

U.S. Municipal Bond Market

Higher Education in Crisis, Systemic Pressures Buck the Golden Age Trend

- The current higher education crisis is characterized by declining enrollment; expensive tuition and rising debt loads; declining government support; inflation; falling confidence in higher education, and the increased chance that college doesn't pay off for individual students.
- Consequently, we are lowering the HilltopSecurities Municipal Credit Outlook for both the Public and Private Higher Education sub-sectors to "Negative" from "Cautious."
- Private institutions are currently under more strain compared to their public counterparts. However, public institutions are not immune, and we anticipate more pronounced credit deterioration within the next one to three budget cycles.
- In the first half of 2024, Moody's downgraded 24 higher education credits and upgraded only three. By comparison, the rating agency upgraded 271 public finance issuers and downgraded 121 in the first half of 2024.
- Regular reviews of all higher education sector holdings are suggested to navigate this complex landscape. We are in a period where investors need to be highly selective even with investment-grade higher education credits.

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We Lowered Our Higher-Ed Credit Outlooks to "Negative" from "Cautious"

The non-profit U.S. higher education sector is encountering severe systemic pressures, bucking the "Golden Age" trend observed in public finance since March 2021. Both public and private institutions are affected, but mostly it is the smaller private institutions which are experiencing the most significant credit stresses, leading to what can be described as an existential crisis for some. Despite recent federal relief, higher than expected economic growth (in 2024 so far), positive investment returns, and the rising importance of future skills that universities are in a unique position to deliver, these institutions are under attack on multiple fronts.

Systemic Pressures Causing Higher Education Crisis

Current Pressures:

- Declining enrollment
- Expensive tuition, rising debt loads
- Declining government support
- Inflation
- Falling confidence in higher education
- Increased chance college does not pay off

Upcoming Pressure:

- Enrollment cliff (2027 per forecast)

Source: HilltopSecurities.

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The current crisis is characterized by declining enrollment; expensive tuition and rising debt loads; declining government support; inflation; falling confidence in higher education, and the increased chance that college doesn't pay off for individual students. These factors have resulted in a significant disparity of rating downgrades compared to upgrades, closures, mergers, and other strategic maneuvers.

Consequently, we are lowering the HilltopSecurities Municipal Credit Outlook for both the Public and Private Higher Education sectors to "Negative" from "Cautious." While both sub-sectors are experiencing significant pressures, the current credit situations differ markedly. Private institutions are currently under more strain compared to their public counterparts. However, public institutions are not immune, and we anticipate more pronounced credit deterioration within the next one to three budget cycles. The entire higher education sector faces looming challenges, notably the impending enrollment cliff and demographic shifts expected to begin in 2027. These factors could present the most significant hurdles yet, potentially leading to the sector's toughest times ahead.

Despite these challenges, many higher education institutions will continue to be vital for the future. The institutions best positioned to thrive will be those that are selective, larger, innovative, and flexible, with budget models that are not heavily dependent on fluctuating student enrollment. These institutions will be better equipped to adapt to evolving educational paradigms, ensuring they remain relevant and effective in preparing students for the future job market.

Investors also should recognize the importance of higher education in the evolving economy. The U.S. workforce is expected to grow to 171 million jobs by 2031, with nearly three out of four jobs requiring postsecondary education or training, according to an analysis by The Georgetown University Center on Education and the Workforce. Such a forecast highlights the growing importance of college for future job prospects, even in an economy increasingly influenced by contemporary technologies such as artificial intelligence.

The Higher Education Rating and Credit Landscape

Rating downgrades have significantly outpaced upgrades in the non-profit higher education sector this year, according to data from Moody's. The challenges outlined above and in the following pages far outweigh the catalysts in the sector. In the first half of 2024, Moody's downgraded 24 higher education credits and upgraded only three. This means for every institution that was upgraded, eight were downgraded, highlighting the substantial financial pressures institutions are currently facing. Many of the downgrades affected small, private institutions struggling with these challenges. In contrast the rating agency upgraded 271 public finance issuers and downgraded 121 in the first half of 2024. A list of Moody's higher education sector rating actions can be found in the Appendix on page 9.

