

## Fixed Income Insight March 10, 2003

### *College and University Financials are Struggling to Make the Grade*

With about 65% of fiscal year finances reporting into the Merritt Research municipal credit database, colleges and universities appear to be struggling with huge declines in their financial performance. Private colleges, especially, have been seeing a swift downturn in their recorded profit margins over the last two years.

While higher tuition levels are evidenced by the higher net tuition revenues for fiscal year 2002, operating and profit margins have deteriorated to the worst levels seen in recent years. Profit margins have been adversely impacted by the negative results associated with the downturn in the stock market. Many colleges rely heavily on their endowments to fund scholarships, capital improvements and general operations. Ironically, the big downturn in finances comes at a time when college enrollments have been rising. Borrowing has also been up for the huge capital plant expansion programs as well as for improvements needed to compete with other colleges.

Another fiscal danger sign reflected in the numbers is the slippage below 1.0x debt service coverage. While the decline below full debt coverage should not be ignored, the number does not necessarily mean widespread defaults in the near term. Recent big borrowing trends mean that some colleges capitalized their early year debt payments from bond funds; in other cases, debt payments maybe were made from non-operating funds, such as endowments. Nevertheless, debt service coverage has historically been easily met from annual net revenues.

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