Why It Can Be So Difficult to Gauge a College’s Financial Health

Fissures in colleges’ finances have been starting to show in the past year, with some prominent institutions, like West Virginia University, the University of Arizona, and the University of Chicago, experiencing unexpected budget shortfalls coming out of the pandemic. Further down the rankings and prestige ladder, the environment is considerably tougher, as regional-public and small-private institutions have had to offer generous scholarship and financial-aid packages just to bring in students.

All this instability has people asking how any particular institution — my safety college, my alma mater, my employer — is faring these days. It can be difficult to find the answer.

To some experts, the most important metrics of financial health are the performance of academic programs — how much revenue history or nursing or engineering brings in, versus how much it costs to offer the programs. But those numbers are almost impossible to know from outside the institution — and many administrators don’t even know those costs themselves, because they don’t track them closely.

Still, certain factors that can be found in public documents can offer clues to an institution’s financial standing, say several experts in higher-education finance that *The Chronicle* consulted. Many of those factors are quantitative — figures on enrollment or the institution’s track record for generating net tuition revenue and operating surpluses. It’s the sort of information found in the Integrated Postsecondary Education Data System, or IPEDS, and the Federal Audit Clearinghouse, which gathers detailed financial information about institutions that have spent more than $750,000 in federal grant money. But others are qualitative — the duration and efficacy of an institution’s leadership, or the clarity of its mission.

A number of institutions have a muddled perception of both. Federal relief funds from Covid-19 masked lots of problems, and now that those funds have run dry, the unsteady finances and market positions of some colleges have become consequential.

“In a lot of ways, we’re in the eye of the storm,” says Chuck Ambrose, a former university president who has written a new book about financial-restructuring strategies, *Colleges on the Brink: The Case for Financial Exigency*. “We’ve set this course. This is decades in the making.”

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In November 2021, Ambrose started his job as a turnaround president at Henderson State University, in Arkansas, where neither state officials nor, it seems, university leadership saw how 20 years of structural deficits and growing debt had brought Henderson to the verge of closure. Ambrose took the university through a painful restructuring.

Now a higher-education consultant for the law firm Husch Blackwell, Ambrose says many institutions are "facing a reset of how we prioritize what's most important" and "a fairly general consensus that the way that we have been doing things, our current state, is going to change." Some colleges will face a hard battle to survive, while other institutions will be thinking much more intentionally about managing revenue, debt, deferred maintenance, and other pressures on the bottom line.

Aside from the usual figures on enrollment and tuition revenue, Ambrose says he also looks at an unusual metric to gauge the health and future prospects for an institution: the graduation rates of its low-income students relative to wealthier ones. A higher graduation rate among low-income students, he says, could be a measure of the institution's commitment to student success, which he believes translates into long-term sustainability.

But many other finance experts have their own signals to turn to. Here are some of the key metrics to understand an institution's financial health, what they do and don't mean, and caveats to keep in mind.

Enrollment and the Revenue It Generates

Most health assessments start with enrollment. Joshua Lassiter, a former college chief financial officer who is the managing director of operational consulting at the financial-advising firm First Tryon Advisors, says the most important sign of an institution's health is its ability to predict enrollment accurately — even if that means projecting a decline. Accurate predictions avoid the "yo-yo cycle" of promising money to parts of campus, then having to claw it back — or even make emergency cuts — when students don't show up. "The schools that are not financially healthy don't know who's coming in the fall," he says. "You find a lot of universities that'll build a budget on hope or an aspirational enrollment target."

Strong enrollment trends — and a strong enrollment manager — are crucial foundations for the financial health of most institutions. Enrollment trends are critical, in part, because the aftereffects of a poor enrollment year can trouble an institution through a full four years or more, as that class wends through the institution.

Showing solid enrollment figures does not necessarily mean that an institution is drawing enough money from the students they're bringing in. "Enrollment, while important, can be a little misleading if you're not looking at the revenues that are generated from that enrollment,"

says Robert Kanzer, managing director of the higher-education and not-for-profit advisory group at Janney Montgomery Scott, a financial services firm. Many institutions offer tuition discounts in the form of scholarships and grants to lure students to enroll — and those discounts have gone up steadily in recent years, to 70 percent or more, undermining the revenue institutions need to bring in. A layperson can gauge an institution's tuition discount rate by calculating the average scholarship and grant aid as a percentage of the tuition and fees, found in the data on College Navigator.