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Rating Action Comparison, Public Finance (All) Versus Higher Ed

| Sector | Rating Action | 2023 | Ratio | First Half of 2024 | Ratio | Note |
|----------------------|---------------|------|-------|--------------------|-------|--|
| High Education | Upgrades | 16 | | 3 | | The pace of downgrades accelerated in 1H24 |
| | Downgrades | 30 | 1.88 | 24 | 8.00 | |
| Public Finance (All) | Upgrades | 716 | | 271 | | Upgrades still outnumber downgrades, pace is slowing |
| | Downgrades | 199 | 0.28 | 121 | 0.45 | |

Source: Moody's and Hilltop Securities.

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We started 2024 with “Cautious” outlooks on both the private and public higher education sub-sectors. For more details, please see [The Municipal Market in 2024, Hilltop’s Municipal Sector Credit Outlooks](#) (Jan. 22, 2024). However, due to the ongoing pressures we discuss herein, the current credit deterioration, and the anticipated further decline in credit quality likely to occur, we are revising both our Higher Education Municipal Sector Credit Outlooks to “Negative” from “Cautious.” The persistent challenges we have outlined are exacerbating financial instability across the sector. Given these compounding issues, we believe a “Negative” outlook more accurately reflects the current and expected future status of both Public and Private Higher Education.

More detailed investor diligence is required when reviewing potential investment candidates in the higher education sector. Regular reviews of all higher education sector holdings are suggested to navigate this complex landscape. We are in a period where investors need to be highly selective even with investment-grade higher education credits.

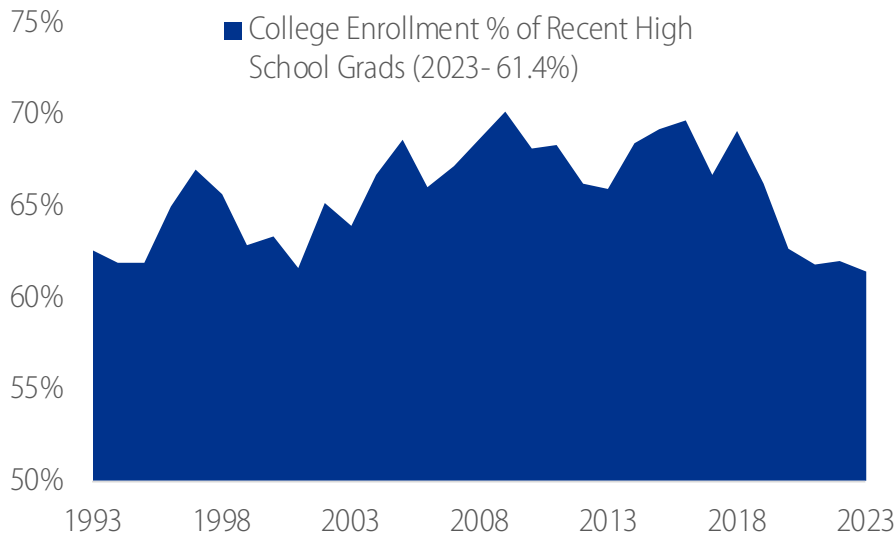
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Declining Enrollment, It’s Happening Now

College enrollment plummeted to a multi-decade low, per [recent U.S. Bureau of Labor Statistics data](#). Only 61.4% of high school graduates enrolled in college in October 2023. The reasons the numbers plummeted are crucial. Skyrocketing tuition costs have made higher education a financial burden for many. The crushing weight of student debt scares off potential students, who fear taking on massive loans without a more certain payoff. Meanwhile, alternative education pathways—like vocational training, online courses, and certification programs—offer cheaper, job-ready options. A robust job market, like we saw before the labor market weakened in 2024, has the potential to lure high school graduates straight into the workforce. The COVID-19 pandemic only worsened the situation, disrupting education and creating financial uncertainty. Institutions in the Midwest and Northeast U.S. are facing intensified enrollment challenges due to population declines in these regions.

Skyrocketing tuition costs have made higher education a financial burden for many.

College Enrollment Rates are the Lowest in 30 Years



Source: U.S. Bureau of Labor Statistics and HilltopSecurities.

