LORING WARD

Is COVID-19 Creating An Education Planning Crisis?

Few things in our lives have been so dramatically altered throughout the COVID-19 crisis as school and education. From online coursework to cancelled proms to a March devoid of Madness but full of uncertainty about whether or not college campuses would even reopen for the fall semester, there seem to be even more questions than answers.

How events unfold is especially high stakes for the students and parents facing the myriad of decisions surrounding the meaningful investment—personally and professionally—of college education. So, both as an advisor and a parent of teens, I asked one of the most knowledgeable people I know on the topic of college planning, my colleague Dave Ressner, a wealth advisor and education planning specialist. And he answered:

Tim Maurer: What impact is the COVID-19 crisis having on institutions of higher learning?

David Ressner: COVID-19 has affected almost every sector of the economy, and higher education is certainly no exception. One higher education group estimates more than $100 billion in emergency response costs across the sector, and some schools are worried they won't be able survive this crisis.

Maurer: Are schools anticipating the prospect of not going back to campus in the fall?

Ressner: With so many unknowns, it's impossible to predict what will happen this fall. However, in a March survey, 36% of college presidents thought this coming school year would be disrupted in some way—such as a later start or restrictions on the number of students on campus. Many schools have decided to go entirely online this summer.

Maurer: Families were already having a hard time affording college. Now, it will be even harder. More will be looking for aid at exactly a time when many schools can least afford to give aid.

Ressner: Yes, even before COVID-19, household income had not kept up with tuition inflation. The National Association of College and University Business Officers does an annual study of private college tuition discounting, which is exactly the aid you're talking about. The average tuition discount across all private colleges is over 50%, so if a school's published tuition is $40,000 the average student pays less than $20,000, not including room, board and fees. Lately, that discount rate has been increasing by about 1% each year. Obviously, that can't continue. But even at today's level, discounting is helping bankrupt some schools. Between 2016 and 2019, more than 20 major private colleges closed their doors. And seven major public universities closed or merged with other schools.

If there's a silver lining, it's low interest rates. Student loan rates – the cost of borrowing – are expected to fall to record low levels. We'll know more in July when those rates are set. And I would add that many planners recommend taking advantage of federal loans called Direct Loans every year. Again, their rates will be low, repayment terms are very flexible, and they are use-it-or-lose-it. What I mean is that if you pass on the freshman year loan, you can't borrow those dollars in later years. Over the course of four years, most students can borrow up to $27,000 in Direct Loans. Of course, if you need to borrow more than that, there are other options, but the Direct Loan is so good that it likely should be everyone's first choice for borrowing. All you have to do to get it is complete the financial aid application called the FAFSA.

Maurer: How can you appeal for more financial aid if one or both parents' livelihoods have been adversely affected by the COVID-19 crisis?

Ressner: Even before COVID-19, families experienced job losses, illnesses, divorces and other financial problems, so there already is an appeal process. That process is usually called Professional Judgement. If your child plans to go to college this fall and your financial situation today is worse than when you completed the financial aid application, then you're a candidate for Professional Judgment. In most years, such reviews are rare, but this year, more families will likely file for Professional Judgment.

Mark Kantrowitz wrote a very helpful book on this topic. Not surprisingly, it's called "How to Appeal for More College Financial Aid." I highly recommend it. On a related note, the same process can be used even when your financial situation has not changed. The success rate varies, but it can be worth asking, especially at moderately and less-selective private colleges—where tuition discounting is most common. If your child was accepted by two similar schools—schools that may often compete against each other for students—and the out-of-pocket cost at one school is more than the other, you can ask the more costly school to reconsider its aid award. Schools are ranked based on something called yield. That is, the percentage of admitted students who actually attend a school. The higher a school's yield, the better. So, if giving a family an additional $5,000 per year, for example, will get the student to attend, some schools are happy to do that to boost their yield.

This works best at schools where the student is among the top 25% of applicants, based on test scores and GPA, which can be found at a great website called CollegeData.com.

Maurer: How about the CARES Act? Were there any provisions in that massive stimulus plan to help students, students' families, and/or colleges?

Ressner: Many provisions in the CARES Act apply to those who have already graduated and are repaying student loans. But $14 billion was allocated to schools and current students for things like emergency food, housing and transportation. It's worth noting that in a letter to Congress, more than 40 higher education groups estimated the actual need to be closer to $60 billion.

Maurer: Is the impact being felt more at private schools than public schools?

Ressner: I think it is fair to say that COVID-19 poses more challenges to private colleges than public universities. Even so, public universities are definitely suffering major cutbacks in state funding. Earlier this year, the University of Missouri learned that its funding will be cut by about 8%, and I'm sure other states are not far behind. Having said that, private colleges were facing many challenges before COVID-19, and those challenges are just magnified by the virus.

