

Quick Takes

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TIMELY TOPICS FOR INSURANCE EXECUTIVES

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Challenges Facing Higher Education: Risks & Opportunities

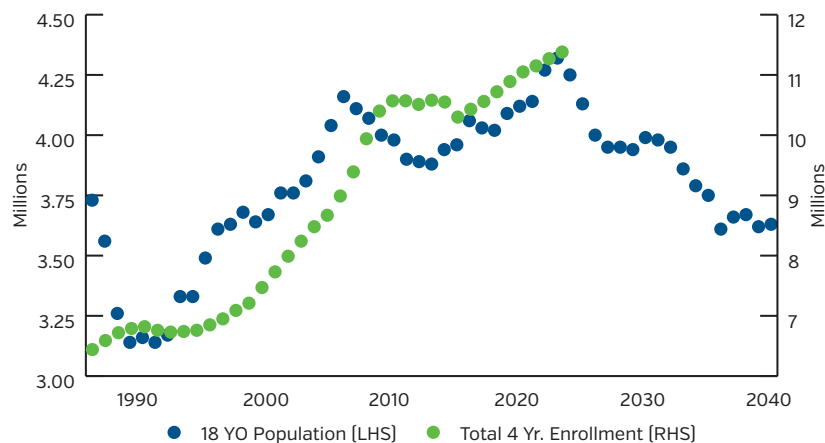
Higher education is undergoing rapid transformation, driven by a range of pressures that are reshaping the marketplace. U.S. insurer portfolios are potentially exposed to these shifts.

Higher education in the U.S. is in a crisis of sorts. The sector is contending with a litany of pressures that are forcing institutions to evolve in an increasingly bifurcated marketplace. This directly impacts insurer portfolios, as higher education represents approximately 9% of U.S. insurance company municipal bond holdings. Despite the recent Federal policy headwinds, the most competitive institutions continue to demonstrate resilience while others face mounting financial and enrollment pressures. A combination of federal funding constraints, demographic shifts, and rising operational costs are converging to create a challenging environment, particularly for institutions with weakening demand and limited financial flexibility. These headwinds have led to wider credit spreads and downward ratings migration, cautionary signals in the higher education sector. In this evolving landscape, identifying where the risks lie is essential for making informed and strategic investment allocation and security selection decisions.

DEMOGRAPHICS: A SHRINKING PIPELINE

A fundamental challenge facing higher education is the projected 13% decline in the number of high school graduates by 2041, a trend rooted in falling birthrates since the Great Financial Crisis. Unlike previous periods of economic prosperity that fueled population growth, recent trends show the opposite. Importantly, this contraction is not uniform: the Northeast and Midwest are expected to see the steepest declines in school-aged populations. Institutions that draw heavily on these regions, especially those with high admissions rates and low selectivity, warrant heightened scrutiny.

Exhibit 1. 18-Year Old Population vs. Total Enrollment



Source: Cdc.gov, National Center for Education Statistics

Research from the Federal Reserve Bank of Philadelphia identifies enrollment declines as a leading indicator of institutional closure risk. Schools with this dilemma often cut budgets, which can lead to reduced program offerings. Persistent deficits, over extended periods of time, can erode institutional competitiveness and increase the risk of closure.

ENROLLMENT PRESSURES & TUITION DISCOUNTING

Enrollment challenges are especially acute for institutions with weak brands and limited demand. Many of these schools rely heavily on tuition discounting, a strategy that, when overused, materially erodes operating margins. While targeted discounting can be effective, widespread use often signals underlying financial distress. In FY22, only 62% of higher education institutions reported positive net income.

Huron Consulting Group estimates that up to 370 private colleges could close or merge by 2035. These institutions often operate with thin margins and modest endowments, making them vulnerable to even minor shifts in enrollment or cost structures.

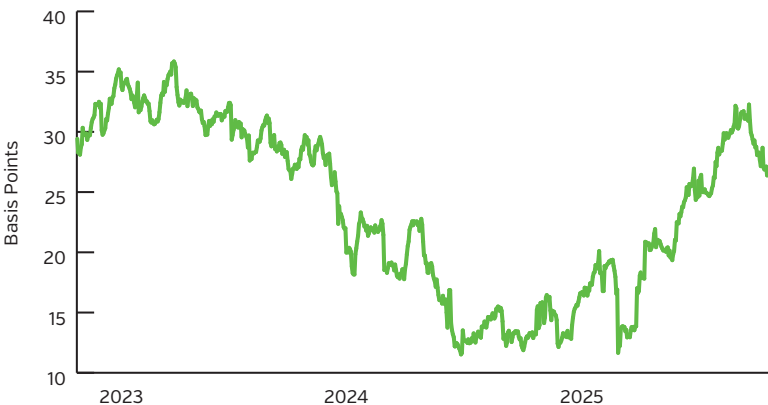
FINANCIAL POSITIONING POST-PANDEMIC

The expiration of Higher Education Emergency Relief Funding (HEERF) has created a revenue gap for many institutions, especially those already at risk. These schools typically received more pandemic-related aid than their fiscally stronger peers, making the loss of support particularly impactful. At the same time, inflation has increased costs across wages, facilities, and operations. The combination of reduced federal support and rising expenses has accelerated credit deterioration among weaker institutions. Colleges with limited reserves and constrained revenue streams now face urgent needs to restructure or consider consolidation.