Much has been made about rising tuition costs in the higher education sector, and the numbers are startling.

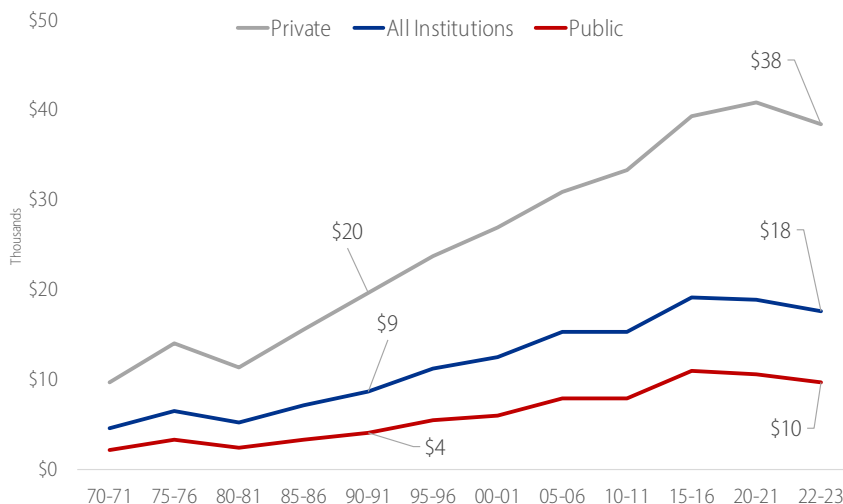
Costs are Rising, Tuition Doubled in the Last 30 Years

Much has been made about rising tuition costs in the higher education sector, and the numbers are startling. Over the past few decades, tuition costs have skyrocketed, making higher education less affordable for many Americans. Since 1992, the sticker price or the full-cost of tuition before taking into account any grants, aid or scholarships for a four-year private college has nearly doubled. For public colleges, the price has more than doubled, even after adjusting for inflation.

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Several factors have contributed to this trend, including reduced government support for higher education, lower enrollment, and others. Today, the average total cost of attending a private college, is about \$38,000 a year, according to data from the National Center for Education Statistics. Many are quick to note the net price after financial aid can bring private tuition down closer to public institutions' costs, sometimes. Public institutions are often more affordable, but costs can still be prohibitively high, especially for out-of-state students.

Cost of College Tuition, Inflation Adjusted



Source: National Center for Education Statistics, Education data initiative and HilltopSecurities.

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Declining Government Support

Declining support for higher education institutions from federal and especially state governments is not a new phenomenon. Decades ago, Arthur Levine identified higher education as a “mature industry,” in his 1997, Higher Education’s New Status as a Mature Industry. Levine expected government funding was unlikely to recover, attributing reduced federal funding in the 1980s and 1990s to two primary factors: macro-economic weakness, and shifting priorities.

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The Center on Budget and Policy Priorities called the period after the 2008 Financial Crisis A Lost Decade in Higher Education Funding. State funding for higher education saw a nearly 4% increase last year, according to the State Higher Education Finance analysis by the State Higher Education Executive Officers Association. This type of increase is unlikely to continue. Some state governments still have a COVID-19 relief cushion to fall back on, but we anticipate increased pressure on state budgets as these funds are depleted.

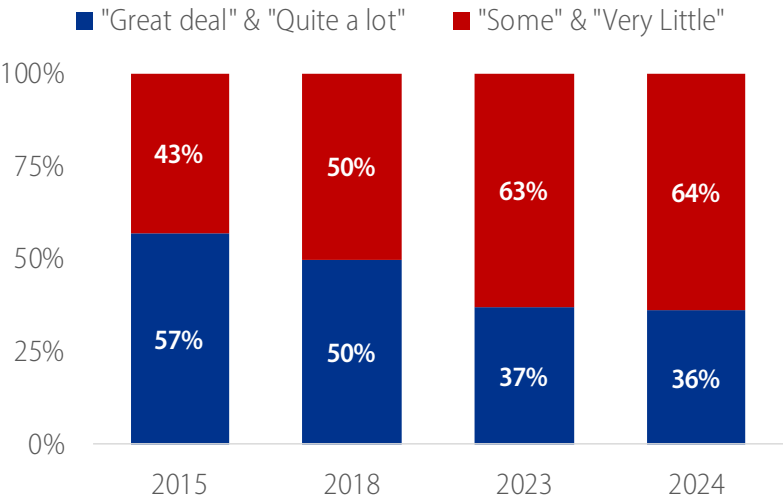
The quest to regain structural balance and the looming threat of the next economic downturn further jeopardizes higher education funding as well. Investors need to be acutely aware of this ongoing risk, which is likely to intensify over time. The financial landscape for higher education remains precarious, and the sector’s ability to navigate these challenges will be crucial for its future stability.

