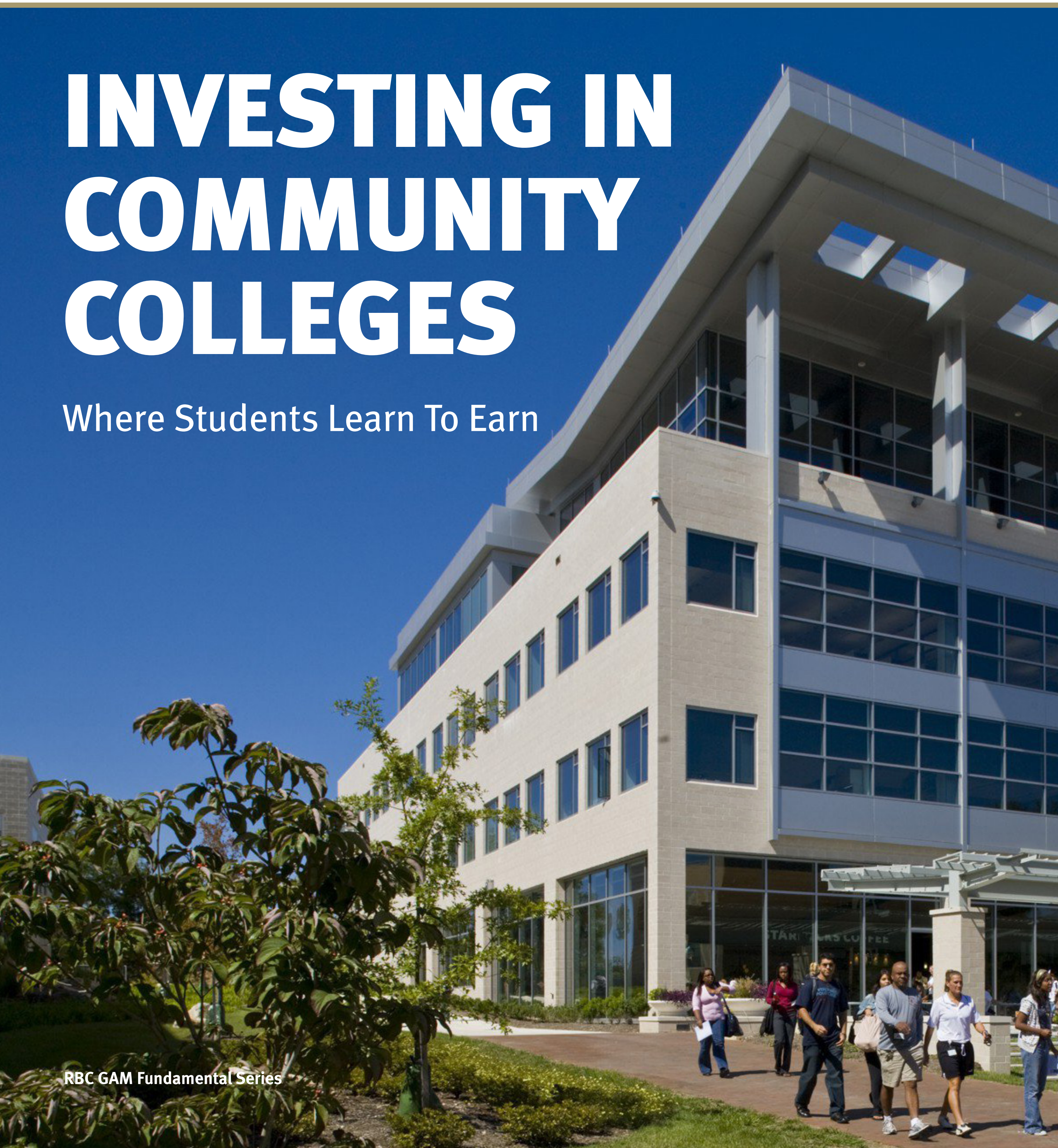
Global Asset Management

INVESTING IN COMMUNITY COLLEGES

Where Students Learn To Earn



RBC GAM Fundamental Series

Introduction

Impact investors who seek to deploy their capital in investments that not only offer a meaningful return but also provide societal benefits have a vast range of choices, from farming in exotic countries to inner city housing and economic development projects. One area that may not immediately come to mind yet offers an opportunity to make a significant social impact is the world of community colleges. These institutions provide post-high school education to millions of disadvantaged students, enabling many of them to enter and move up in the job market. Community colleges also help local companies find trained workers, which can be an important factor in helping a locality attract and retain employers. Community colleges typically cover operating expenses through a combination of tuition, student fees, and grants from state and local governments, while longer term capital needed to construct or remodel facilities are frequently financed in the bond market.

