HIGHER EDUCATION ENROLLMENT TRENDS FAVOR HIGHER QUALITY CREDITS

While the pandemic's impact on the higher education sector continues to diminish, challenges remain in the form of flat-to-declining enrollment trends, a tight labor market and uncertain economic conditions.

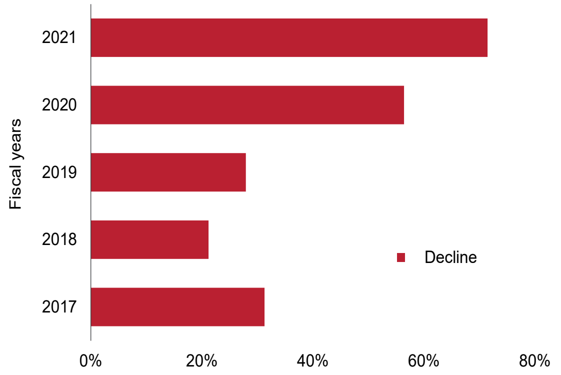
Unsurprisingly, the emerging headwinds for the sector suggest that higher-quality credits will be better positioned to manage the evolving landscape than their lower-rated peers.

In response to lower enrollments in 2020 and 2021, most universities left tuition rates unchanged, but offered larger student aid packages and higher discounting. These sector-wide policies led to a decline in net tuition revenue.

In its annual US Public University Medians report published in June, Moody's reported that nearly 75% of its rated public universities witnessed a year-over-year decline in net tuition revenue. The agency notes three consecutive years of enrollment losses across the space contributed to the accelerating declines in this key revenue stream since 2018.

CHART 1

Public Universities - Annual Decline in Net Tuition Revenue per Student



Source: Moody's Investor Service, June 2022

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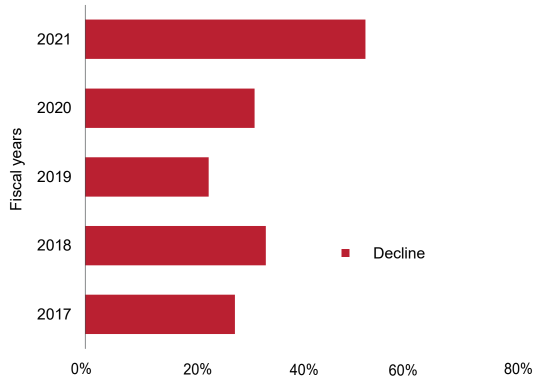
HIGHER EDUCATION ENROLLMENT TRENDS FAVOR HIGHER QUALITY CREDITS *continued*

In a similar May 2022 analysis of private universities, Moody's reported that more than 50% of private colleges experienced a year-over-year decline in net tuition revenue. Similar to their public peers, the revenue shortfall quickened during the pandemic.

CHART 2

Private Universities - Annual Decline in Net Tuition Revenue per Student



Source: Moody's Investor Service, May 2022

Despite the underperformance displayed above, the sector posted solid margins in fiscal 2021 with Moody's calculating a median EBIDA margin of 13.7% and 15.7% for public and private universities, respectively. Both cohorts benefited from federal pandemic assistance, coupled with staffing, service and program cuts enacted in response to fewer students, and a shift to remote learning. For public systems, state appropriations which average approximately 25% of operating revenue, showed steady gains, as many states extended cash windfalls and portions of federal awards to their university systems. Furthermore, strong investment returns boosted endowment values and padded reserves for the year ended June 30, 2021. While college campuses have largely resumed pre-pandemic operations and activities, the competition for students remains heightened and is complicated by a tight labor market.

Undergraduate enrollment trends have been flat to declining across the US since 2010. Demographic trends in certain regions of the country point to a declining number of high school graduates. Public four-year universities appear to be experiencing the brunt of the impact as the National Student Clearinghouse reports

HIGHER EDUCATION ENROLLMENT TRENDS FAVOR HIGHER QUALITY CREDITS *continued*

that from Fall 2017 to Fall 2021, enrollment in four-year public universities fell 4.1% to 7.77 million, while registration at private four-year colleges was flat at 3.78 million.

Against the backdrop of unfavorable demographic forces, a tight labor market poses two sets of challenges. On the demand side, more high school graduates may choose to enter the workplace rather than pursue college, while active employees contemplating continuing education may opt to remain on the job. Conversely, wage pressures drive up personnel costs which typically account for 30% of a university's operating budget. Tuition hikes are becoming increasingly difficult for many schools given the greater emphasis on affordability and value. Federal pandemic assistance, which supported margins and reserves in the absence of tuition increases, has largely been exhausted.

Given the current sector backdrop, we believe higher quality institutions will fare best. These schools are characterized by large, stable enrollments, solid demand trends, strong academic reputations, revenue diversity, prudent management practices, reasonable debt levels and healthy balance sheets. We currently hold debt issued by 34 public universities and 21 private institutions representing 7.1% of our intermediate Strategy. Our public higher education credits are large systems, including many state flagship and nationally-recognized institutions. Enrollment statistics are in line with sector averages, posting a median acceptance rate of 70% and a matriculation rate of 26%. Revenue diversity is reasonable with tuition and auxiliary revenues representing 31% of total receipts and reliance on state funding limited to 14%. These metrics stack up favorably against Moody's public university medians of 41% and 24%, respectively. Debt levels appear manageable with spendable cash covering debt 1.98x versus Moody's median of 1.72x for all public institutions. Our private university credits also tilt toward larger schools with median enrollment of 15,846 versus Moody's median of 3,436 for the 226 private schools rated by the agency. Academic reputation is strong in this cohort as well, with seven Ivies among our holdings. Spendable cash to debt at 2.31x is considerably higher than the public peer group, bolstered by endowment funds.

In light of demographic trends, the competition for students amplified during the pandemic is projected to continue for the sector. We believe our higher education credits are positioned to successfully manage future challenges and we continue to look for value opportunities within the universe.

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