FitchRatings

The Next Phase: Back to Campus

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Higher Education Sectors Adjusting to Post-Crisis Landscape

Potential Long-Term Impact

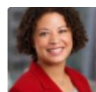
	For industry	For ratings	
Higher education providers	Enrolment to recover to pre-pandemic levels, but continue to slowly decline longer term	4yr Public	Negative
		4yr Private	Negative
		2yr Public	Negative
Student housing	Recovery to historical levels Potential increased rental housing offer in large cities	CMBS	Neutral
		Project Finance	Neutral
Student loans	Loan forgiveness and income-based repayment to potentially increase	SLABS	Positive
		Lenders	Positive

Source: Fitch Ratings

Related Research

Student Housing Vulnerable in New Normal of Higher Education (Pressures on Universities, Public Private Partnerships and CMBS Loan Performance) (June 2020)

Analysts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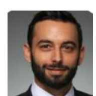
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Acute Short-Term Stress from the Pandemic, with Some Long-Term Effects

Coronavirus-accelerated changes will have a limited long-term impact on US student housing-exposed CMBS, as well as Infrastructure Projects and US student loan ABS. In its third year of a negative sector outlook, US higher education institutions may be further affected over a longer term due to a pressured high school graduate pipeline, though near-term enrolment is expected to return to pre-pandemic levels.

Student housing was affected in 2020-2021 by lower enrolment and remote-learning, but Fitch Ratings expects housing demand to recover to historical levels as in-person learning returns during the 2021-2022 academic year. Although the pandemic has resulted in higher payment deferrals for student loans, we expect this to be temporary with payments increasing as the economy recovers.

This report explores the potential short- and long-term effects of the pandemic on the demand for higher education providers (US Public Finance), student housing (Infrastructure & Project Finance and CMBS), student loans (SLABS) and student lenders (NBFI).

Demographics Drive Enrolment

Enrolment by first-time, international and community college students fell sharply in autumn 2020, but we expect it to normalise once coronavirus-related effects diminish. The pandemic-induced recession is not expected to increase higher education enrolment unlike in previous downturns, due in part to the uncertainty of the duration and the public health risk of this crisis. This makes it different from many other recessions.

Declining enrolment predated the pandemic and will persist geographically and across institutions. Longer term, the fall in high school graduate numbers will put pressure on enrolment beyond 2025, particularly when coupled with fewer foreign students.

In-Person Learning to Recover

Remote learning will continue even when the pandemic is contained, but Fitch does not expect it to remain the predominant mode of learning, particularly at undergraduate level. We believe most students will return to a predominantly in-person learning environment in autumn 2021. However, remote learning, will continue to complement traditional delivery and remain more relevant in the for-profit and non-traditional space.

Policy Changes Central for Student Loans

The pandemic has increased the emphasis on social injustice, access and affordability. In particular, it has intensified discussions on how to decrease the student loan debt burden and provide relief to borrowers who are struggling financially. We expect the implementation of student loan forgiveness to have the most direct effect on Federal Family Education Loan Program (FFELP) SLABS.

Will Enrolment for US Higher Education Providers Stabilise?

- Enrolment to rebound before returning to pre-pandemic pressures
- Students are expected to return to campus, but remote delivery is here to stay
- Pressure on tuition fees from amplified access and affordability concerns
- Strong need for stimulus

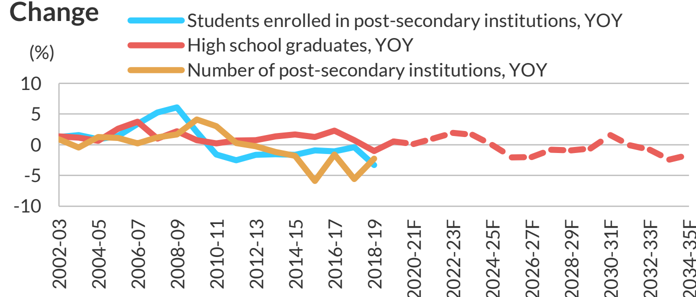
Enrolment Is Down

Fitch expects enrolment levels to return to pre-pandemic levels once infections decline, but slowly decline in the longer term. In total, post-secondary enrolment fell by 3.3% yoy in autumn 2020, driven largely by undergraduate declines across all institution types. The largest drops were in certificate and associate programmes, which had a particularly large impact on community college (enrolment fell 9.5%).

First-time student enrolment (down 16.1% yoy) may recover more quickly as most gap years/deferments are short-lived. International enrolment (down 13.7% for undergraduate and 7.6% for graduate students yoy) in particular had already been on a several-year decline before the pandemic and thus may face a more protracted recovery post-pandemic. Prospects for fall 2021 will depend upon travel and visa conditions as the year progresses.

