Education Market Update

Industry Consulting Team | February 2024

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Looking Beyond Asset Allocation to Enhance Educational Endowment Returns

7 Considerations for Rethinking your Higher Education Capital Structure

Short-term Investment Strategy Takes on New Urgency

Events:

- **NBOA Annual Meeting**
  February 25th-28th
  Atlanta, GA
  Goldmine Session
  Governance and Fiduciary Considerations for the Investment Committee
- **SACUBO Annual Meeting**
  April 14th-16th
  Louisville, Kentucky

Outlook for 2024:

- Charter Schools: Stable due to strong enrollment and market share trends.
- Higher Education: Stable due to total cash and investment returns, giving increases, and slowing expense growth.

Charter School Market Outlook for 2024

Moody's and S&P's 2024 outlook for charter schools is stable. It is predicted that the median operating margin will stay below 3% due to inflation and rising labor costs, falling from almost 6% and 8% pre-pandemic. Charter schools are working uphill with labor costs on four fronts:

1. **Labor Shortages:** The K-12 sector is seeing some strain with attracting and retaining qualified teachers. The pandemic marked the peak of labor shortages, and while there has been progress, the problem persists.
2. **Labor Costs:** In fiscal year 2023, 46% of budgeted expenses were reserved for labor costs. In fiscal year 2024, the budget for labor increased to 48%.
3. **Funding for Labor:** Charter schools are also at a disadvantage when compared to traditional public K-12s because they generally receive less funding.
4. **Unionization:** Charter schools are experiencing unionization, with 11% of schools unionized nationwide. Due to unionization in 2023, there was an uptick in strikes from teachers demanding better compensation.

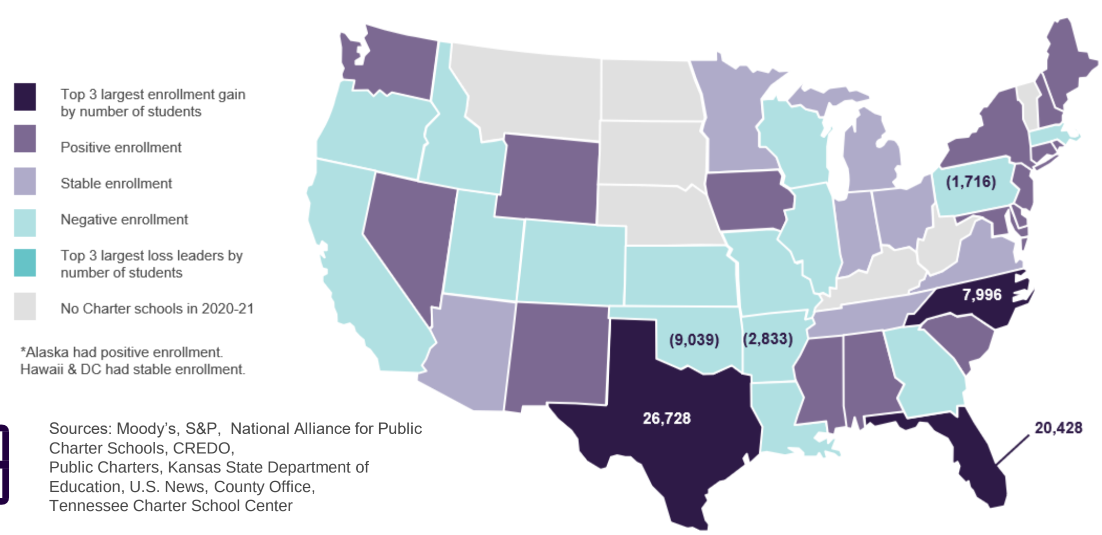
S&P predicts that labor unrest will continue into 2024. The trend of higher demand for increased compensation is expected to continue.

Charter School Enrollment Outpaces Public School

Charter school enrollment has been strong since the inception of the charter school law in Minnesota in 1991. Between the fall of 2019 and the fall of 2022, charter schools enrolled over 300,000 students (9% enrollment increase) while traditional public schools lost 1.5 million (3.5% enrollment decrease) in the same time period. Charter schools currently serve 7.4% of the public school student body, this number has steadily increased over the years, since 2016 market share has increased from 6 to 7.5%. Washington D.C.'s public student body has shown great acceptance to the charter school model with 48% of public school students attending a charter school. Arizona is the top state with 1 in 5 students attending a charter and California has the most amount of students attending charters with nearly 700,000 students (12% of public school students).

The Center for Research on Education Outcome (CREDO) at Stanford University released a study that shows charter schools were able to shift to a remote learning environment within a week. In contrast, 70% of public K-12s were unable to provide instruction in the spring of 2020. This led to charter schools having a 2% year-over-year increase in enrollment from the fall of 2021-2022. Moody's predicts that enrollment will increase by 1-3% in 2024. Charter schools continue to grow their market share due to having greater flexibility in what they teach and offer to their students.