For many private colleges, the most common problem was—and still is—that their main source of revenue is tuition, but their enrollments have declined. So, like I said earlier, to attract students, many colleges were heavily discounting their tuition, but only about 100 schools have endowments large enough to make up the difference. And more than 1,000 schools say that have no endowment at all. Those schools and many others are playing a game that just is not sustainable.

Now that the effects of COVID-19 are being felt, enrollment will probably fall even further. In fact, a recent poll confirms this. It found 9% of students who had planned to attend college this fall are strongly reconsidering that plan. And that number is expected to rise, as the poll was completed in mid-March when the COVID-19 crisis was just beginning. Groups representing colleges and universities predict a 15% drop in enrollment this fall. Either way, the pool of college students will probably shrink.

Of course, this crisis is evolving quickly, so a lot can change, but the drop in enrollment before COVID-19 was a clear trend that is expected to continue until at least 2030. Ironically, people think that it's difficult to get into college. While that is true at the most selective schools, literally hundreds of other fine schools don't fill their freshman classes each year because—across all colleges—there are just more seats than there are students. Before COVID-19, if students were willing to consider colleges outside of the most elite, they likely could find schools that would welcome them—often with generous financial aid, especially for high-achieving students. That's probably still true, but I'm sure COVID-19 will lead some schools to re-evaluate their aid policies.

In addition to declining enrollments, it's no surprise that COVID-19 has resulted in declining endowments, too. Of course, this won't hurt schools that didn't have an endowment in the first place, but it could tip the scales for schools that have been barely surviving on their endowment income. In fact, a recent article in the Harvard newspaper said, COVID-19 has put that school in a "grave financial situation." Now before all this began, Harvard's endowment was well over $40 billion—the largest college endowment in the U.S. So, if Harvard's situation is "grave," then no one is safe.

Maurer: Could schools struggle enough to maintain cash flow that their very viability could be questioned?

Ressner: Absolutely. Every school now faces challenges.

Let’s look at an example. The University of Wisconsin said it expects COVID-19 to cost $100 million—mostly the result of room and board refunds. And that figure assumes students will return to campus this summer and fall, which is far from a sure thing. As we discussed earlier, the federal government recently approved a $14 billion relief package. Wisconsin expects to receive about $19 million, half of which must go to students. So, while the relief dollars are huge, the losses are expected to be much bigger.

Even before COVID-19, Fitch and Standard & Poor’s rating agencies reported negative outlooks for the higher education sector. Moody’s had issued a stable rating late last year, then quickly revised it to negative after COVID-19 struck.

In addition to the challenges we’ve already discussed, Fitch predicted lower international student enrollment due to immigration policies before COVID-19. Now, travel restrictions will compound that problem. That hurts schools because international students tend to pay full price—effectively subsidizing American students. Fitch also expects fewer U.S. students to attend public schools outside their home states. Many state schools depend heavily on non-resident tuition that is often double the in-state rate.

And even if a school does not close, it could be forced to cut programs to survive.

Maurer: How can families discern the viability of their school of choice?

Ressner: There are many sources of information, but you have to know where to look. Just like governments, colleges often issue bonds to finance projects, and those bonds are rated according the financial strength of the school. If you can find such reports, you can see how financially strong a school is.

Although the colleges that most students attend are tax-exempt, all tax-exempt organizations must file a form with the IRS. That form, called the 990, contains a lot of financial information.

For example, the 990 contains the value of the school’s endowment. To support operations, it’s common for schools to withdraw 4%-5% from their endowments each year. If they withdraw much more, that could be a red flag. You can also compare a school’s income and expenses to see if they’re running a surplus or deficit. According to Moody’s, 25% of schools have been running annual deficits in recent years.

Last November, *Forbes* analyzed the financial health of about 900 private colleges. More than 600 schools were rated C or D.

A website called College Viability is a good resource.

And especially for private colleges, I would be wary of schools with declining enrollment, rapid tuition increases, and/or high debt payments.

Some of this information is available in the 990, but some of it can be difficult to find. If you can’t find it, ask. Ask each school you’re considering. If they’re not willing to tell you, that’s a bad sign.

Finally, it’s important to understand that, even if your school does not close, there are many reasons you want it to be financially strong. One of the dirty little secrets of college financial aid is that some schools give less aid to students after freshman year. So, you choose your school—at least in part—based on the cost, but then you find out sophomore year that the next three years are going to cost more than you thought. The website CollegeData.com has some information on this, but those numbers are just averages. After you receive your acceptances and aid notices, I recommend that families explicitly ask: Is there any reason I should not expect this level of aid all four years? One more thing to keep in mind is graduation rate. The four-year graduation rate at many schools is dismal. And it’s often not the students’ fault. It’s often due to insufficient class offerings. If you budgeted for four years, but have to pay for five, that can be devastating. So, make sure you consider graduation rate when choosing a school.

