cycle," he said, speaking over the phone from Florida, where he is attending a leadership conference organized by the Council of Independent Colleges. "If a college goes into the next year's budget without some kind of contingency plan if enrollment or tuition were to come in below expectations, that is a big red flag."

College leaders at the conference seemed to show an intense interest in financial issues, he said. "I think there are some institutions that feel locked in," he said. "They now recognize the risks of the variable-rate debt that they took on, but they are not quite sure how to get out of it when a lot of the outs that would normally be there just aren't there in this environment."

The report is available to Moody's subscribers.