At the beginning of 2015, the Federal government proposed to introduce legislation offering grants that would make community college free for students who met certain criteria. Meanwhile, the states of Tennessee, Oregon, and Minnesota have created programs to make community college free for qualified students by covering their tuition and fees, and similar legislation was introduced in 11 other states during 2015. These actions indicate that more government leaders believe in the power of education, particularly that offered by community colleges.

The U.S. Community College System

There are 992 public community colleges in the U.S. and 35 tribal community colleges serving Native Americans. Community colleges grant two year Associates degrees as well as a wide variety of certificates indicating that a student has successfully completed a specific job training course. Some 7.4 million students are enrolled in credit programs and another five million are enrolled in non-credit programs. These students represent 46% of all U.S. college undergraduates. Of those enrolled in community college credit programs, 61% are part time students while 39% are full time.[1] In contrast to many four year colleges, which in some cases are highly selective, community colleges offer open enrollment: anyone can be admitted.

Approximately a quarter of community college students have enrolled immediately after graduating from high school; some of them are seeking a two year degree but others intend to complete two years of study at the community college and then transfer to a four year institution to earn a Bachelors degree.

However, the majority of community college students are over 20 years old, and they are "going back to school." They have enrolled after a few years in the labor market or after completing military service. They may be coming back after a previous unsuccessful or incomplete stint in college. These students have enrolled largely to improve their career prospects. Some are there in order to pursue a particular career interest and others are taking courses because they have lost their job and are looking for a new one.

Community College Demographics

The demographic profile of community college students differs significantly from those of students in four year colleges. The median age of U.S. community college students is 24; these students are not only older than students at four year colleges, they are lower income, more likely to be minorities, and more likely to be the first generation in their family to go to college.

- According to recent data from the Education Longitudinal Study (ELS), half of the 7.4 million community college students are Caucasian, while the other half are students from different ethnicities.[1,2]
- Community colleges draw many of their students from lower income households: one study found that 44% of students from families with annual incomes under $25,000 attend community college as their first college after high school. By contrast only 15% of students from higher income families choose community college as their first post-high school college. Meanwhile, a survey conducted in 2003-04 found that 57% of first time college students from households with family incomes of $32,000 or less started at community colleges, rather than at four year institutions.[2,3]
- 38% of students whose parents did not graduate from college choose community colleges as their first college, compared to 20% of those whose parents graduated from college.[2]
- 50% of Hispanic college students start at community college as do 31% of African American students, versus 28% of Caucasian students.[2]

There are several appeals of community colleges. As noted above, they offer open enrollment so for those who did not do well in high school, community college is one of the best forms of post-high school education available to them.

Another major appeal is cost. One study found the average tuition and fees at community college totaled $3,347 versus $9,139 on average for a public four year college.[1] Moreover, community college students typically live at home and do not incur the room and board costs associated with "going away to school" at many four year colleges.

[1]American Association of Community Colleges, 2015 Community College Fast Facts, [headcount enrollment for Fall 2013].
[2]Community College Research Center, Community College FAQs, American Association of Community Colleges, 2015 [analysis of IPEDS Fall 2013 Enrollment Survey data].
[3]Berkner, Lutz and Chow, Susan, "Descriptive Summary of 2003-04 Beginning Postsecondary Students: Three Years Later," National Center for Education Statistics, US Department of Education, 2008.

Community colleges also offer convenience. Many community colleges hold classes at several locations around town, so students have choices near their homes. Moreover, classes are offered throughout the day as well as at night and on weekends. This makes it easier for the many community college students who have a job or childcare responsibilities to fit classes into their schedules.

