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Many Colleges Could Close or Merge Because of Financial Problems, Standard & Poor's Warns

By MARTIN VAN DER WERF

In an unusually blunt assessment of the financial problems in higher education, a Standard & Poor's report released on Tuesday predicted that colleges and universities might "consolidate in large numbers or close as they struggle against stagnant levels of financial resources and substantially higher levels of debt."

The report, "Weak Equity Markets Hurt U.S. Higher Education Endowments," also suggests that accounting procedures used by colleges are inconsistent, potentially hiding financial problems.

"Some colleges record all investment income and gains as operating revenue, so when investment performance is positive, their operating results appear favorable," the report reads. "For those that record only endowment spending as operating revenue, even a year with significant investment losses can appear uneventful."

Joshua Stern, a co-author of the report and a director of Standard & Poor's higher-education group, said, "We have not seen anything in the way of irregularities" in college financial statements, but because colleges have a lot of latitude in the way they report their financial dealings, "not everything is clear-cut all of the time."

For a relatively small college with a large endowment, a swing in the value of the endowment from year to year can be larger than the college's operating budget. "The swings make it difficult to define typical operating results and mask the underlying stability of the [higher-education] sector," the report says.

The prediction that more colleges could merge or close is based on anecdotal evidence, Mr. Stern said. "We can't attach a definitive number to it. It's what we see, and what we hear, and what we feel, dealing with as many colleges as we do."

Standard & Poor's publicly rates about 450 colleges and universities. It and Moody's Investors Service are the leading bond-rating agencies in higher education.

At least 31 colleges have closed since 1997, 18 of them four-year undergraduate institutions. There have been nine mergers of colleges since November 2000.

Mr. Stern characterized that volume as relatively small, and said, "I think that the number is bound to increase."

Most colleges have had two successive years of investment losses, meaning their endowments are

contributing less to their operating budgets. But the chief reason colleges may fail, Mr. Stern believes, is increasing debt.

"A lot of schools got into this arms race, or facilities race. They needed a rec center because the school they compete with has a new one. Or they had to have a new dorm because the college they compete with had one. Now those buildings are done, and they have to pay for them. There's a lot of colleges out there that before they can spend a dime, they have already committed 10 or 15 percent of their budget to debt service."

The report is available by sending an e-mail message to Mr. Stern at josh_stern@standardandpoors.com

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