Maurer: The COVID-19 crisis is affecting just about everything and everyone, including prospective college students and their parents. One of the points of discussion recently has been the notion of a gap year. What exactly is a gap year, and who should be considering one?

Ressner: A gap year is time between high school and college that someone spends on something other than education—for example, work, volunteering, travel, etc. The benefits of a gap year include strengthening credentials, exploring interests, or maybe just maturing a bit before investing a lot of time and money in college. For example, Harvard reports that about 100 of its accepted freshmen postpone enrollment each year to pursue a gap year.

The process is pretty simple. Apply to colleges as you normally would. Get accepted. Pick the one you want to attend. Then request to defer your enrollment for a year. However, be aware that not all schools permit this. I recommend students ask in advance if they’re considering a gap year.

Middlebury College in Vermont is one school that supports gap years. In fact, Middlebury’s website contains a long list of programs and resources. But a gap year doesn’t have to be organized or sanctioned. All you need is passion for a job, internship or other activity.

Before COVID-19, gap years were increasing in popularity, but I suspect we will see even more students choosing that path this fall, especially if the virus has not been eliminated and if many schools might still be online. In fact, a recent poll confirms this. According to it, 6% of college-bound students are strongly considering a gap year this fall.

Of course, a gap year does not eliminate the possibility of contracting COVID-19, especially if your plans include working or volunteering in a group of people. And frankly, with unemployment so high now, paid work might be difficult to find. So even gap year plans might have to be adjusted.

Maurer: Following the financial crisis of 2008-2009, it became evident that a number of 529 plan sponsors had been too aggressive in some of their portfolio models, such that accounts designed to pay for education in the relative near term experienced serious declines. How is the performance of 529 plans holding up in the face of coronavirus-driven market declines?

Ressner: Yes, many people thought their age-based investment options would prevent losses if their child was near college age, but many of those portfolios contained a lot of stocks—even for high school seniors. Some plans have just one age-based investment track, while others have three tracks—conservative, moderate and aggressive. As you can imagine, many aggressive tracks hold stocks well past age 18. Today, in examples of three commonly used plans—Utah, Missouri and New York—an 18-year-old participant in those aggressive portfolios would have 20-30% in stocks.

But here’s what makes it even more confusing. Most 529 plans have names for each age-based investment. For example, at age 18, a participant in Missouri’s aggressive age-based track would be invested in the “conservative” portfolio. In isolation, the portfolio is conservative, but not if someone needs every penny in the next year. So, it’s important to look under the hood and see what you’re actually invested in.

Maurer: So, what to do if your child just graduated high school and your college fund has lost money recently?

Ressner: If the losses are too much for you, you might consider reducing your risk. And to parents of younger children, I would say to double check their plan's risk level.

People not invested in age-based portfolios have what are called static portfolios because they do not change as the child ages. Their college fund could have been decimated if they were taking too much risk. If so, I recommend a few options. Of course, I don't know what you hold, but if you believe your investments will recover, you could continue to hold them until your child's sophomore year or later. Then use other funds or loans to pay for the first year or two. As we discussed earlier, it is likely that student loan interest rates will be lower, so borrowing may cost less than ever. And COVID-19 has led many students to reconsider their college plans—attending a less expensive school, postponing college for a year, or even living at home while attending college. In fact, some families are considering these options even if their 529 plan investments have held up, especially if family income has suffered due to COVID-19 or if classes will still be online this fall.

Maurer: Many parents are facing a cash crunch and may feel the need to take money from their 529 college savings plans to pay for elementary or high school expenses. Is that allowed?

Ressner: This trips up a lot of people. Federal law permits that, but 12 states do not: California, Colorado, Hawaii, Illinois, Michigan, Minnesota, Montana, Nebraska, New Mexico, New York, Oregon and Vermont.

And this is not governed by the 529 plan. It's governed by the state where you pay taxes. So, if you live in one of the 38 states that complies with federal law, then you ARE allowed to withdraw up to $10,000 per year per child for K-12 tuition. Tuition only.

On a related note, many current students have received refunds for unused room and board fees. If those fees were paid from a 529 account, the refund can be put back into the same account within 60 days. Otherwise, the refund will be considered non-qualified and subject to income tax and a 10% penalty, but only on the growth, not the entire amount.

As you can see, the COVID-19 crisis has created an education crisis of sorts that is likely to have an impact on students, parents, and the schools that serve them. As students and parents, we don't have control over many of these factors, but hopefully this interview helps you discern what you can.

For more on taking control of education planning for your household, read The Non-Conformist's 4-Step Education Savings Plan.

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