

Higher Education in Distress: Key Challenges and Considerations

TMA NYC Webinar

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Section I: Background – How Did We Get Here?

The Rising Cost of Tuition

- The cost of tuition has increased tremendously for both public and private institutions between the mid-1960s and 2020
- Beginning in approximately 1985, the federal government significantly expanded student borrowing capacity
- Institutions absorbed these additional dollars and spent the money on facilities, administrative staff, student services, and amenities

Impact of Financial Crises

- The decline in birth rates brought on by the 2008 financial crisis
- COVID-19's impact on enrollment during the global pandemic
- The current “demographic cliff” – not enough high school graduates to sustain current institutional capacity
- Institutions most vulnerable to financial distress share several common characteristics:
 - Small enrollment
 - Tertiary (non-flagship) status
 - Private governance
 - Many with religious affiliation
 - Limited endowment
 - High tuition discount rate (“We’ll make it up in volume.”)
 - Located in the northeastern quadrant (New England, Mid-Atlantic, Midwest)

Challenges in Identifying a Path Forward

- Unlike other industries, in higher education, bankruptcy is not a restructuring option
- Long-term solutions require a significant liquidity runway
- Financial factors such as failing financial scores and mandatory or discretionary triggering events might require a school to post financial security or limit the way it can draw down Title IV aid, which can exacerbate existing financial challenges



Section II: Unique Governance Challenges

Higher Education Governance Challenges

- The nature of higher education boards presents a unique governance challenge in this context.
- Must exercise fiduciary duties while navigating shared governance, academic freedom, faculty authority over curriculum, student-protection obligations, accreditor expectations, donor relationships, government oversight, and reputational sensitivity.
- Can result in slow decision making.
- Can also lead to that poorly sequenced or insufficiently coordinated actions that can create additional challenges:
 - faculty opposition
 - accreditation scrutiny
 - student attrition
 - donor resistance
 - PR challenges

Higher Education Governance Challenges

- Boards may be slow to recognize the problem:
 - Lack of financial sophistication — not only on boards, but also in the business office
 - Lack of robust budgeting or financial forecasting resources
 - Institutional inertia — “We’ve been here for X number of years and we always came through.”
 - Reacting may require difficult and painful choices across institutional silos
 - Decision-making is further complicated by the need to address multiple constituents with competing interests (lenders, regulators/accreditors, faculty, students, donors)



Section III: A Core Challenge – Liquidity Runway

The Need for Liquidity Runway

- A central challenge in higher education workouts is the need for a significant liquidity runway to enable meaningful institutional changes that typically require an extended timeline.
- Liquidity needed not merely as cushion, but as the capacity to absorb shocks, avoid crisis borrowing, and fund the restructuring measures needed to preserve long-term optionality.
- Growth through new programs typically takes 2-3 years, requiring state authorization, accreditor review, curriculum build-out, faculty hiring, marketing, and enrollment.
- Mergers and related transactions typically take 2-3 years

Section IV: Regulatory Challenges

Merger or Acquisition Transactions

- A merger or acquisition transaction in higher education generally takes up to 2-3 years to complete
- Steps include:
 - Identifying the parties who will engage in negotiations,
 - Exchanging NDAs and conducting due diligence,
 - Signing letters of intent and exclusive negotiating rights,
 - Negotiating with lenders and/or bondholders,
 - Obtaining proper approvals from the Department of Education, state regulators, and accreditors, and
 - Finalizing the merger and change of control (CIO)

Change of Control and Title IV Eligibility

- Whenever a school changes ownership that results in a change of control (a “CIO”), it ceases its eligibility to participate in Title IV programs. However, it may continue to participate so long as it meets certain regulatory requirements.
- The Department of Education characterizes transactions involving the acquisition of a school as either a 1-step CIO or a 2-step CIO. It doesn’t matter whether it is a state law merger, a stock or membership interest acquisition, an asset acquisition or a donation or gift.

1-Step CIO

- Institution is acquired by an entity which may or may not own another institution.
- The 1 step results in a school undergoing a change in ownership but maintaining its separate existence as a separate institution.
- Takes less time than the 2 step, but it still takes time to complete because of the regulatory requirements to continue participation in Title IV federal financial aid programs:
 - 90 day notice prior to the date of the CIO
 - State and accrediting agency approval of the CIO
 - Accrediting agency approval can involve lengthy pre-notice, substantive change applications and approval by an agency committee or commission, which may meet only quarterly.
 - Two years of audited financial statements for the institution and its new owner (the availability of these financial statements, along with the timing of the accreditor approval process dictate the optimal timing for the change in ownership.
 - Audited same day balance sheet of the institution consolidated with its new owner (the deadline for this submission means that transactions should optimally close within the first 10 calendar days of a month)

1-Step CIO

- The review process for a 1-step CIO can take up to a year, and depending on the complexity of the new owner's financial structure or circumstances, it could take longer.
- Once the CIO is reviewed and approved, the acquired school is issued a new provisional program participation agreement ("PPPA").

