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U.S. Municipal Bond Market

Higher Education Sector Using Debt As COVID-19 Liquidity Buffer

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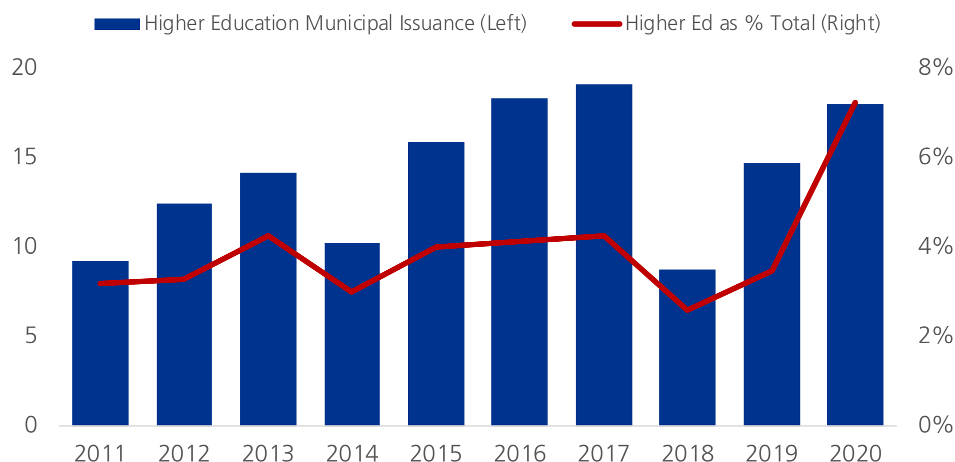
Uncertainty of Higher Education Sector Financial Conditions

The financial trajectory of the higher education sector is one of the most concerning, probably only second to transportation, among major sectors in the municipal bond market. This viewpoint is reinforced by the fact that higher education is also second behind transportation regarding how many credits possess "Negative" and "CreditWatch Negative" outlooks according to S&P,[1] one of the major rating agencies that rate municipal debt.

Some thought there was time for higher education institutions to work out strategies when the COVID-19 shutdowns began in March, and even when the reopening rollbacks occurred in June. Now, almost at the end of August, credit questions remain about the sector as it relates to what fall enrollments and instruction models will look like. In a mid-year higher education sector review S&P wrote:

> Approximately 40% of the 435 U.S colleges and universities we [S&P] rate maintain a negative outlook, which reflects our view that there is at least a one-in-three chance that operating and economic conditions will worsen to a degree that affects the ability of the school to maintain credit characteristics in line with the current rating level. Given continued uncertainty around fall 2020 enrollments and fiscal 2021 operating budgets, further rating actions, including owngrades, remain likely.[2]

Higher Education Municipal Issuance Already Much Larger % of Total Issuance



Source: Thomson Reuters data via The Bond Buyer; HilltopSecurities. $ in billions.

Fiscal policy solutions have not been near enough for higher education institutions to withstand the COVID-19 storm.

Fiscal Policy Has Not Been Enough for Higher Education

Fiscal policy solutions have not been near enough for higher education institutions to withstand the COVID-19 storm. The Coronavirus Aid, Relief, and Economic Stabilization Act (CARES Act) did include a $31 billion Education Stabilization Fund.[3] $14 billion of the allocation was available to higher-ed entities via the Higher Education Emergency Relief Fund, but restrictions on the use of the money have kept it underutilized. Paycheck Protection Program funds (from the CARES Act) have

provided a buffer for some but eligibility was only open to schools with less than 500 employees.[4]

We are certainly seeing that colleges and universities are executing taxable and tax-exempt refundings to create debt service savings. One of the strategies we have not commonly seen higher education entities use is new issue debt to provide a buffer.

The Landscape and Financial Strategies are Different this Time

The budgetary response by higher education organizations in times of financial stress in the past have played out with common themes. Some of these strategies have been used or considered this year as well. Discretionary spending was usually the first thing to go. Other spending was examined as needed, but final cuts depended upon the severity of the fiscal stress. Rainy day funds or similar accounts were considered a buffer as well. We are certainly seeing that colleges and universities are executing taxable and tax-exempt refundings to create debt service savings. One of the strategies we have not commonly seen higher education entities use is new issue debt to provide a buffer.

This time may be different.

At first glance, we are already seeing through July higher education *municipal* debt issuance has been a much larger percentage of overall issuance. Through the first seven months of 2020, colleges and universities already sold about $18 billion of municipal debt. That par amount is 7.24% of all municipal bond market issuance, which is $248 billion through the end of July. The higher education issuance through July would have been considered a very high total for even an annual period, relative to past years. Typically, we saw higher-ed issuance range from 2.59% and it even reached as high as 4.25% of all issuance back in 2013; Over 7% is very high, especially considering this data is only through July. Another element that is not factoring into the municipal issuance numbers is the rise of the use of taxable debt with corporate CUSIPS by higher education institutions. Higher-ed sector issuance of taxable debt with corporate CUSIPS has been on the rise as well this year.

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Timing is a Factor

It could be that higher education debt issuance falls off from here, or at least relative to what we saw over the first seven months of the year. It could be that colleges and universities, if they were able to get into the market before the end of the summer, acted as quickly as they could in coming to the capital market for strategic reasons. They may have been expecting there could be more questions than answers arise about budgets and enrollments after the end of the summer. This could be a reason why they wanted to access the market so quickly after the COVID-19 shutdowns began and why issuance has been relatively higher than in past years. Also, it seems that with the high level of uncertainty about what the future holds and the lack of relief from the federal government, debt issuance was one of the only alternatives higher-ed finance officers could consider at this point. We will certainly be watching to see how the rest of the summer, fall, and remainder of 2020 plays out.

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[1] *Please see S&P data on page 3: Kozlik, Tom; Public Finance Downgrades to Outpace Upgrades, Probably for Years; HilltopSecurities; August 13, 2020.*
[2] *Not-For-Profit Higher Education Mid-Year Sector View: Fall 2020 Enrollments Will Drive Credit; S&P Global Ratings; August 18, 2020.*
[3] *Kozlik, Tom; Agreement on the $2+ Trillion CARES Act; Not Nearly Enough for State and Local Governments; HilltopSecurities; March 25, 2020.*
[4] *Kelderman, Eric and Dan Bauman; Millions in Paycheck-Protection Dollars Went to Colleges on the Brink of Closing; Chronicle of Higher Education; July 8, 2020.*

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