Change in Charter School Enrollment from the Fall of 2021 to Fall of 2022 Across The United States



Sources: Moody's, S&P, National Alliance for Public Charter Schools, CREDO, Public Charters, Kansas State Department of Education, U.S. News, County Office, Tennessee Charter School Center

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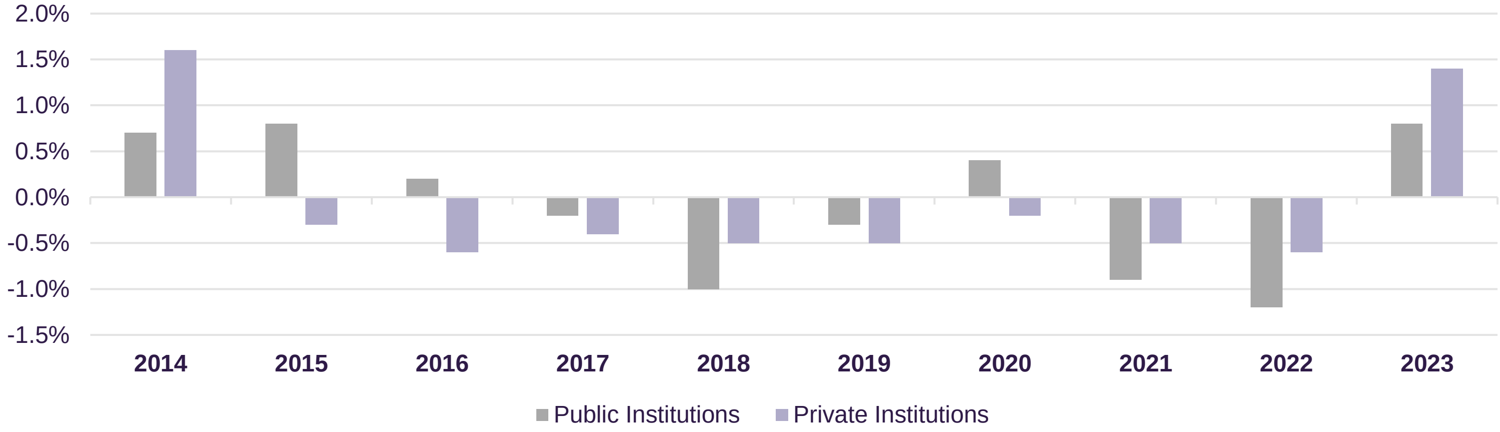
Higher Education Market Outlook for 2024

The divergence within the higher education sector continues to grow. As headwinds with enrollment and credit concerns continue to face the sector, schools are not equally challenged. Schools that continue to be highly selective are projected to withstand the sector headwinds and maintain a healthy balance sheet in 2024. Less selective schools that were already facing challenges before the pandemic are predicted to see continued enrollment pressures extending to financial and credit challenges. Three core obstacles are on the horizon for institutions, including enrollment, high operating expenses, and budget pressures.

Enrollment:

For the fall of 2023 enrollment in public universities is up 0.80% year-over-year, while private universities experienced a 1.40% increase year-over-year. Positive enrollment growth reversed the trend of recent enrollment declines. Public universities last had an increase in enrollment in the fall of 2020 at 0.40%. Private universities have not experienced an increase in enrollment since 2014 from 2015 to 2022. Their average enrollment has declined by 0.50% year-over-year.

College and Universities Experience It's First Year-over-Year Enrollment Increase in Nearly a Decade



High Operating Expenses:

As high-interest rates impact the sector, debt capacity continues to tighten encouraging borrowers to defer maintenance and projects until a more favorable interest rate market. Currently, expense growth projections exceed revenue growth, leading to compressed margins. The end of 2023 experienced unusually high expense growth due to the rise in labor costs, now comprising almost two-thirds of most college and university budgets. Expense growth has been on the rise since 2021 slightly above 2.5% and has now remained over 7% in 2022 and 2023. It is projected to drop to about 4% in late 2024, due to cooling inflation and labor costs flattening out as compensation is realigned and head counts are reassessed.

Budget Pressures:

We see the divergence between public and private institutions widening due to budgetary pressures in 2024. Net tuition revenue is projected to increase by 3.5% for private universities and by 2.7% for public institutions; accounting for 68% of private universities' operating revenue and 40% of public universities' operating revenue. State funding is 18% of public universities' operating revenue and increased for the third consecutive year; this year by 5%. Financial reserves are predicted to see strong investment returns, as higher interest rates support stronger yields, increasing interest income. Total cash and investments remain at an elevated rate and continue to be supported by powerful returns in fiscal year 2021; approximating pre-pandemic levels. In addition, giving is expected to increase in terms of bolstering schools' reserves. In 2022, endowment donations increased by 22% year-over-year, which helped to offset negative returns.

With budgetary pressures and school campus closures increasing, S&P predicts the number of payment defaults to rise. There have only been three payment defaults by rated institutions within the industry, all by private schools. Both colleges and universities of all sizes are looking for ways to stay relevant and financially strong within the industry, including programmatic consolidation and increasing certifications offered.

TRUIST

Sources: S&P, Moody's, Fitch, National Student Clearinghouse