Community Colleges and the Job Market

Leaving aside the 18 year olds saving money before moving on to a four year school and the adult education group taking a course or two from time to time, the vast majority of community college students are there to advance their careers: They want to get a job or get a better job.

And they have good reason to think community college will help them. U.S. census data from 2009 show that on average a person with an Associates degree earns $9,144 more annually than one with only a high school diploma.[4]

Community colleges offer a wide variety of practical, job-oriented courses designed to prepare students for specific occupations. Typically there are courses that train students to become dental hygienists or auto mechanics as well as paralegals or licensed practical nurses.

In addition, many community colleges provide training designed to prepare students for jobs at specific local employers. Indeed, there is an increasing trend within economic development programmers to offer local companies considering setting up operations in the area the option to host custom tailored courses at the community college that will train people to fill jobs for the new employer.

In some cases, the community college will even hold classes at the prospective employer's facilities or staff from the company will teach courses at the community college that prepare students to work at the employer. For example, Bluegrass Community and Technical College in Lexington, Kentucky created an Advanced Manufacturing Technician (AMT) program in partnership with a local Toyota assembly plant. Students in the AMT program, work three days a week and attend school two days a week. Those who complete the program end up with an Associates degree in applied science as well as paid work experience. The program, which began in 2010, has been expanded to include more than a dozen other manufacturers.

These kinds of partnerships create a symbiotic relationship for the employer, the locality, and the students: The students who complete the training program have good prospects for being hired; in some cases they even get a guarantee, provided they finish the training program. Meanwhile, the employer has a continuing stream of qualified potential employees, and the locality has a better chance of attracting and retaining the employer.

This symbiotic relationship extends beyond specific individual employers. In general, community colleges help students get better jobs while helping local employers gain a better workforce and enabling communities to bolster their tax base.

Graduation Rates

A continuing problem in the community college world is low graduation rates. Only 39% of those seeking a degree or a certificate complete their programs within six years of enrollment. By contrast, 55% of those who enroll in four year colleges receive a degree within six years of enrolling.[5] There are several reasons for the relatively low graduation rate at community colleges: Some students find juggling jobs, family life, and studying too demanding and need to drop out. Others find a job and decide they don't need to finish their courses. And still others lack the motivation or skills to complete their studies.

Community colleges have tried a number of remedies to raise graduation rates. These include working more closely with employers so that students who have a job can coordinate their work and their schooling; enhancing guidance counseling to help students manage their time and efforts more efficiently; and seeking to integrate schooling with government aid programs so that those receiving various kinds of benefits can manage the costs associated with taking courses.

The measures of graduation rates depend on the time span. Given the work and family obligations of many students, it is not unusual for a significant number of students to take more than six years to complete what is nominally a two year program. And given the issues facing many community college students, some commentators would say the right perspective is not to focus on how many don't graduate but rather on how many do. Even students who do not complete their course of study still obtain benefits–economic, intellectual, and personal–from the additional schooling they obtain in community college.

[4]U.S. Census Bureau, Statistical Abstract of the United States: 2012, Table 232.
[5]Shapiro, D., Dundar, A., Yuan, X., Harrell, A. & Wakhungu, P.K. (November 2014). "Completing College: A National View of Student Attainment Rates – Fall 2008 Cohort" (Signature Report No. 8) Herndon, VA: National Student Clearinghouse Research Center.

Investing In Community Colleges

Many of those interested in impact investing believe community colleges play an important role in helping disadvantaged students to advance their education and their careers. They also find these institutions can play a valuable role in community development by training the labor force for local employers.

Those interested in channeling capital to community colleges can do so through the municipal bond market. In 2014 community colleges came to market with more than 100 new bond issues.

According to the American Association of Community Colleges, in recent years, about 29% of community college annual revenues came from tuition, another 29% from state aid, 18% from local governments, and 15% from the federal government.[6] While student fees and government grants cover operating costs, community colleges finance their capital projects, such as the construction or remodeling of classroom buildings, through the bond market. The capital budgets for community colleges focus on providing and maintaining basic classrooms and laboratories as well as administrative offices. Many community college facilities are former office buildings, warehouses, or manufacturing plants that have been purchased by the school and remodeled to provide classrooms, laboratories, and replicas of work sites, such as service stations or dental offices. These facilities are more about function rather than form.