Eroding Confidence in Higher Education

We have been closely monitoring polling data, which shows that Americans’ confidence in higher education has steadily declined over the past decade. It is crucial for investors to recognize this trend, understand the underlying factors driving it, and acknowledge that this shift in attitude likely influences some college-path decisions. However, it is also important to note that, despite the declining confidence in higher education, college remains a worthwhile investment for many individuals.

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Americans' Confidence in Higher Education Continues to Fall



Source: Gallup and HilltopSecurities.

Americans' confidence in higher education fell sharply between 2015 and 2023. Recently, a July 2024 Gallup poll confirmed again that Americans’ confidence in higher

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education remains shaky. The recent July poll reported only 36% have a “Great deal” and “Quite a lot” of confidence. More detailed results from the poll unveil that perceived political agendas, the wrong focus/not teaching the appropriate skills, and costs are the top three reasons for the lack in confidence.

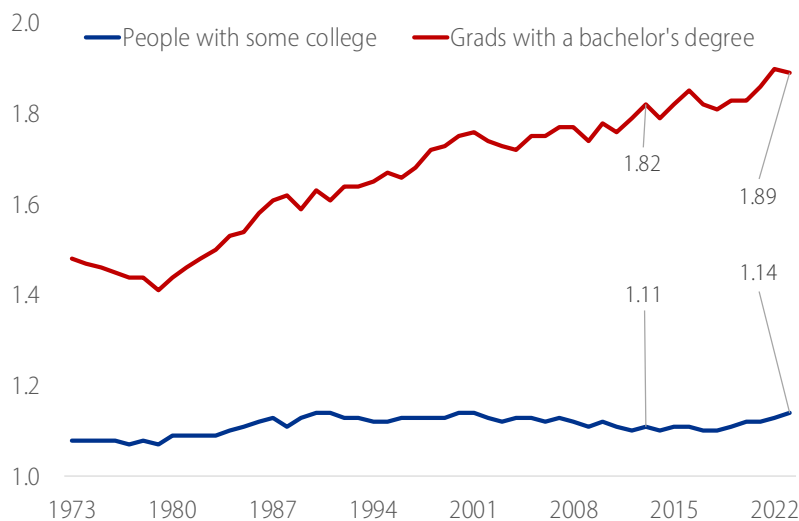
While the Gallup results from July 2024 highlight a growing concern—“costs” as noted above and or more specifically rising tuition expenses and high student debt levels are also eroding confidence in higher education—a deep dive into this dynamic reveals more details about the specific reasons behind this relationship. Dr. Douglas Webber, Associate Professor of Economics at Temple University, emphasized, “Let me be clear, the financial returns to graduating from a four-year college far outweigh any costs for the average student.” However, he cautions, “Not everyone receives the average payout from a college degree. There are sizable differences in lifetime earnings, which depend on factors like a specific college major, the school you attend, your own abilities, dumb luck, and many other factors,” as discussed in his paper, [Is College Worth It? Going Beyond Averages](#).

Increasing Chance College Does Not Pay Off, For Some

We believe investors should consider Webber’s analysis carefully. At the top end, there is a 96% chance that a college degree pays off in some situations, while in others, there is less than a 40% chance. This range and these factors make a significant difference in outcomes. Webber writes, “A better way to think about whether college pays off is through the lens of the financial investment, which involves some degree of risk.” And, the more debt a student incurs, the greater the chance college does not pay off. This is a key risk and reason why some potential candidates may opt out of college in the future, further weakening enrollment.

