Education Market Update

Industry Consulting Team | Q4 2023

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Check out our latest industry articles below:

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

Highlights:

- The Federal Bureau of Investigation has declared Education institutions as a top target for cyber criminals
- Higher Education braces for the impending enrollment cliff in 2026
- Endowment returns hit their lowest return since the 2008 financial crisis

Cyber Security Market Update

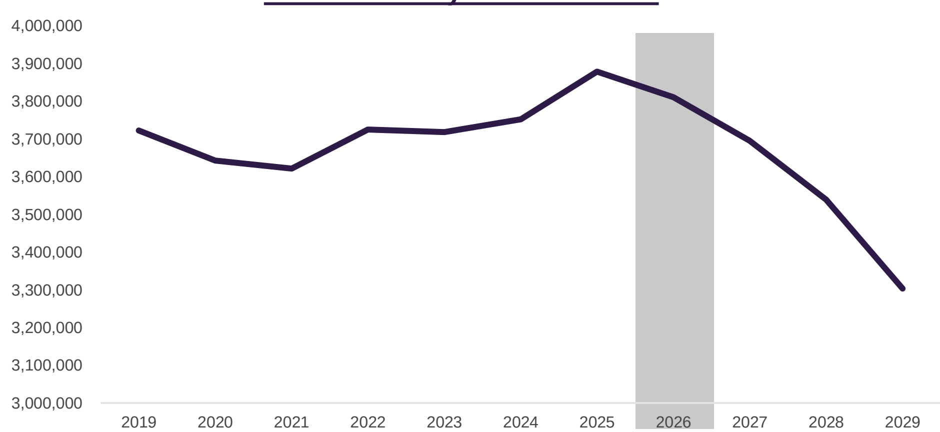
The Education sector is a top target for cyber criminals. K-12 ransomware attacks have doubled from 2021 to 2022, with 29% of K-12 schools reporting cyber attacks. The Federal Bureau of Investigation believes that the Education sector is being disproportionately targeted by cyber criminals. The sector has been aggressively targeted as it increased exposure and vulnerabilities were exposed when adapting to COVID-19 learning environments. The shift to remote/hybrid learning occurred quickly and without layering in the proper security precautions. With large gaps in security protection, K-12 schools house a wealth of personal information desired by cyber criminals.

Institutions should be prepared for potential threats. Two proactive steps for organizations to take are: (1) make a technology investment in end-point detection and response and (2) devise a clear and detailed plan for threat strikes. End-point detection and response allows the duration and intensity of the attack to be less severe. A clear threat plan should map out responsibilities of each party involved and for all actions to be taken. Who writes this plan? Who presents it to the public? Once a plan is created, it should be taken for a test drive through a table-talk hypothetical environment or a simulated event. Strong muscle memory of how to react when a cyber strike happens is critical to responding swiftly and purposefully.

Higher Education Enrollment Pressures

Enrollment is facing headwinds as the enrollment cliff of 2026 approaches and students begin to both question the value of college and to evaluate their options. In the wake of the 2008 financial crisis, U.S. birthrates declined, which reduces the next college-age cohort by 15%. The COVID-19 pandemic only exacerbated full-time, in-person, enrollment challenges across Higher Education institutions. As institutions attempted to keep up with the ever-evolving landscapes, schools have advanced their online course offerings. As online learning presented a favorable option with its increased convenience and lower cost, some commuters opted to be online rather than take the drive to campus. Factually, online students are both a low cost to serve and a low revenue source for the school. Schools are losing the commuter group; low cost to serve and high revenue students. The National Association of Intercollegiate Athletics (NAIA) encourages schools to investigate how they can bring in more athletes as they are higher revenue generating students with a high graduation rate. The NAIA has seen positive effects on an intuitions' graduation rates and revenue levels with the addition of reserve athletics and e-sports. Colleges and universities must build a strategy on how to increase enrollment and to retain students to be able to weather the impending enrollment cliff.

