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Moody's warns that lackluster state support will strain public university budgets

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Paltry state investment in higher education could strain the budgets of public colleges and universities this year, with small schools bearing the brunt, Moody's Investors Service said Monday.

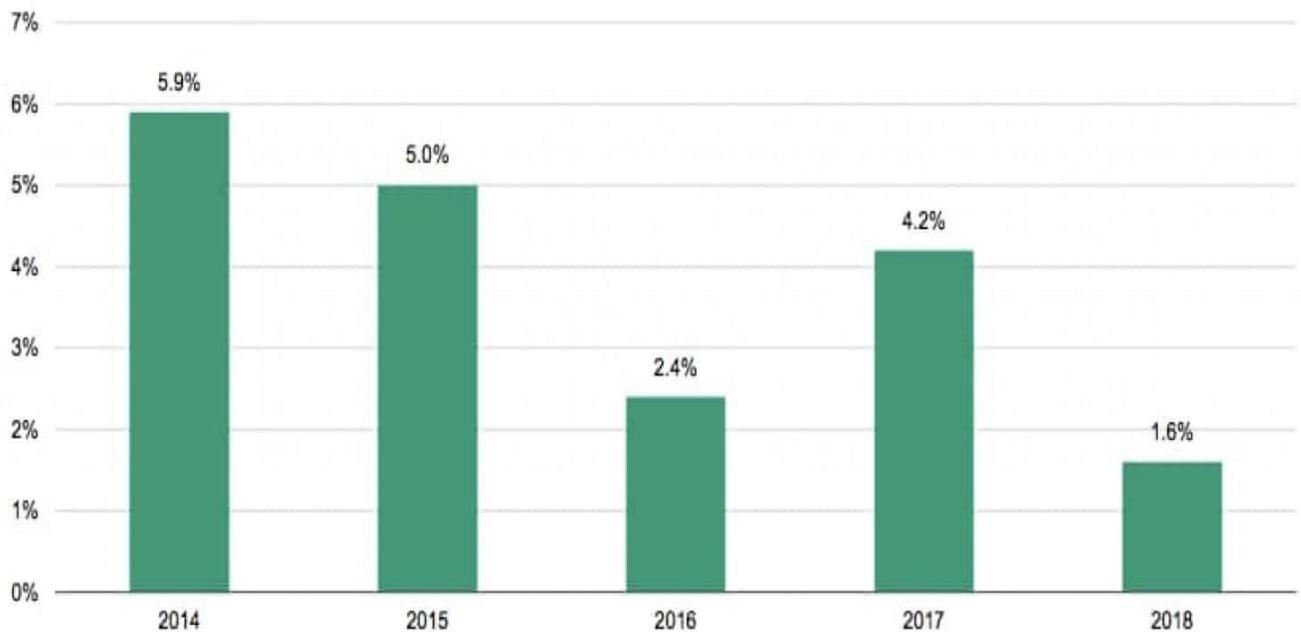
In a note to investors, the credit rating agency said marginal increases in state funding are a “credit negative” for public colleges and universities, meaning the limited financial support could be a factor in future ratings.

The warning arrives on the heels of a bleak [report](#) on state appropriations from the Grapevine survey conducted by Illinois State University’s Center for the Study of Education Policy and the State Higher Education Executive Officers Association. Results released last week show state funding for public higher education increased by 1.6 percent for the fiscal year ending June 2018, the lowest annual growth in the past five years.

[Students now pay more of their public university tuition than state governments]

“This year’s findings reflect the struggle a lot of states have to sustain the revenue needed to increase funding for colleges and universities,” said James Palmer, a professor of higher education at Illinois State and the editor of the Grapevine survey. “This is the consequence of many factors, including political decisions to decrease or not raise taxes, downturns in certain sectors that state economies are reliant on or the need to direct tax revenue to address underfunded pension obligations.”

Increase in state appropriations for US higher education is the smallest in five years



Source: Grapevine Compilation of State Fiscal Support for Higher Education

Appropriations in California, Florida and Georgia accounted for almost all of the increased spending between fiscal 2017 and fiscal 2018, with total funding in the remaining states rising by 0.2 percent, according to the survey.

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More than one-third of state legislatures cut money for public colleges and universities this fiscal year. Mississippi and North Dakota, for instance, reported double-digit decreases, while Virginia had a nearly 2 percent decline. Maryland is among a dozen states, along with the District of Columbia, providing slightly more money than the previous fiscal year, with increases of 0.6 percent and 2 percent, respectively.

“In order to increase funding for higher education, two things have to happen: You have to have the political will to do it, and you have to have the fiscal capacity to do it. But many states have a limited capacity, at least this year, to provide increases,” Palmer said.

State appropriations to higher education have been rocky coming out of the recession. Higher education often takes a back seat to other priorities, so funding has fluctuated from one year to the next in the face of slow revenue growth. Twenty-two states ran into trouble covering their overall expenses in fiscal 2017, according to a [report](#) from the Center on Budget and Policy Priorities, a think tank. Revenue growth has not kept pace with demand for government services, even as state budgets have largely stabilized.

Despite the lackluster increase in state funding during the current budget year, support for higher education grew at a relatively robust pace between 2013 and 2018, rising by 20.7 percent, according to the Grapevine survey.

“It is encouraging to see that five-year trend. In most cases, states want to sustain the fiscal viability of their higher education institutions,” Palmer said. “It’s just interesting to look at the one-year change, which is relatively low in the face of an otherwise growing economy.”

[Going to a public college isn't as affordable as it used to be]

Current funding conditions are a cause for concern, according to Moody's. Limited state funding could wreak the greatest havoc on small public universities, where almost 30 percent of operations are funded with state appropriations. Moody's expects that state funding will remain constrained for fiscal 2019 and will require budgetary adjustments, which could prove difficult for many schools.

“Having consumed much of their pricing power after large post-recession increases, public universities, especially regional universities, have limited ability to respond to the modest increase in state appropriations,” Moody's wrote Monday. “Many regional universities serve primarily in-state undergraduate students, where tuition increases may be limited by the state or effectively constrained by a demand for affordability.”

Analysts say flagship and research universities will withstand much of the impact because of their diversified revenue and enrollment, with many attracting out-of-state and international students who pay more in tuition. Those schools also have healthy financial reserves and endowments as a result of stronger fundraising.

What's more, they can generate revenue by conducting research or through investment income, Moody's said. But an earlier report by the credit rating agency said reductions in federal research and development funds will strain universities' budgets and put pressure on them to fund their own projects, requiring schools to redirect money from other priorities.

It will be difficult for many universities to further cut expenses to offset the weak state investment. Moody's expects universities will find areas to reduce spending, but rising post-retirement liabilities, tenure and unions will create challenges to cutting expenses.

In an increasingly competitive environment, analysts say, universities will strategically invest in technology, facilities and programs to attract students and faculty. But many schools may slow hiring and let attrition reduce their compensation spending.

Danielle Douglas-Gabriel covers the economics of education, writing about the financial lives of students from when they take out student debt through their experiences in the job market. Before that, she wrote about the banking industry.

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