Not So Free: Financial and Investment Implications of New York’s Excelsior Scholarship Program

KEY INSIGHTS

- While opening opportunity to many New York families, the recently enacted Excelsior Scholarship Program will likely stress the financial resources of small private colleges and universities in New York State, particularly those with a high percentage of state resident students, modest endowments and high tuition discount rates.

- With revenues from tuitions facing pressure, the importance of endowment in support of operating budgets and scholarships will increase.

- The legislation will require fiduciaries of institutions to develop strategic responses that incorporate academic, finance, development and endowment resources.
BACKGROUND

New York Governor Andrew Cuomo’s Excelsior Scholarship, enacted by the state legislature in April, has been promoted as an unalloyed benefit for New York families struggling with high tuition payments and student debt. Under the plan, students from families with incomes less than $100,000 (rising to $120,000 over the next two years) will receive state scholarships that will complement other financial aid up to the full cost of tuition at any four-year public institution of higher education in New York and up to $5,500 at any New York community college.

Private institutions in New York State are also covered by the Excelsior Scholarship scheme, but to a lesser degree. Qualifying students can receive up to $3,000 per year, but the schools are required to match the grant and also to freeze tuition during the period that the student is receiving the scholarship.

The program requires that students be enrolled full time, earn passing grades and complete 30 credits per year; these incentives are intended to encourage them to graduate on schedule. After leaving school, Excelsior Scholarship students must remain in the state for the same number of years that they received the scholarships; if they leave, the grants will be converted into loans that must be repaid. While the program has been criticized as regressive for not covering other items such as travel, room, board and books, its supporters state that it goes a long way toward eliminating barriers to higher education among middle-income and working-class families. Governor Cuomo’s office estimates that close to 200,000 students will benefit from the program.

POTENTIAL IMPACTS

Sounds great, yes? But the details – and the distortions introduced by this program – are likely to lead to unintended consequences for the educational sector. These challenges will mainly affect private institutions, but public colleges and universities are not immune.

According to the Commission on Independent Colleges and Universities in New York (CICU), an industry group of more than 100 New York private nonprofit colleges and universities, independent nonprofit institutions enroll about 492,000, or 39 percent, of New York’s total 1.3 million students. Sixty percent of these institutions enroll fewer than 2,000 students, and many may be highly dependent for revenue on tuition flows rather than endowment. A recent article in Inside Higher Education said that according to CICU, “just over half of the state’s colleges have student bodies that are at least 75 percent New Yorkers”. The impact of the Excelsior Scholarship program on these institutions is therefore likely to be significant.

If you are a fiduciary of a private institution of higher learning in New York, here are some items that you may want to put on your next Board meeting agenda:

Fewer students may enroll in your institution, and your cash flow from tuition may decrease. Many students from middle-income families will likely decide to take advantage of the Excelsior Scholarship’s offer of free tuition at a public institution. A recent study by CICU estimated that median enrollment at private colleges and universities in the state would decline by 11 percent and their revenues shrink by $1.4 billion as a result of the Excelsior Scholarship program. Unlike the few well-endowed New York institutions that can afford to provide need-blind financial support to students, if your institution is less selective and more dependent on tuition you may see your applicant pool decrease significantly as families choose the Excelsior Scholarship route rather than the mix of grants and loans that most private institutions offer. Furthermore, since many middle-income students qualify for Federal or other New York state assistance such as the Tuition Assistance Program and Pell grants, you will lose this cash flow as well, even if you were already discounting your tuition for these applicants. And if you do accept the $3,000 Excelsior Scholarship aid available to students attending private institutions, you will be required to match it...
with $3,000 from your own funds and freeze tuition for the period that the student receives that aid.

For less-selective private institutions, discounting of tuition has long been employed as a tool to help attract more-qualified students and to achieve a desirable mix in each year’s entering class. According to the National Association of College and University Business Officers’ 2016 Tuition Discounting Study, the estimated 2016-17 national average tuition discount rate for first-time, full-time freshmen was 49.1 percent, the highest ever recorded. For smaller institutions the rate was even higher, at 50.9 percent. Size is important, as we have noted, because the impact of the Excelsior Scholarship program will fall disproportionally on those institutions with small enrollments, high discount rates and a high concentration of students who are New York State residents.

Nor will it be possible, as in the past, to find groups of students who will pay full tuition to make up the shortfall. In recent years, many institutions have sought to increase cash flow by admitting students from outside the U.S. who could pay full tuition and fees. Under the Trump administration’s “America First” immigration policy, however, it seems likely that fewer visas will be granted to foreign students, and that as a result this route to revenue improvement will be constrained if not shut off.