2-Step CIO

- Adds an additional step after the PPPA issuance in step 1.
- Only applies when the entity that acquires the institution also owns another institution.
- In Department parlance, this process of an institution becoming an additional location of another institution is referred to a merger (but has nothing to do with the mechanics of the transaction).

2-Step CIO

- The regulatory requirements following the CIO remain the same, although the accrediting agency must also approve the addition of the additional location.
- While Step 1 of the CIO is under review, both schools must maintain separate state authorization and accreditation. Both schools also maintain their Department of Education identification numbers.
- Once the PPPA is issued in Step 1, the acquiring school can apply to the Department to add the acquired school as an additional location.
- Application is usually timed (and must be coordinated with the Department) so that it is approved at the end of an award year (so around June 30th) so that federal financial aid can be administered under the “merged” school for the next award year.
- The time from the application to approval of the additional location is unpredictable, which is now driven by limited personnel and systems issues.

**Section V: Thoughtful
Covenants – Advanced
Warning of Liquidity
Concerns**

Advanced Warning of Liquidity Concerns

- Thoughtful structuring at issuance to provide advance warning of liquidity issues benefits both lenders and higher education borrowers
- Strong covenants that provide early warning and compel the institution to address emerging issues
- An enrollment covenant is a faster-acting and more effective early warning mechanism
- Strong continuing disclosure agreement with required investor calls

Section VI: Workout Priorities and Tools

Workout Tools and Strategies

- Robust financial forecasting and budgeting function are critical
 - The forecast should be tied to scenario planning around enrollment, retention, tuition discounting, auxiliary revenue, fundraising, unrestricted liquidity, and federal or state funding assumptions.
- External consultants should be engaged as necessary to supplement institutional capacity. Team typically needs to include:
 - turnaround financial advisors
 - higher-education counsel
 - restructuring or creditor counsel
 - communications support
 - where restricted funds or endowment issues are implicated, nonprofit/endowment counsel
 - auditors

Workout Tools and Strategies

- Board should establish a cadence for rapid but documented decision-making
 - Liquidity dashboard
 - Weekly management update, clear escalation triggers for covenant defaults, missed payroll risk, restricted-fund issues, accreditation developments, Department of Education reportable events, and material changes in enrollment or retention
- Extend the liquidity runway to bridge to a long-term strategic solution. Objective is to buy time without simply postponing the inevitable:
 - stabilize cash
 - preserve Title IV eligibility and accreditation
 - maintain student services
 - avoid value-destructive asset sales
- Objective is to create credible runway for a strategic transaction, merger, teach-out, affiliation, program redesign, or orderly closure if no going-concern solution is feasible.

Workout Tools and Strategies

- Cost reduction measures.
 - Near-term actions may include nonessential spending freezes, hiring freezes, procurement controls, travel reductions, deferral of noncritical capital projects, renegotiation of vendor terms, shared services, administrative restructuring, and program-level margin analysis.
 - Personnel actions are often unavoidable because higher education is labor-intensive, but they should be evaluated against mission, accreditation, student outcomes, tenure or shared-governance obligations, collective bargaining obligations, and the risk that excessive cuts will accelerate enrollment decline.
 - Program eliminations, location closures, or large-scale reductions may also create federal financial-responsibility or Department of Education reporting issues.

Workout Tools and Strategies

- Asset sales
 - Asset monetization should start with a realistic inventory of what is actually liquid, what is restricted, what is encumbered by debt or donor limitations, and what is mission-critical.
 - Real estate should be treated cautiously: research notes that colleges often have limited ability to sell campus assets, and that closures or severe cutbacks can affect local communities because colleges often function as anchor institutions and local economic and cultural engines.
 - For colleges in small towns or rural areas, the campus may be one of the largest specialized real estate assets in the market, so a forced sale may generate far less liquidity than book value suggests.
- Evaluate ability to utilize endowed and other restricted funds.

Section VII: Restricted and Unrestricted Funds

Gaining Access to Restricted and Unrestricted Funds

- Solicitation of unrestricted gifts
- Modification of restrictions on restricted funds, with appropriate segregation of newly unrestricted funds
- This can be an important liquidity tool, but it must be handled as a legal and fiduciary process

Section VIII: Unique Issues involving Bond Debt

Unique Bond Issues

- Trustee cannot act without appropriate bondholder direction
- Consequently, interest rate relief or modification of debt may be difficult to achieve
- TIP proceeding may be an alternative to bankruptcy
- Forbearance is a frequently used option
 - However, there are several limitations

Questions?

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