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Fitch: CARES Act Gives Higher Education Some Relief

Fitch Ratings-Chicago/New York-06 April 2020: The $2 trillion CARES Act, signed into law on March 27, provides some relief to colleges and universities facing budget pressures, as a result of the coronavirus pandemic and subsequent decisions to shut down campuses, but will not be sufficient to fully compensate for revenue losses and increased expenses, according to Fitch Ratings.

A prorated decline in some student fees, auxiliary and other revenues, coupled with increased operating expenses, including the shift to online learning, without offsetting revenue has affected the higher education sector. These pressures will be most acutely felt by those with less liquidity, lower margins, and greater budget gaps, and smaller, residential colleges reliant on student-fee revenue. Many institutions are evaluating expense reduction actions, including support-staff layoffs or furloughs. Higher-rated institutions with strong financial cushions should have sufficient resources to cover budget gaps at least through the end of the 2020 fiscal year.

The CARES Act establishes a $31 billion Education Stabilization Fund supporting both K-12 and higher education. Colleges and universities will receive $14.3 billion, 10% of which is divided between historically black colleges and universities (HBCUs) and grants for small institutions with unmet needs related to coronavirus. Seventy-five percent of the remaining 90% will be distributed based on enrollment of full-time students who receive Pell Grants. We expect this will favor those with disproportionately large numbers of low-income students and community colleges. The remaining portion will be allocated by the relative share of enrollment that is not Pell Grant supported. Institutions must use half of the funding for student aid, before the remainder can be used to offset lost revenues or increased expenses.

Two federally chartered entities, Howard University (BBB-/Stable) and Gallaudet University, will receive direct appropriations of $13 million and $7 million, respectively. An additional $99.5 million will benefit research universities that are conducting coronavirus research. Teaching hospitals may also benefit from a $100 billion emergency fund for healthcare providers. Small universities with less than 500 employees may benefit from the Payroll Protection loan program under the Act with up to a maximum loan amount of $10 million.

Using 2018-2019 enrollment data, Fitch estimates the enrollment-based aid equates to roughly $1,400 per Pell student and $200 per non-Pell student if applied uniformly across eligible students. Larger, highly-rated institutions are likely to have more resources available to manage through the coronavirus disruption but are also likely to receive the most aid. Smaller private colleges with thinner financial cushions, typically rated 'BBB' and lower, may be in more need of federal assistance. Even with funds earmarked specifically for small institutions with unmet coronavirus-related financial needs, the demand for, and method of, disbursement for these funds is yet unknown and may leave some smaller institutions to face heightened financial strain and rating pressure.

Budget pressures are likely to continue into fiscal 2021 without further federal aid if coronavirus restrictions persist beyond our current expectation of two to three months. Building a 2021 budget will be very challenging given uncertainty of fall enrollment prospects for both first time and returning students, and consequently some universities may have meaningful gaps next year, which would need to be addressed via other funding sources or significant expense reductions.

Broadly, we expect margins will tighten across the sector. Funding of $3 billion provided to states under the Act does include a requirement that state governments not reduce funding for higher education, similar to the American Recovery and Reinvestment Act of 2009 stimulus funds provided during the prior recession. This should help stabilize this important source of funding, although states are facing their own budget and short-term liquidity crunch in the face of delayed tax revenues and coronavirus expenses. Public universities are generally less dependent upon state funding than they were heading into the 2008 recession, although the shift toward more tuition dependence may not be sustainable in the face of the economic crisis and its effects on individual income.

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