A large endowment always helps an institution, as it regularly spins off money that supports scholarships, research, and operations. Experts say it's difficult to peg a minimum endowment figure for institutional viability, because much depends on the mission and size of the institution. Rob Ketner, who advises colleges on finance, borrowing, and restructuring at First Tryon, says that some banks over the past year have mentioned that, at minimum, institutions should have an endowment of $150 million to $250 million to be considered for a loan. Generally, he adds, it's a good sign if an institution shows positive trends in the percentage of alumni who donate, a growing number of "big" gifts, and a lack of restrictions on how to spend the money.

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"If all those things are happening, you're likely looking at a school that's well-run and that donors trust to make good decisions," Ketner says.

Many people (particularly in the general public, but even some in higher ed) don't understand that portions of an endowment are often restricted — that is, they can be used only for a donor's original intent to support an academic department or a scholarship. If endowment restrictions are too tightly defined, those portions can go unused year to year. Audits will note what portion of an institution's endowment is restricted versus unrestricted. Those notes sometimes refer to quasi-endowments, which are funds dedicated to institutional activities but have restrictions that can be lifted if necessary.

Because of those restrictions, an endowment is not simply a slush fund or bail-out money, although colleges sometimes have to take from the unrestricted part of the endowment to plug a budget hole. (The process of lifting restrictions usually has to go through a court, and may involve lawsuits from a donor.) "An extraordinary draw on an endowment is a good indicator that things are not going well," says Lassiter. It means, he says, that the institution couldn't balance its budget — and didn't anticipate the need to raid the endowment.

If administrators then spend that money on programs and initiatives that are poorly conceived or already losing money, Ketner says, they will accelerate the institution's demise.

Financial Performance Over Time

Finance experts, in evaluating the health of an institution, note the trends in its operating performance. “So not just looking at top-line revenue, but also what are expenses doing in relation to that revenue?” says Kanzer, of Janney Montgomery Scott. Small, struggling institutions are often running operating deficits — and they do not have the endowment strength to absorb those losses.

Larry Goldstein, who spent decades as a college financial adviser through his company, Campus Strategies, and has taught a course every year at the University of Kentucky on how to measure an institution’s Composite Financial Index, or CFI. Goldstein calculates the CFI using publicly available data, seeking to answer four questions about an institution: First, does it have enough resources to operate for a reasonable period of time if revenues were completely cut off? Revenues are almost never completely cut off — even universities shutting down in the midst of a natural disaster are still pulling in money through investments and other passive forms of income. “Survivability means you have to be able to operate for at least a semester with no revenues coming in,” says Goldstein. “That seems pretty reasonable to me — four months to get your act together and do something.”

Second, does the institution have enough reserves to pay all its debt? “You need at least 125 percent of what you owe in reserves to be functional as an institution — not to be well off, but just to have what they call minimum survivability,” says Goldstein.

Third, did the institution end the year financially better off than it began? Goldstein says this figure is a “straightforward calculation” of an institution’s net assets, whether they’re earned through things like investments and revenue generators like classrooms or sports arenas, or they come in the form of subsidies like gifts and governmental appropriations. An institution may need a 6 percent or 7 percent growth in net assets to be healthy.

Finally, the CFI considers whether a college spent more money than it took in on its operating budget, the everyday revenue and expenses that make the university run. At minimum, institutions should have a surplus of 2 percent.

The first two factors each represent about a third of the CFI score, and the last two factors compose the remaining third. When those numbers are combined and calculated, they yield a CFI score between -4, the lowest possible score, and 10, the highest. A score of 3 is considered minimum viability, says Goldstein. Calculated over successive years, an institution will show a trend line going up or down.

If the trend line is going down. Goldstein suggests digging a little deeper to find out why. Many financial statements will include a narrative section known as the “management discussion and analysis,” or MD&A, where managers put an organization’s performance into context. An institution might explain a sudden run-up in debt by pointing to the establishment of new programs or institutes that have revenue potential, or it might describe the ways that it is addressing flagging student enrollment.

The narrative is not audited, and it may try to paint a rosy picture, Goldstein says. “What’s not allowed is to speculate about the future.” Understanding the embedded details of the MD&A may require some knowledge of the higher-education sector and how colleges work, but it cannot make false statements about an institution.