Post-secondary school enrolment rates have been largely flat for several decades and we expect the rate of growth in high school graduates to slow beyond 2025, falling by just over 7% to 2032. In addition, the college-going rate has flattened. Enrolment growth has slowed significantly in the past decade and we do not expect the typical "bump" provided by economic downturns.

Enrollment, High School Graduates, Total Schools, YOY Change



F: Projected.
Source: Fitch Ratings, NCES & WICHE

Remote Learning to Complement In-Person Experience

Fitch expects the virtual delivery model to wane in the post-pandemic environment. Student and faculty preference remains highly in favour of in-person learning, and questions of quality and outcomes will continue. We expect remote delivery to continue to increase, albeit incrementally, and remain a particularly important component of delivery in for-profit and non-traditional institutions as they tend to serve a disproportionate amount of older, working, and non-degree-seeking students than their four-year counterparts.

Remote learning dramatically increased in use under both public mandate and institutional choice, and many institutions have retained a significant level of online and hybrid course capacity in spring 2021. Pre-pandemic levels of remote delivery were relatively nominal, with less than 20% of undergraduates exclusively enrolled in distance education. Of note, enrolment at primarily online institutions rose by over 6% yoy, including a 4.9% increase in undergraduates.

Access and Affordability Concerns Amplified

The pandemic has amplified existing access and affordability concerns. Private institutions will face meaningful pressure given their higher tuition. Fitch expects those with weaker competitive positions and small, tuition-dependent revenue bases to be particularly challenged.

Public institutions have the advantage of relative affordability for students and scale, as well as some revenue diversity away from student fees, but are often constrained in how much practical pricing power they have in their role as the public postsecondary education provider for their states' students.

Funding Is Under Pressure

In the medium to long term, funding presents a real concern as state budgets grapple with meaningful revenue declines. In the absence of more federal stimulus for state and local governments, Fitch expects cuts in state funding to be significant. State funding for public institutions remains below the level prior to the Great Recession of 2008, forcing some institutions to make up the difference with higher student fees.

Federal support for higher education is likely to be neutral to favourable under the new administration. The Biden/Harris platform called for increases in Pell Grant Awards, student loan forgiveness, and a less restrictive immigration platform.

Potential Rating Relevance

	Enrolment	Tuition fees	Funding
Four-year public	5	4	3
4-year private	4	3	5
2-year public	3	5	4

1 = Negative Impact, 5 = Neutral Impact, 10 = Positive Impact
Source: Fitch Ratings

Will Students Fully Return to Campus Housing?

- Campus closures and remote learning negative for short-term housing performance
- Housing demand to return or even increase in the medium to long term
- Competition increasing from traditional rental housing for off-campus providers and upper-classmen housing

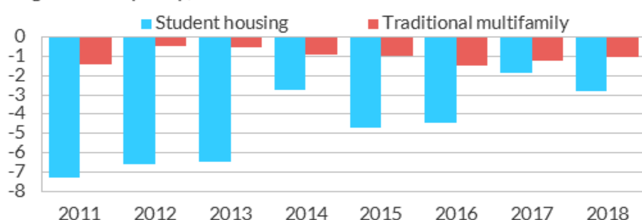
Housing Demand Expected to Return

Fitch does not expect the pandemic to be a catalyst for longer-term secular changes to student housing, as most students will want to return to campus to enhance their education and experience the related social benefits. Remote learning will be more dominant in the for-profit and non-traditional institutions and is not expected to put pressure on student housing occupancy levels.

However, student housing assets are at a heightened risk of further performance weakness in the short term. Continued remote learning, reduced enrolment during the pandemic and low on-campus participation will continue to affect occupancy negatively until infections decline.

Fitch-Rated CMBS 2.0 Student Housing and Traditional Multifamily Loans

Changes in occupancy, issuance to 2019



Note: Data reflects loans in the Fitch-rated US CMBS 2.0 portfolio that reported both occupancy and net operating income figures for the full-year 2019 as of May 31, 2020
Source: Fitch Ratings

The magnitude of the impact on student housing project ratings depends on housing configuration, issuer liquidity and university support. Housing projects that have a configuration that supports social distancing, such as those designed for single occupancy or suites, have seen a more limited impact on occupancy then double-occupancy housing, resulting in more stable cash flows and minimal rating impact. Projects that started the pandemic with substantial liquidity and reserves have also been able to weather a period of lower occupancy. Whereas student housing projects that saw a substantial decline in occupancy due to reconfiguration and those with limited liquidity have seen rating pressure or downgrades.