**POTENTIAL REMEDIES**

The conclusion seems inescapable that, at many private institutions, cash flow will be reduced and budgets subjected to stress.

**Your endowment will have to provide more support to the operating budget.** It will be very difficult, at least in the short term, for your institution to cut costs to match the decrease in cash flow from tuition. The difference will have to be made up by distributions from the endowment. But endowment returns over the last 10 years, as measured by the 2016 NACUBO-Commonfund Study of Endowments (NCSE), have averaged just 5.0 percent, barely enough to cover the 4.7 percent that an average institution distributes from its endowment, and nowhere near the 7.1 percent average nominal return desired by participating colleges and universities.

Like many institutions, you may express your long-term investment goal using the shorthand formula of CPI + 5%. That is an ambitious target, given that Commonfund expects a passive index portfolio composed of 70 percent public equity and 30 percent public bonds to deliver average returns of just 6.2 percent in the coming five years. Diversification into a prudently-chosen portfolio of alternative strategies such as private equity, venture capital and hedge funds may help to lift these numbers, but only if your institution has access to top-performing managers in each strategy. In any case, your endowment will increasingly be required to bridge the gap between lower tuition receipts and the ongoing expenses of running the institution — a challenge that will be exacerbated by the fact that most endowment is donor-restricted and cannot be used for general operational purposes.

**Your institution will have to raise more endowment funds.** Since endowment support will be essential to plug the budgetary hole created by the Excelsior Scholarship program, new and substantial endowment funds will have to be raised to support increased scholarship aid and bolster the general operating budget. To achieve this goal, your institution will have to improve the quality of development staff, communicate the value of your mission strongly and clearly, and practice transparency with respect to your endowment investment and spending practices. Not all institutions will be able to meet these challenges; for those that cannot raise sufficient funds, difficult conversations about institutional sustainability, merger or even closing may lie further down the road.

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To sum up, it will be incumbent upon private institutions to continue to make the case for their own relevance and value. Competition based on price, via tuition discounting, may have reached its limits given these institutions’ high degree of tuition dependence, particularly at smaller colleges and universities. Schools will need to differentiate themselves, in the eyes of applicants and families, on the quality of their academic programs and the educational experience they offer to students. Achieving this worthy goal will require a much higher degree of coordination among the endowment, finance and development functions than has typically been the case.

Public colleges and universities, too, will face challenges as the Excelsior Scholarship students arrive on their campuses. If you are a fiduciary of a public institution or a foundation that supports one, here are two important items to put on your next Board meeting agenda:

**Will we have sufficient capacity to absorb the new enrollees?** A substantial number of additional students are expected to matriculate at public institutions as a direct result of the Excelsior Scholarship program. CICU estimates that enrollment at New York public colleges and universities will increase by a median 16 percent or 116,000 students, with an estimated incremental cost to the state of over $1 billion that is not currently provided for in the educational budget. Public institutions have suffered from declining state budgetary support for decades, and their existing facilities may be strained by the new arrivals. Apart from the stress on physical assets such as classrooms, dining halls and athletic facilities, average class sizes will by definition increase if new faculty are not hired – a prospect that seems less than certain despite the Cuomo administration’s assurances that a “generous maintenance of effort” will form part of the state’s financial support for public institutions of higher learning.

**Will we subvert our democratic educational mission by becoming more selective?** As demand increases, even public institutions may have to make decisions as to who will be admitted for a limited number of available places. This is particularly true for community colleges, which are expected to experience the highest increase in enrollment due to their lower costs and to students’ ability to go on to a four-year institution upon graduation. According to the CICU report, a similar program in Tennessee led to enrollment surges of up to 25 percent at some community colleges, while Oregon’s program resulted in a population of eligible community college enrollees that exceeded projections by 18 percent, leading to declines in enrollment at four-year colleges. In New York, a lottery process has been mooted as the decision-making tool, but it is not clear how it will work. If in fact public institutions become more selective, they will risk undermining their core mission of educating lower-income students who may be less well-prepared but whose lives could be immeasurably transformed by a college education. This result, which has already occurred in states such as Georgia with its Hope Scholarship program, would be the ultimate unintended consequence.

The Excelsior Scholarship is now the law, and the results will be visible to all. For many students and families, the prospect of strong tuition subsidy is the answer to a prayer. For New York’s system of private and public higher education taken as a whole, however, the distortions that will be introduced by the program will almost certainly lead to challenging stresses that will require a creative strategic response from each affected institution.
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