To show investors that not all trends related to higher education are negative we thought it was important to remind that the value of a college degree remains high. That the gap between what one earns in hourly pay with a degree compared to one without a degree is higher and has been rising. Also, changes in the workforce are likely to also increase the value of a college degree as well.

Rising Value of a College Degree, Ratio of Average Hourly Pay (in \$) Comparison



Source: Economic Policy Institute and HilltopSecurities.

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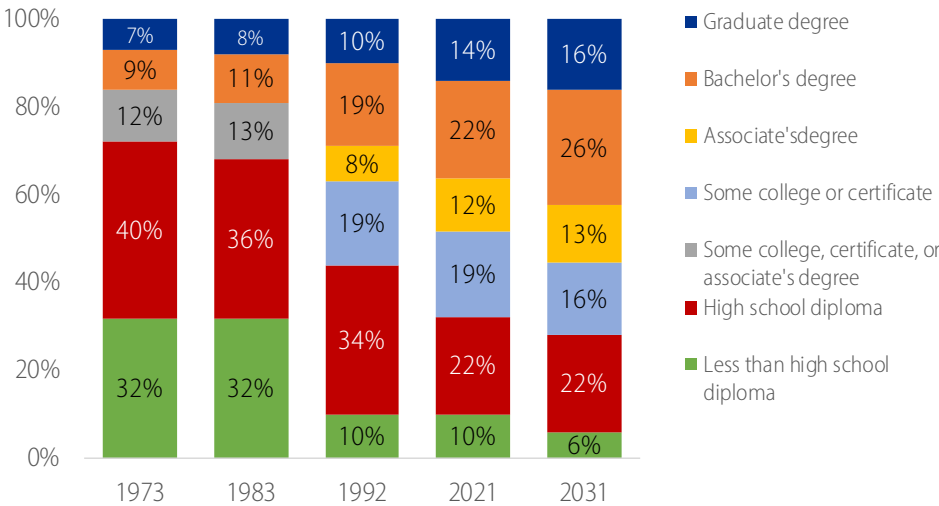
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Within the next decade the U.S. workforce is expected to grow to include 171 million jobs according to analysis contained in the report After Everything- Projections of Jobs, Education, and Training Requirements through 2031 published by Carnevale et al., and The Georgetown University Center on Education and the Workforce. The analysis states a little over half (55%) of U.S. jobs will require a bachelor's, graduate, or associate's degree which highlights the growing importance of higher education for future job prospects. This is especially true for an economy that is evolving due to new technological shifts driven by advances such as artificial intelligence. After Everything further projects the workforce will be increasingly bifurcated into two parts: one requiring higher education for managerial and professional roles, and another where non-professional jobs are accessible to those with lesser qualifications.

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Future demand for postsecondary education is driven by the fastest-growing industries needing higher education qualifications such as technology and business and the overall trend of those in the managerial and professional occupations requiring more education and training over time. This ongoing shift has made higher education a crucial pathway for Americans to middle and upper-class status and earnings, with a significant increase in jobs requiring higher education from 1983 to 2031. This ongoing shift has occurred despite Americans' falling confidence in higher education.

Distribution of Jobs by Education Level



Future demand for postsecondary education is driven by the fastest-growing industries needing higher education qualifications such as technology and business and the overall trend of those in the managerial and professional occupations requiring more education and training over time.

Source: Anthony P. Carnevale, Nicole Smith, Martin Van Der Werf, and Michael C. Quinn. After Everything: Projections of Jobs, Education, and Training Requirements through 2031. Washington, DC: Georgetown University Center on Education and the Workforce, 2023. cew.georgetown.edu/Projections2031 and HilltopSecurities.

The Anticipated Enrollment Cliff of 2027

We have outlined the current pressures that have created a crisis situation for some institutions in the non-profit U.S. higher education sector. Now, we must address an impending challenge that could have even more profound implications: the upcoming enrollment cliff and the expected demographic shifts projected to start in 2027.

The Western Interstate Commission for Higher Education (WICHE) projects that the number of high school graduates in the U.S. will begin to decline starting in 2027. This trend follows a period of growth and stabilization, with the peak expected around 2025.