Forecasted 4-year Enrollment



Sources: McGriff, NBOA, S&P, CDC

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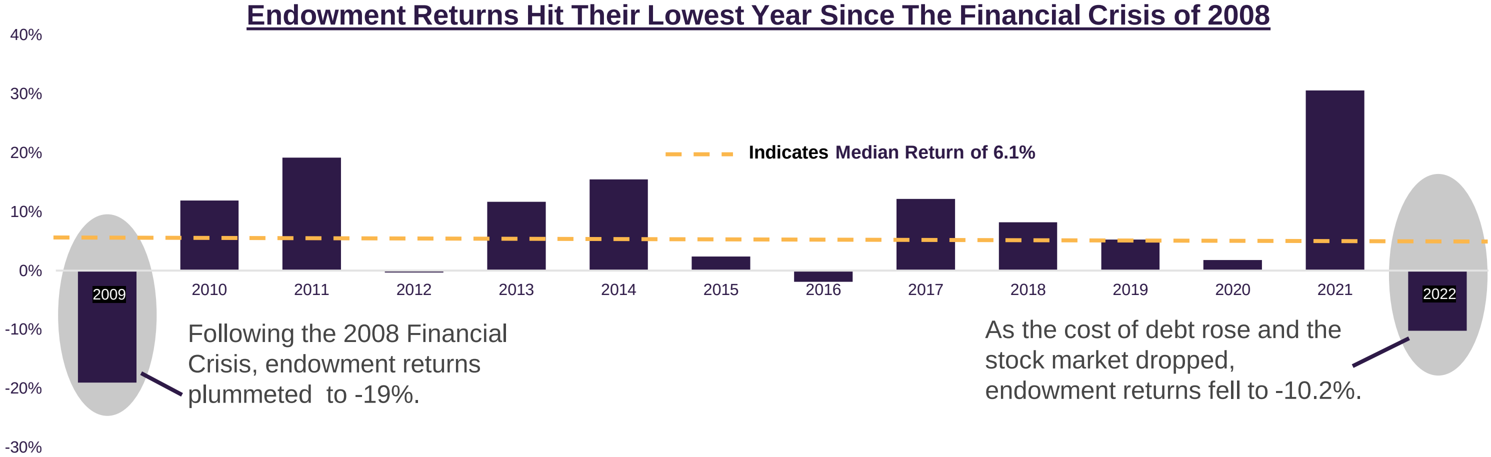
Endowment Returns

With inflation and the impending enrollment cliff, endowment returns will need to stretch further in the years ahead. Over the last ten years, the median return for higher Education endowments is 6.1% annually. The fiscal year ending in 2022, saw the largest loss since 2009 at (10.2%) return.

Endowment Returns Hit Their Lowest Year Since The Financial Crisis of 2008



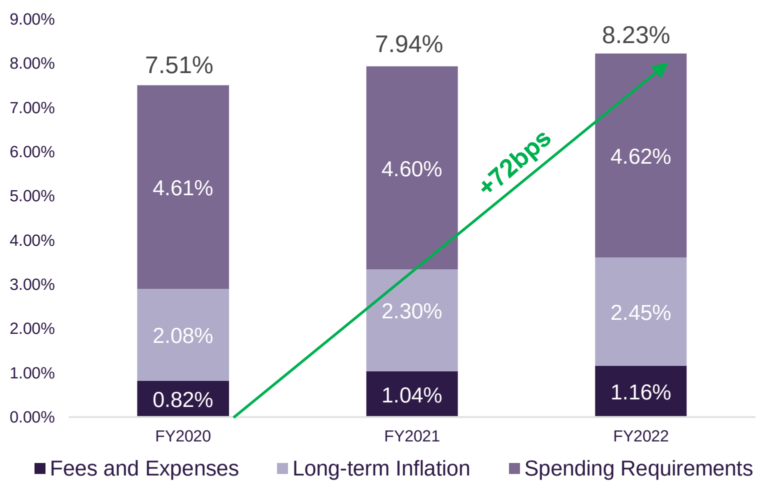
Despite negative returns in 2022, endowment donations increased 22% year-over-year which helped to offset negative returns. Endowments are a necessary resource for schools, accounting for approximately 11% of a school's revenue. The average spend rate in FY'22 dropped from 4.79% to 4.17% YoY. On average in 2022, 10% of endowment draws went towards operating and maintenance costs, while 46% went towards student financial aid.

For years, endowments had a target return rate of 7.5%. Three factors determined the target return rate: (1) fees and expenses, (2) long-term inflation, and (3) spending requirements. From FY2020 to FY2022 the target return rate has increased from 7.5% to 8.23% lead by increasing fees and expenses and long-term inflation. Fees and expenses increased 22bps from FY2020 to FY2021, likely due to private asset class returns, such as private equity and venture capital investments. Strong private asset class returns often come with incentive fees on top of management fees increasing the overall fees and expense section of the endowment target return rate.

Moody's predicts that inflation will continue to strain US budgets through 2024. Coupling inflationary sensitive assets with dropping enrollment, makes a strong endowment return increasingly more important.

Opting to introduce an Outsourced Chief Investment Officer (OCIO) would provide a strategic partner to help navigate this strained financial environment. As of FY2022, 46% of higher Education endowments used an OCIO, up from 34% in FY2010. This trend reflects the increased implementation of the Outsourced Chief Investment Officer model.

Endowment Target Return Rate up 72 bps Over the Last Two Years



6 Benefits of an Outsourced Chief Investment Officer

1. Streamlined decision making for your board
2. Shared fiduciary responsibilities
3. Reduced investment related expenses
4. Access to institutional investments
5. Constant monitoring of the portfolio
6. Leverage deep expertise and experience

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Sources: NACUBO, Bloomberg, Inside Higher Ed, Business Source Corporate Plus, Moody's