As government entities, community colleges can issue bonds in the municipal bond market. The $3.7 trillion "muni" bond market provides funds for a vast array of state and local governments as well as thousands of specialized government agencies, including airport authorities, water and sewer districts, school districts, and a host of other specialized public sector entities.[7] One of the appeals of municipal bonds is their exemption from federal taxes, and, in many cases, from state and local taxes as well. The tax-exempt status of munis has made them attractive to many individual investors while enabling issuers to offer lower interest rates than bonds in the taxable market.

While most community college bonds are issued in the tax-exempt market, there are also a number of taxable munis issued by community colleges. Taxable bonds give community colleges more freedom in spending the proceeds than do tax-exempt bonds, which have significant restrictions on "private use." Taxable bonds permit using the money to finance buildings that house a community college's joint venture with a private company that is a partner in a job training program. Taxable bonds also permit redeploying money in response to unanticipated developments, which is difficult to do with tax-exempt bonds. In addition, community colleges have also issued Build America Bonds, a taxable alternative to tax-exempt munis authorized under the American Recovery and Reinvestment Act of 2009. In contrast to tax-exempt munis, taxable community college bonds can be attractive to institutions that are already tax-exempt, such as qualified pension plans, philanthropic foundations, and endowments.

Examples of tax-exempt community college bonds include a May 2013 issue by the Maricopa County Community College District, which serves 265,000 students in the Phoenix, Arizona area. It sold $151 million of tax-exempt general obligation bonds to raise funds for construction of classrooms and laboratories as well as to enhance its technology. And in June 2015, Pulaski Technical College which is located in North Little Rock, Arkansas, launched a $25 million tax-exempt bond issue backed by student tuition and fees. In July 2015, Ivy Tech Community College, which serves the entire state of Indiana and enrolls 179,000 students, sold $28 million in tax-exempt bonds backed by student fees to refinance existing bond issues.

Meanwhile, in the taxable segment of the market, in May 2014 the Eastern Iowa Community College District, which serves nearly 7000 students, sold a $4 million bond issue to finance a new jobs training program created to serve local employers. These bonds were backed by certain system revenues as well as a standby property tax. And in December 2014 the Los Angeles Community College District, which serves some 200,000 students, issued $47 million in taxable general obligations to raise funds for new construction and remodeling of buildings.

Some colleges issue in both the tax-exempt and taxable segments of the muni market. In November 2014, for example, Carl Sandberg Community College in Galesburg, Illinois offered $9 million in taxable and tax-exempt general obligation bonds. The proceeds were used to refinance bonds issued to pay for building construction for the college, which has some 3,700 students.

Credit Quality

The great majority of community college bonds are investment grade securities, typically rated A or AA. Community college bonds are not issued by city or county governments; rather the issuers are separate entities with their own sources of income to repay the bonds. These bond issues may be general obligations of a community college district, or they may be secured by tuition and other revenues. In some cases, they may be secured by real estate taxes or some other claim on local tax revenues. While there are no definitive databases regarding defaults in the municipal bond market, there have not been any publicized defaults on bonds issued by community colleges.

[6] American Association of Community Colleges, 2015 Community College Fast Facts.
[7] Securities Industry and Financial Markets Association (SIFMA) and the Federal Reserve System, represents holders of U.S. municipal securities as of September 2015.

Conclusion

In short, community colleges offer attractive opportunities for impact investors. These investors can help advance the mission of community colleges without requiring investors to forego competitive returns. Most community college bonds are issued in the traditional tax-exempt segment of the municipal bond market and offer returns in-line with other investment grade munis, making them attractive to taxable investors. There are also taxable community college bonds that offer returns on par with other bonds of similar credit quality, making them a reasonable addition to portfolios that are not subject to income taxes. Thus, adding an exposure to community college bonds in the context of a diversified portfolio could be an appropriate and attractive decision for an impact investor.

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