



McDonnell Investment Management

State Budget Cuts Impact Public Higher Education

Challenges and Opportunities

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States have historically held the view that there is an important link between their public higher education systems and the state's economic strength. State governments as well as local governments, however, are up against strong anti-tax and anti-debt sentiments which have forced many states facing budget shortfalls to consider budget cuts in order to spend cash on the state's pension liabilities. States seem to be looking more and more to higher education to make these cuts in order to fund other programs. As a result, there has been a dramatic shift in funding from state sources to tuition. Twenty-five years ago, public higher education derived 24.5% of total revenue from tuition. Today that number has nearly doubled.

Rising Student Costs

In order to offset the state appropriation cuts, public universities have been raising tuition and fees, thereby making colleges less affordable for students and their families. Students are questioning the perceived value of a college degree, especially in light of the rising costs. Over the last quarter-century tuition has increased on average a staggering 440%, which is higher than health care costs and far more than the Consumer Price Index over the same time period. In light of these increases, student-loan debt has grown to approximately \$1.2 trillion, which is above total national credit card debt for the first time in history, according to Forbes.

Over the last 20 years, the price of attending a four-year public college or university has grown significantly faster than the median income. According to the Center on Budget and Policy Priorities, "Annual published tuition at four-year public colleges has risen by \$2,068, or 29%, since the 2007-08 school year, after adjusting for inflation. In Arizona, published tuition at four-year schools is up more than 80%, while in five other states — California, Florida, Georgia, Hawaii and Louisiana — published tuition is up more than 60%." ⁽¹⁾

Increasing Administrative Costs

State appropriation cuts aren't the only culprits for contributing to the rising tuition rates. The number of non-academic administrative and professional employees at U.S. colleges and universities has more than doubled in the last 25 years, greatly outpacing the growth in the number of students or faculty, according to an analysis of federal figures.

Challenges of the Higher Education Sector

The challenges facing the sector include pressure to upgrade facilities in order to remain competitive (leading to increased debt burdens), decreased state support, rising student costs, changing demographics, more first-time college students and increased competition due to decreasing number of high school graduates in certain regions, mainly in the Northeast and Midwest.

Opportunities

While the challenges of the public higher education sector are numerous, we believe there are opportunities within the sector by remaining very selective. Some of the characteristics we favor include strong student demand with geographic diversity, institution flexibility to increase student charges, diverse revenue sources, schools with a favorable niche (i.e., engineering, health), stable operating performance, strong legal security and debt structure, large endowments with strong alumni support and systems that have strong management with the ability and demonstrated willingness to react to the changing market demands.

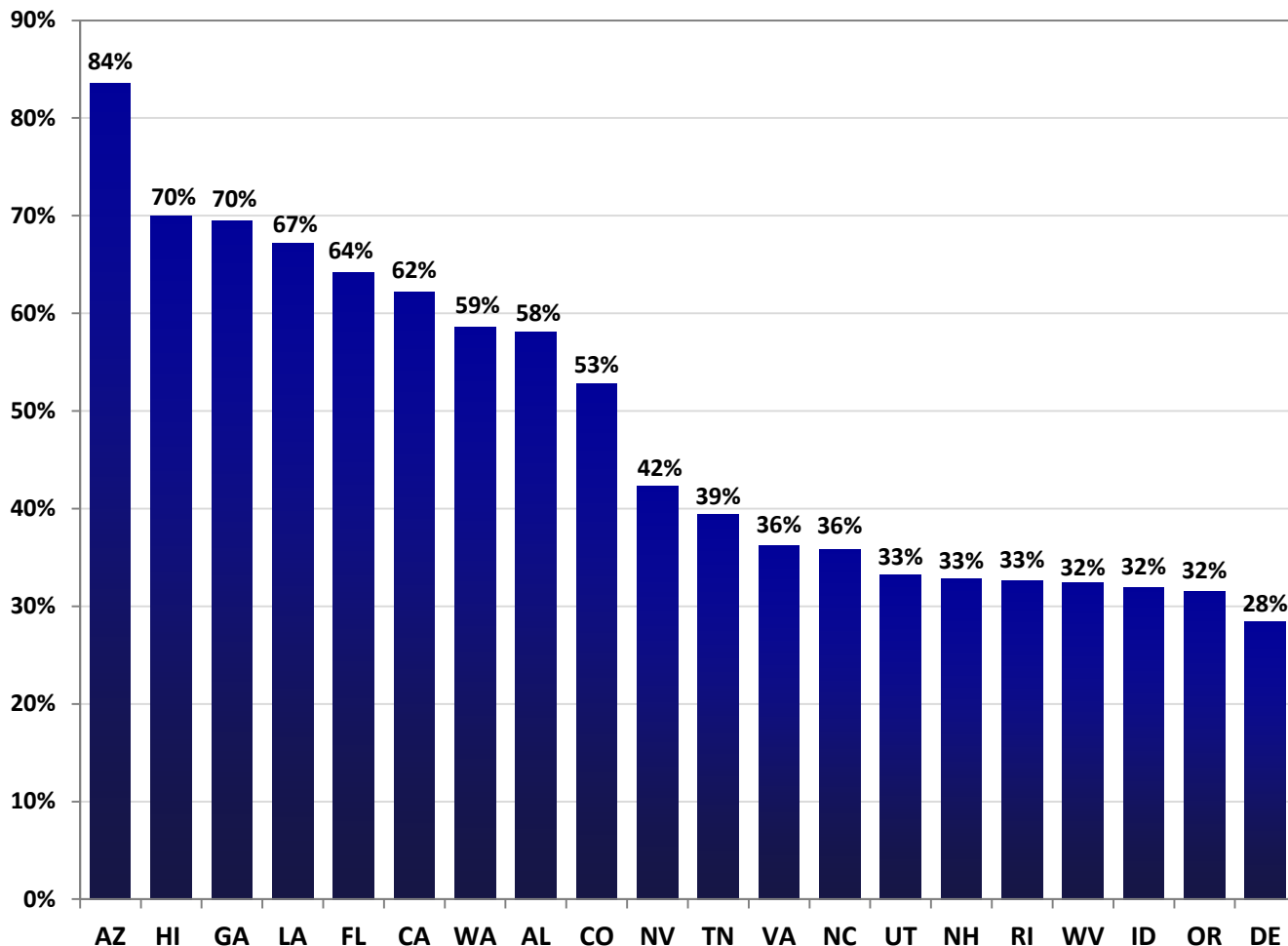
McDonnell Investment Management Research Team



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Colleges & Universities
Percent Change in Average Tuition at Public, 4-Year Colleges
(Top 20 States, Inflation Adjusted)
Fiscal Years 2008 - 2015



Source: College Board.

Notes and Disclosures

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Sources: (1) Center on Budget and Policy Priorities, "Years of Cuts Threaten to Put College Out of Reach for More Students," May 13, 2015; Inside Higher Ed; Forbes; McDonnell Investment Management internal research.

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