Favourably, some privatised student housing benefit from university support, with universities reimbursing students for unused housing as opposed to reimbursement from the project company. This cash flow support has helped to bolster a project's financial position.

Following widespread closures in spring 2020, for the 2020-2021 academic year, US student housing projects saw lower occupancy but very few full closures. Housing assets configured for single occupancy have generally seen limited reductions of 5%-10% in capacity to account for social distancing, while assets configured for double occupancy saw substantial declines in capacity of more than 30% in some instances. Early data for autumn 2021 indicate a return towards full capacity, with some projects already planning to allow for full occupancy.

For the UK purpose-built student accommodation (PBSA) sector, recent booking performance supported by stronger enrolment shows little damage from the pandemic despite early negative signs. EU students are the only group with falls in applications with Brexit being most likely the greatest factor. Evidence from the Fitch-rated Unite (USAF) II Plc transaction, which we consider a good proxy for nationwide performance, suggests a drop of about 10% in occupancy, which we expect to be reversed in the next few academic cycles.

Additional Stock Needed, Increased PPP Demand

Post-pandemic, additional housing stock may be needed in the US to support a potential longer-term shift in campus housing density standards. Colleges and universities may turn to private student housing to help house students, given already constrained housing supply on many campuses. A public private partnership (PPP) structure can enable external funding for student housing and transfer some risk of housing demand and operations away from the institution to a PPP partner.

Some Off-Campus Long-Term Rental Pressure

In the US, Fitch expects demand for on-campus housing to remain strong for first time in college (FTIC) students. Thereafter, an institution's on-campus housing policy, housing supply and cost-competitiveness all will play a role in determining demand. Even for schools without on-campus housing policies, FTIC demand generally remains strong and vacancy rates are in line with institutions that require on-campus living. For non-FTIC, the cost-competitiveness of off-campus housing has a large impact and this type of housing is viewed as a likely alternative to on-campus housing.

Outside the US, traditional rental housing may start to compete with traditional student housing in densely populated areas. Megacities like London may see housing demand continue to be redistributed outwards, towards more affordable suburbs and beyond as the distance to the workplace becomes less relevant if remote work persists. We expect this to result in depressed rental rates for urban housing.

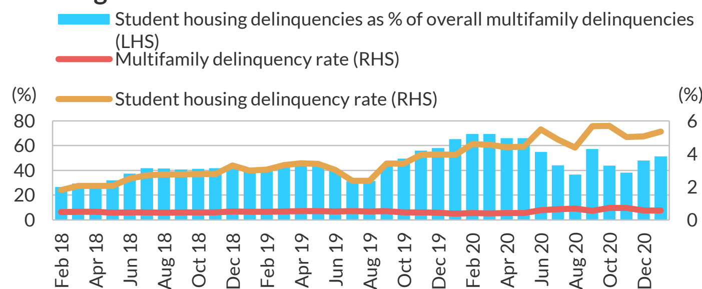
If urban housing rents remain at lower levels, these dwellings will become more affordable to students. The lower pricing equilibrium will put downward pressure on PBSA rents in those areas, although we expect they will preserve some rental premium where they continue to present a superior product offer.

Weak CMBS Housing Performance

Student housing loans within US CMBS transactions already exhibited weaker performance than traditional multifamily loans prior to the outbreak of the pandemic. Student housing occupancy and net operating income are highly vulnerable to such factors as new supply and market competition, university enrolment trends and on-campus housing policies, property quality and amenities, proximity to campus and operator experience.

Fitch expects student housing loan delinquencies will continue to comprise an increasingly disproportionate share of overall multifamily delinquencies. Before the pandemic, student housing delinquencies had accounted for more than 69% of total multifamily delinquencies. Although this ratio has since fallen, largely due to more traditional multifamily loans becoming delinquent, it remains high at about 50% as of January 2021 despite comprising a small portion of overall multifamily loans. The student housing delinquency rate peaked at 5.70% in October 2020 from 4.55% pre-pandemic. It was 5.35% in January 2021, which is more than nine times the overall multifamily delinquency rate of 0.57%.

CMBS Delinquency Rates for Multifamily and Student Housing Loans



Source: Fitch Ratings

Additional pressures on occupancy and net operating income could further impair the performance of student housing loans in the short term. Improvements in property-level fundamentals will be predicated on how quickly the vaccine can be distributed to the wider population, how quickly students return to campus, university requirements and the lifting of campus-driven or government-mandated social distancing measures.