CREDIT MARKETS: SPREAD WIDENING CREATES SELECTIVE OPPORTUNITIES

These sector challenges have led to wider credit spreads and relative underperformance. While some credits justify the increased risk premium, others appear mispriced, presenting attractive entry points. The top five universities¹ represent 23% of the total higher education endowment pool. During last spring's period of elevated issuance and intensified Federal rhetoric (which temporarily widened spreads) there were opportunities to capitalize on the dislocation.

Exhibit 2. 30-Year T/E Higher Education – 30-Year AA T/E Muni

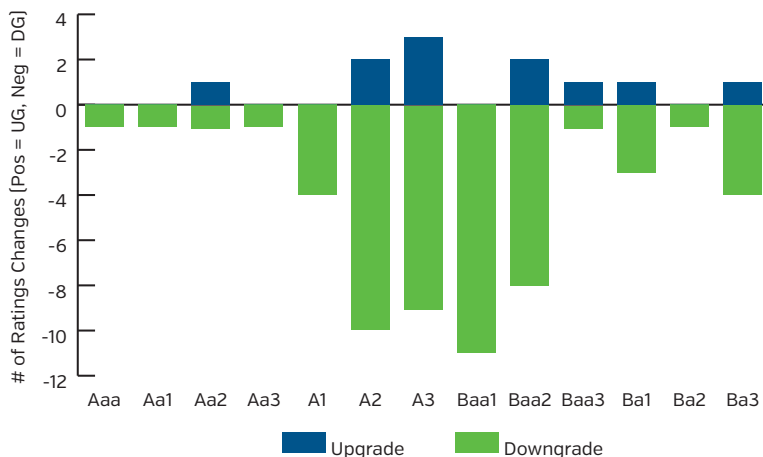


Source: NEAM

CURRENT ENVIRONMENT: CLOSURES, DEFAULTS, & STRATEGIC CONSOLIDATION

Since 2020, approximately 50 colleges and universities have closed, including 16 non-profit institutions. These closures have been concentrated among smaller schools with high tuition dependency and limited alternative revenue sources. As of 2023, Municipal Market Advisors counted 17 higher education municipal bond defaults, 4 rated BBB or below at issuance while 13 were unrated, representing a negligible amount of par value relative to the sector's size. Unsurprisingly, downgrades have outpaced upgrades over the past two years [consistent with observed Moody's data below]. Strategic mergers may offer a path to survival for some, though often at the expense of institutional identity. In other cases, schools are exploring collaborative models, such as shared course offerings or joint programs with nearby institutions, to reduce costs and expand access without requiring full consolidation.

Exhibit 3. Moody's 2024-2025 Higher Education Ratings Migration

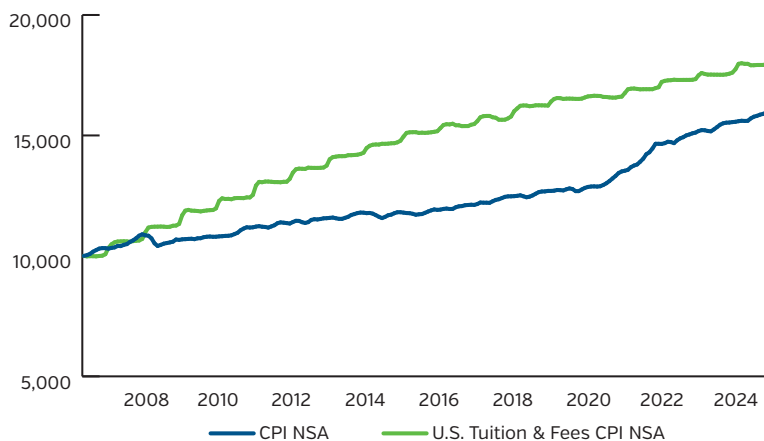


Source: Moody's, NEAM

VALUE PROPOSITION UNDER PRESSURE: RISING COSTS VS. CAREER OUTCOMES

There is a growing perception that graduate earnings often fail to offset rising student debt burdens. As a result, there is increasing emphasis on STEM curricula, which are generally associated with higher salaries and stronger employment outcomes. However, not all students are inclined towards fields like engineering or medicine. The value proposition of a traditional liberal arts education remains a topic of debate, especially as tuition costs continue to outpace inflation. In fact, today's college-aged freshmen face tuition levels that have risen ~12% above the rate of inflation since they were born.

Exhibit 4. Growth of \$10K with U.S. Tuition Inflation & Broader CPI



Source: Bloomberg, NEAM

CONCLUSION: NAVIGATING THE CYCLE

Thematically, insurance company allocators would be well served by maintaining exposure to leading institutions, as well as to schools with strong STEM programs, solid demand metrics, and sustainable tuition revenue. Additionally, state-supported colleges and universities benefit from a layer of state-level structural support, bolstering credit quality. Despite the difficult backdrop, higher education bonds can continue to offer meaningful portfolio diversification and attractive risk-adjusted yields for insurance investors.

KEY TAKEAWAYS

- A combination of federal funding constraints, demographic shifts, and rising operational costs are converging to create a challenging environment, particularly for educational institutions with weakening demand and limited financial flexibility.
- Despite the recent Federal policy headwinds, the most competitive higher education institutions continue to demonstrate resilience while others face mounting financial and enrollment pressure.
- Insurance investors should focus on leading institutions, schools with strong STEM programs and demand metrics, and state-supported colleges, which benefit from additional structural support and credit quality.
- Through thoughtful security selection, higher education bonds can provide meaningful portfolio diversification and attractive risk-adjusted yields for insurance investors.

ENDNOTE

¹ As of 2021: 1) Harvard University 2) Yale University 3) University of Texas 4) Stanford University 5) Princeton University



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