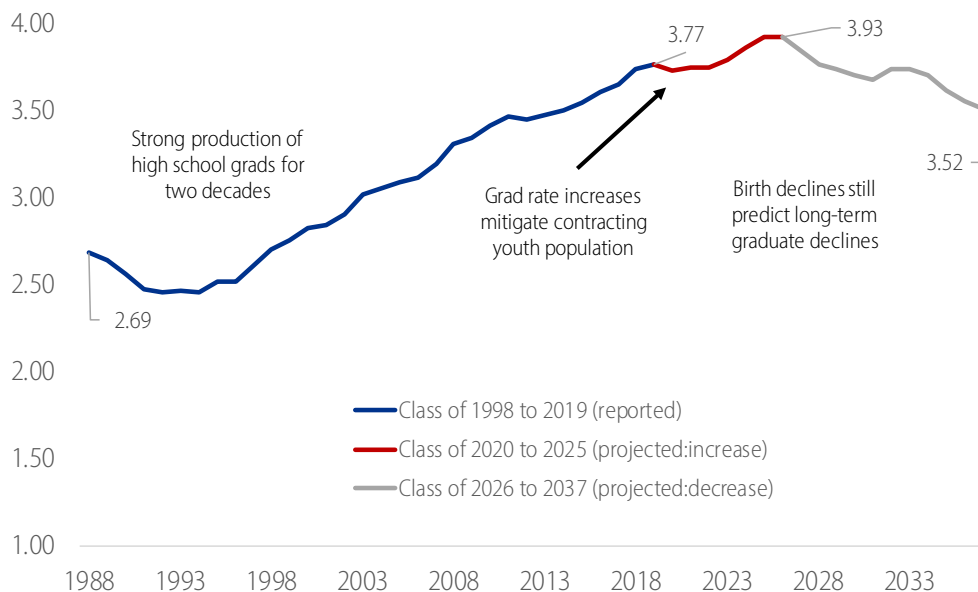
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The decline is attributed to lower birth rates following the Great Recession, leading to fewer students progressing through the U.S. K-12 primary and secondary school system. From 2027 onwards, the average size of graduating classes is expected to be smaller, continuing this downward trend until at least 2037. This projected decline poses significant challenges for higher education institutions, which may face reduced enrollment and increased competition for students.

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These changes could present the most significant challenges the sector has ever faced. In essence, the sector may be on the brink of its toughest times ahead. It is crucial for investors to take proactive measures now to navigate not only the current pressures but also this looming threat. The time to act is now, as the outstanding underlying ratings, and financial stability of institutions may hang in the balance.

Number of High School Graduates Projected to Decline Starting in 2027



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Source: WICHE and HilltopSecurities.

Definitions of HilltopSecurities Municipal Sector Credit Outlooks

Positive: HilltopSecurities believes there are factors which point towards improving issuer or sector credit quality. This may result in a higher level of credit ratings upgrades versus downgrades if issues are rated.

Stable: HilltopSecurities believes there are factors which point towards stable issuer or sector credit quality. This is likely to result in an even level of credit ratings upgrades versus downgrades if issues are rated.

Cautious: HilltopSecurities believes there are factors which introduce the potential for declines in issuer or sector credit quality. This may result in credit ratings downgrades only slightly outnumbering upgrades if issues are rated.

Negative: HilltopSecurities believes there are factors which point towards weakening issuer or sector credit quality. This will likely result in a higher number of credit ratings downgrades versus upgrades if the issues in the sector are rated.

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Appendix

Higher Education Rating Actions in 2024 (Through Sept 2024)