Pre-pandemic, student housing properties in CMBS typically received a minimum 10% vacancy assumption in Fitch's cash flow analysis at issuance, incorporated higher capital expenditures, and used higher capitalisation rates and refinance constants than traditional multifamily properties. Since the pandemic, Fitch has increased the stresses on student housing properties, incorporating a minimum vacancy assumption of 20% for new student housing loans at issuance, applying higher property volatility scores and increasing the additional haircuts to servicer-reported net operating income in surveillance.

Fitch expects to see fewer student housing loans being contributed to new CMBS securitisations. Already a small overall percentage of the multifamily universe, student housing has gradually declined from 7% at the start of 2018 to 5.5% as of January 2021.

Potential Rating Relevance

	Demand	Cash Flow volatility	Property values
CMBS	5	4	4
Project finance	5	4	n.a.

1 = Negative Impact, 5 = Neutral Impact, 10 = Positive Impact
Source: Fitch Ratings

How Will Student Loan Borrowers and Lenders Be Affected?

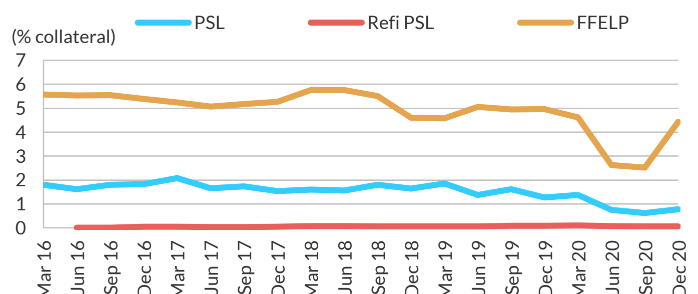
- Pandemic could accelerate student loan reforms
- More support potential for overindebted borrowers
- Continued push to reduce student loan debt

Loan Performance Aided by Borrower Support

The coronavirus pandemic and associated containment measures resulted in elevated loan forbearance for borrowers to weather short-term financial challenges. However, Fitch does not expect a material longer-term impact on the arrears, defaults and payment delays for SLABS.

Asset performance across SLABS segments, including in-school private student loans (PSL), PSL refinancings (Refi PSL), and Federal Family Education Loan Program (FFELP), has been resilient to the economic fallout arising, with declining forbearance after an initial peak in May 2020. Performance has been distorted to some degree as a result of unprecedented government stimulus, widespread lender forbearance and a sharp contraction in consumer discretionary spending.

SLABS - 90+ Delinquencies



Source: FitchRatings.

A weaker post-pandemic economic outlook may challenge PSLs if graduates face diminished employment opportunities, eventually reducing lifetime earnings and their ability to repay student loans. However, these loans are predominately underwritten with co-borrowers providing additional protection against default.

Performance for Refi PSLs is expected to remain stable, supported by stronger credit profiles with high prime FICO scores (averaging about 780). These borrowers are employed after graduation with concentrations in sectors, such as medical professionals, which are less affected by unemployment stress.

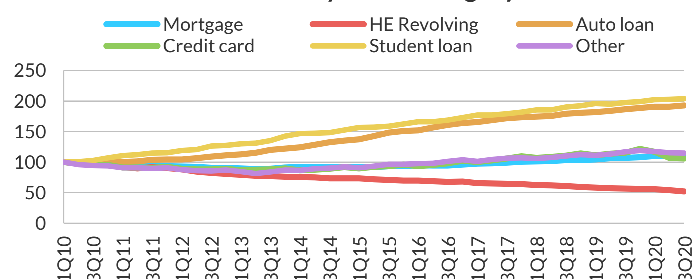
A high number of FFELP borrowers are expected to seek income-based repayment (IBR) plans, exacerbating a trend that has been seen since 2014. This resulted in lower periodic inflows from the portfolios and heightened maturity risk on the ABS bonds. However, this could be counterbalanced by the potential positive impact from loan forgiveness, if enacted, because this would result in significant prepayment, improving the maturity risk of transactions with senior bonds maturing in the next few years.

Rising Student Debt Burden in Focus

The economic and social impacts of the coronavirus intensified political discussions focused on student loan debt reforms, namely proposals to shrink the amount of student loan debt in the US, and provide relief to borrowers who are financially challenged.

Under the Biden administration, Fitch expects increased federal support for student loan borrowers, which may take the form, of loan forgiveness programmes, expansion of or changes in IBR plans and/or expanded student loan dischargeability in bankruptcy. The nomination of Rohit Chopra by the Biden administration to head the Consumer Financial Protection Bureau (CFPB), if approved by the Senate, could pose challenges for student lenders. Chopra, who served as student loan ombudsman at the CFPB during the Obama administration, has been highly critical of student lenders, particularly their loan servicing practices. Increased regulation of student loan originators/servicers could result in higher servicing.