“An MD&A is going to be the most revelatory publicly available piece of data that we can find,” says Ketner, of First Tryon. Especially in the wake of Covid-19, a financial statement might describe how a college responded to the pandemic. “It’s been such a unique environment over the past handful of years that you can glean a lot of information from how schools weathered that storm,” he says. “How folks manage through times of crisis tells you a lot.”

Qualities and Comparisons

The MD&A is one of a number of qualitative measures that finance experts examine when evaluating colleges. The narrative in the financial statement can offer some clues about the dedication and experience of the leadership team. “The financials tell you what already happened,” says Kanzer. “The really hard thing to assess from the outside is, What is management doing? How are they thinking about where they’re going in the future?” Ratings agencies like Moody’s Investors Service consider the longevity and record of the leadership team during their evaluations. The leaders that steered a college into a ditch might not be the best team to lead it out. Turnover in leadership could also be a bad sign.

“You’ve got to have good leadership in place at the top, but you also have to have an alignment between the president, his finance team, his board, the enrollment team — everybody’s got to understand the criticality of the situation,” says First Tryon’s Lassiter. A lack of dialogue between those administrators can lead to problems. “When those communication lines get severed, or when there is political pressure to make a budget work, those situations create schools on the brink.”

The profile of an institution itself — its size, location, and mission — are important qualitative factors that help assess health. Small colleges are not necessarily endangered simply because of their size, but they have several inherent disadvantages: They often have to employ the same types of roles as a large university but have a smaller base of students to generate revenue to cover those positions. Rural colleges are generally thought to have disadvantages compared with colleges in or near urban areas, situated close to employers, internship opportunities, and entertainment. Given the decline in churchgoing among some significant populations of students, many consider the small, rurally situated, church-affiliated college to be among the most endangered types in higher education. But church-based colleges that understand and lean into their mission can still generate strong enrollment numbers.

“A lot of small, private schools can’t define their reason for being and can’t define their competitive advantage, and that’s the trouble they face,” says Ketner.

In a sector as competitive as higher ed, perhaps the most important qualitative factor rests on how a college compares to its peers, in resources it can put toward instruction, in retention and graduation rates, and in increasing or stabilizing enrollment. Cutting programs and laying off staff does not necessarily mean that a college is going to close — in fact, in many cases, that kind of retrenchment can be healthy for an institution in the long term. Particularly among smaller private colleges, where financial figures can be more difficult to acquire, seeing how a college tracks with peers can be a way of discerning its future prospects.

Gary Stocker, an entrepreneur who was trained as a medical-laboratory scientist and makes part of his living in the health-care industry, has focused his College Viability App entirely on comparing private colleges. The “app” is essentially a suite of websites that pull together self-reported data from IPEDS, allowing users to compare the vital statistics of graduation rates, enrollment, net price, and more. Parents can pay as little as $30 for a version that pulls five IPEDS data categories, while executives can shell out $1,500 for a 32-point version.

For Stocker, the focus on comparisons provides apples-to-apples measures and keeps him out of a courtroom. He learned from watching companies like Edmit, which four years ago released a list of colleges likely to close — and which was subsequently threatened with lawsuits from institutions that insisted the predictions were not only wrong, but could actually cause colleges to close by undermining public confidence in them.

“I moved from predicting — I’m not sure I had the skills to do it — to comparing,” says Stocker, who still occasionally uses a bombastic tone in his promotional material. “I didn’t care for the litigation that would follow.”

Stocker is self-trained and somewhat new to college finance, having first become familiar with the topic as chief of staff to a former president at Westminster College, a small, private Missouri institution. A few years later, after researching college finance more thoroughly, Stocker decided that parents and students needed some key, some road map, to figuring out the health of the colleges they were considering — and the College Viability App was born. To promote it, he occasionally posts explanatory videos on YouTube, aimed at helping parents and students understand college finances.

“I’ve kind of created a Kelley Blue Book or a Consumer Reports version for colleges that kicks the financial tires,” says Stocker. “Can people from outside assess the financial health of colleges? Eh, the typical mom and dad, no. But can they compare them, just like they do cars and computers and restaurants? Yeah. Probably so.”