| Date | Rating Action | Old | New | Par Amt (\$ in mill) | Name of Institution (Issuer) | St | Type |
|-----------|---------------|------|------|-------------------------|-------------------------------------|----|---------|
| 1/18/24 | Upgraded | A2 | A1 | 318 | Embry-Riddle Aeronautical Univ. | FL | Private |
| 1/30/24 | Downgraded | B3 | Caa1 | 119 | Rider Univ. | NJ | Private |
| 2/8/24 | Upgraded | A3 | A2 | 82 | A.T. Still Univ. of Health Sciences | MO | Private |
| 2/9/24 | Downgraded | A2 | A3 | 104 | Southwestern Univ. | TX | Private |
| 2/14/24 | Downgraded | Ba3 | B1 | 124 | Webster Univ. | MO | Private |
| 2/14/24 | Downgraded | Baa2 | Baa3 | 51 | Allegheny College | PA | Private |
| 2/20/24 | Downgraded | B1 | B2 | 249 | Roosevelt Univ. | IL | Private |
| 2/21/24 | Downgraded | Baa3 | Ba1 | 92 | Robert Morris Univ. | PA | Private |
| 2/28/24 | Downgraded | B2 | Caa1 | 35 | Hartwick College | NY | Private |
| 3/4/24 | Downgraded | A2 | A3 | 30 | Truman State Univ. | MO | Public |
| 3/18/24 | Downgraded | A2 | A3 | 188 | Bryant Univ. | RI | Private |
| 3/26/24 | Downgraded | Ba1 | Ba3 | 56 | St. Michael's College | VT | Private |
| 3/28/24 | Downgraded | Aa1 | Aa2 | 3,228 | Univ. of Southern California | CA | Private |
| 4/10/2024 | Downgraded | A3 | Baa1 | 8 | North Idaho College | ID | Public |
| 4/12/2024 | Downgraded | Ba2 | Ba3 | 47 | Magellan Int. School | TX | Private |
| 4/15/2024 | Downgraded | Ba1 | Ba2 | 22 | Georgian Court Univ. | NJ | Private |
| 4/19/24 | Downgraded | Ba3 | Caa1 | 265 | Marymount Univ. | VA | Private |
| 4/19/2024 | Downgraded | A3 | Baa1 | 138 | Stetson Univ. | FL | Private |
| 4/19/2024 | Upgraded | A3 | A2 | 48 | Wright State Univ. | OH | Public |
| 4/29/2024 | Downgraded | Baa2 | Baa3 | 118 | Willamette Univ. | OR | Private |
| 5/01/2024 | Downgraded | A2 | A3 | 65 | Muhlenberg Univ. | PA | Private |
| 5/06/2024 | Downgraded | A3 | Baa2 | 365 | Samford Univ. | AL | Private |
| 6/06/2024 | Downgraded | A2 | A3 | 250 | Marshall Univ. | WV | Public |
| 6/11/2024 | Downgraded | A3 | Baa1 | 156 | Louisiana Tech Univ. | LA | Public |
| 6/24/2024 | Downgraded | A2 | A3 | 307 | University of San Francisco | CA | Private |
| 6/27/2024 | Downgraded | A3 | Baa1 | 114 | University of La Verne | CA | Private |
| 6/28/2024 | Downgraded | Baa2 | Baa3 | 409 | Suffolk Univ. | MA | Private |
| 7/22/24 | Upgraded | A3 | A2 | 179 | Illinois St. Univ. | IL | Public |
| 7/25/24 | Downgraded | Baa2 | Baa3 | 264 | Simmons Univ. | MA | Private |
| 7/30/24 | Upgraded | Ba1 | Baa3 | 63 | Eastern Illinois Univ. | IL | Public |
| 8/14/24 | Downgraded | Baa1 | Baa3 | 1,400 | Icahn Schl of Med at Mt Sinai | NY | Private |
| 8/14/24 | Downgraded | A3 | Baa1 | 179 | Centre College of KY | KY | Private |
| 8/22/24 | Downgraded | Baa1 | Baa2 | 92 | Whitworth Univ. | WA | Private |
| 9/13/24 | Upgraded | Ba1 | Baa3 | 216 | Southern Illinois Univ. | IL | Public |

Source: Moody's and HilltopSecurities

Recent HilltopSecurities Municipal Commentary

- [Our 2024 Election Preview: We Could See an Unprecedented Threat to U.S. Municipals from Potential Tax Policy Changes](#), September 11, 2024
- [Revised Again: Strong GDP Growth Boosts Our 2024 Issuance Forecast to \\$480 Billion](#), September 5, 2024
- [Inflation Part II](#), September 4, 2024
- [The Time is Now](#), August 27, 2024
- [Bonds Are Back](#), August 15, 2024

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