Growth in Debt Balances by Loan Category Since 2010



Source: Fitch Ratings, New York Fed Consumer Credit Panel/Equifax

Loan Forgiveness Proposed

Student loan forgiveness is the most significant proposal that could affect outstanding US SLABS through reduced maturity risk and lower defaults. Proposals are for the cancellation of between USD10,000 and USD50,000 of student loan debt per borrower based on need. These proposals have varied in the amount of forgiveness, scope (whether private student loans are included, for example) and ways to proceed (such as via executive action or traditional legislative action that would run through Congress).

For ABS, loan forgiveness is most likely to impact FFELP and result in significant prepayments. Loan forgiveness to borrowers with weaker credit profiles and lower income levels could decrease the overall expected default rate at a pool level, as the forgiven loans would be prepaid before a default occurs. Additionally, FFELP SLABS borrowers currently in IBR would likely be included in any needs-based assessment, and declining IBR concentrations would improve longer-term payment rates, which would benefit the ABS trusts from a maturity risk perspective.

Proposed scope is important since the size of FFELP, PSL and Refi PSL is small compared to Federal Direct loans (loans funded and owned by the US Department of Education and not in ABS) and are not owned by the federal government, a factor that led to their exclusion from the Federal coronavirus forbearance relief in 2020. Even if FFELP loans are not directly included, ABS could still see increased prepayments as borrowers seek to consolidate their FFELP loans into the Federal Direct program.

Changes to Payment Programmes Increase Maturity Risk

Proposed changes to Federal loan payment programmes would either increase or reduce maturity risk. For example, under Biden's proposed IBR plan for federal student loans, individuals would pay 5% of their discretionary income toward their education debt, followed by forgiveness after 20 years. Individuals with annual earnings of USD25,000 or less would not owe any payments on their student loans. It is uncertain whether legacy FFELP loans would be included.

IBR programmes generally reduce cashflow to ABS trusts until forgiveness provisions begin, resulting in higher bond maturity risk for ABS trusts depending on maturity dates on the ABS bonds. Changes that lower eligibility thresholds or further reduce payment based on income would continue to increase maturity risk. However, changes that provide for earlier forgiveness would benefit ABS trust performance depending on the legal final maturity dates for a particular ABS trust.

Loan Dischargeability Key for Payment Priority

Changes to bankruptcy law or their application could make it easier for consumers to discharge student loan debt. Fitch would view this as credit negative for private student loan lender and ABS ratings, where expanded dischargeability could lower the priority borrowers give to student loans versus other types of debt, thereby increasing propensity to default and likely reducing unsecured recoveries upon default. This impact will be muted by the co-borrower nature of these loans, which would require both borrowers to file for bankruptcy.

Overall, this would not negatively affect FFELP ABS ratings, which are indirectly guaranteed by the US Department of Education. Increased claim reimbursements resulting in involuntary prepayments could therefore improve the cash flow profile of FFELP transactions subject to maturity risk, while worsening that of transactions subject to credit risk, a consequence of the reduced available excess spread following higher loan defaults

Private Student Loan Origination Volumes Uncertain

Student loan volumes could reduce through more Federal support for the cost of higher education and free tuition to public schools based on need, which already exists for some state public schools. However, any decline in traditional in-school private student loan ABS origination could be muted because of pressures on the budgets of higher education institutions, which could increase tuition fees, and additional expenses, such as housing, incurred to obtain higher education.

Furthermore, private loans are geared to a higher household income demographic, who are less likely to qualify for tuition assistance. We expect the impact from remote learning, and resulting possibly lower tuition fees and housing costs, to be marginal in the short to medium term on the loan origination volumes as we believe students derive benefit from learning in-person and will want to return to campuses once the effects of the pandemic are over.

Private student loans for refinancing and consolidation are expected to remain robust given low interest rates, despite borrowers being more reluctant to refinance their federal student loans without more clarity on the terms of student loan forgiveness.

Potential Rating Relevance

	Income based repayment changes	Loan forgiveness	Dischargeability
PSL	5	5	3
Refi PSL	5	5	4
FFELP	3 – 6[a]	5-7[b]	5
Lenders	5	7	3

[a] Expected impact different depending on final proposals: shorter time periods to loan forgiveness beneficial, while expanded access negative.
[b] Dependent on the size of the program and eligibility criteria.

1 = Negative Impact, 5 = Neutral Impact, 10 = Positive Impact
Source: Fitch Ratings

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