

# **Bond Case Briefs**

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## **Problems Mount for the 'Other' College Debt.**

The bond markets are giving a new grade to America's small colleges: A gentleman's C.

Spooked by bad news out of the higher-education sector in recent months, including unexpected campus closures, potential mergers and poor enrollment projections, some prospective buyers are steering clear of bonds being sold by small, private colleges that don't have national reputations, schools that rely heavily on tuition revenue, and those in regions facing population declines.

Moody's Investors Service Inc. in September warned investors to expect closures at public and not-for-profit colleges to triple by 2017 from an average of five a year over the past decade, concentrated among the smallest schools. Some small schools have experienced several years of shrinking class sizes, which leaves fewer students paying for their relatively high fixed costs, and have lost market share to larger universities, Moody's said.

Concerns about market forces were at play at Roseman University of Health Sciences in Henderson, Nev., when the school of about 1,500 students sought \$67.5 million worth of bonds to pay for a new office and research building last spring. The process took two to three times longer than usual, said Ken Wilkins, the school's vice president for business and finance. Standard & Poor's had downgraded the 16-year-old school's debt in February, and investors were asking about everything from the market viability of the school's academic programs to its possible responses to increasingly far-fetched disaster scenarios.

"It felt excessive at times, especially those questions which we affectionately began to call the 'asteroid questions,'" he said.

Roseman ultimately sold the bonds at an average yield of 5.68% in April, about three percentage points more than highly rated municipal bonds, according to Thomson Reuters Municipal Market Data.

Roseman joined colleges and universities that are selling more bonds than ever. Schools including highly rated Stanford, Northwestern and the California State University System have sold a record \$32.7 billion worth of debt through September, almost twice as much as in the same period of 2014, according to data from Thomson Reuters. This "other" college debt still is small compared with the market for student-lending debt, which is \$1.2 trillion.

Yet as many colleges and universities are eager to tap the bond market to take advantage of low interest rates, bond investors have grown wary of their debt.

Yields on the S&P Municipal Bond Higher Education Index this week reached 2.55%, up from a low of 2.12% in February, and ahead of the broader market's 2.38%. Yields rise as prices fall. Investors often find some extra yield in the higher education sector, which contains many high-quality bonds but has grown increasingly risky when compared with debt backed by essential services such as power or water, said Howard Cure, director of municipal research at Evercore Wealth Management.

"You can't just buy bonds from your alma mater anymore, because you might end up getting the short end of the stick," said Hugh McGuirk, head of the municipal bond team at T. Rowe Price Group Inc. He said his firm is generally avoiding small liberal-arts colleges and is sticking with schools that have national brands and strong student demand, either public or private.

Colleges and universities are selling more bonds, but investors have grown wary of those from smaller, private colleges. In contrast, Stanford University has a AAA debt rating. ENLARGE  
Colleges and universities are selling more bonds, but investors have grown wary of those from smaller, private colleges. In contrast, Stanford University has a AAA debt rating. PHOTO: PAUL SAKUMA/ASSOCIATED PRESS

Concerned about volatility in the public markets, some low-rated colleges and universities have been pursuing alternatives to bond issuance, such as placing debt privately or borrowing directly from banks, says Lorrie DuPont, head of the higher education finance group at RBC Capital Markets.

Hawaii Pacific University, a private school with campuses in Honolulu and Kaneohe, Hawaii, opted in January for short-term bonds to finance the renovation of a waterfront property, hoping that it can refinance the debt once its credit rating—currently BB-plus by Standard & Poor's—improves. The school expects that the renovation will yield new retail and housing revenue.

The school borrowed \$32.5 million in a five-year deal at a 4.48% yield. Bruce Edwards, vice president and chief financial officer, estimates that had the institution opted for a more traditional 30-year bond, it would have paid "a little bit north of 6%."

All the school's new debt was bought by Nuveen, which had acquired a chunk of the school's \$42 million issuance in 2013. While other investors expressed interest, "they were going to need to do some lengthy due diligence" and the school was looking for a fast close since construction was already under way, Mr. Edwards said, and construction deadlines outweighed questions over potential improvement in market conditions later in the year.

For schools without strong financial footing—or those in categories perceived to be susceptible to financial pressure—the timing is far from ideal. Many such institutions have put off facility upgrades since the financial crisis and now face massive deferred maintenance backlogs, or need cash to pay for capital projects that could make them more attractive to potential students.

Moody's has been seeing undiminished demand to initiate ratings on smaller colleges this year, the firm says, as schools fret about higher interest rates on the horizon and look to access money through one outlet or another.

McDaniel College in Westminster, Md., is planning a private placement this fall to cover about \$3 million in new energy-saving and infrastructure upgrades. That school last issued a bond in the public markets in 2006 and has funded renovations and a new stadium with donations and cash on hand.

W. Thomas Phizacklea, vice president for administration and finance, said a private placement was more attractive because it allows the school to avoid the upfront costs of issuing a bond in the public markets—including fees for lawyers, accountants and ratings companies—and provide more freedom when structuring debt-service payments. Mr. Phizacklea said the school is near a 10-year bank deal and has begun its cost-saving projects using available cash.

"I don't think we'll get a better rate" with a private placement, he said, "but I do think we'll get more flexibility."

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By MELISSA KORN and AARON KURILOFF

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Write to Melissa Korn at [melissa.korn@wsj.com](mailto:melissa.korn@wsj.com) and Aaron Kuriloff at [aaron.kuriloff@wsj.com](mailto:aaron.kuriloff@wsj.com)

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