

AMERICAN BANKRUPTCY INSTITUTE JOURNAL

The Essential Resource for Today's Busy Insolvency Professional

Feature

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A Degree of Difficulty: Navigating Higher-Education Insolvencies

Over the last few years, the higher-education sector, primarily private nonprofit institutions, has been increasingly experiencing distress and closures, including institutions such as the College of New Rochelle (2019), Marymount California University (2022), Bay State College (2023), the University of the Arts (2024), the College of Saint Rose (2024) and Paier College (2025). These closures provide a cautionary tale for distressed higher-education institutions and the challenges faced by insolvency professionals in guiding those institutions through a successful restructuring.

Distressed higher-education institutions have sector-specific challenges that encompass regulatory (state and federal departments of education, state attorneys general and accreditors), competitive, constituent-related and reputational landmines. They are typically smaller (under 3,000 students) liberal arts schools that are tuition-dependent; have small endowments; are often based in the Northeast, Mid-Atlantic and Midwest regions; and are not differentiated from their peers. This article outlines the current challenges faced by colleges and university systems, why restructuring is especially challenging in this sector, and how insolvency professionals can approach a higher-education turnaround from an informed perspective.

The Financial Anatomy of a Typical College

Before stepping into a distressed higher-education situation, it is essential to understand the sector's financial structure. A typical private, nonprofit college's primary assets consist of campus real estate and endowment funds. Endowments can be generally delineated into "restricted" and "unrestricted" funds, with restricted funds earmarked

for specific purposes and unavailable for use to bridge any gaps in the institution's operating budget, unless permission is received from the donor or the state attorney general. Distressed higher-education institutions typically have a limited amount of "unrestricted" endowment that can be used to ease financial distress.

On the liability side, higher-education institutions often carry a complex mix of financial obligations that can present significant restructuring challenges. These liabilities could include municipal bonds, which are usually tax-exempt and secured by campus real estate and future tuition revenue, as well as bank debt and lines of credit, which may be collateralized by receivables or auxiliary revenue streams. In addition, institutions might have donor loans or conditional gifts, which can carry legal or reputational risks if not honored.

Deferred revenue from prepaid tuition, room and board, or auxiliary services also creates liabilities, particularly when students must be refunded in the event of closure or a teach-out, an arrangement in which students from a closing institution are allowed to complete their degrees at another school offering comparable programs.

Further, like most enterprises, there are ordinary course trade liabilities. For tuition-dependent schools, even relatively modest debts can become unserviceable once enrollment begins to decline.

The cash flow of the typical distressed institution is heavily cyclical, front-loaded and tuition-dependent, making liquidity management a persistent challenge. The bulk of operating revenue arrives in predictable surges at the start of each academic term, driven primarily by student tuition, room and board, fees, and federal financial aid disbursements. This creates an annualized cash cycle with long dry periods in between, during which fixed

costs such as payroll, facilities, debt service and maintenance continue unabated.

Schools with limited available reserve funds (*e.g.*, an unrestricted endowment) might experience significant liquidity stress, particularly if they face such issues as unexpected enrollment shortfalls. Because many institutions infrequently report actuals (typically quarterly) and do not closely forecast and report cash flow, early warning signs of a cash-flow crisis might be masked until midway or late in a spring semester.

Most higher-education institutions are heavily dependent on federal student aid programs authorized under Title IV of the Higher Education Act (HEA), such as Pell Grants, federal student loans and other forms of aid that the U.S. Department of Education provides to eligible students. When students use this aid to enroll, the federal government typically disburses those funds directly to the college, often at the start of each semester, which is then applied to cover tuition, fees, housing and meal plans. For many institutions, this federal aid is their primary source of revenue — in some cases accounting for more than 80 percent of total cash inflow. As schools have increasingly sought lower-income students to address declines in enrollment, they have become more dependent on revenue funded by federal student aid programs.

The Regulatory Environment

Higher-education institutions operate in a complex regulatory environment, shaped by federal funding rules, accreditation standards, state regulations and restrictions on how institutional assets, particularly endowments, can be used. Understanding this framework is essential, because missteps can trigger irreversible consequences, such as the loss of federal aid and accreditation, donor litigation or regulatory intervention. At the center are three key components: Title IV of the HEA, institutional accreditation, and state-endowment law under the Uniform Prudent Management of Institutional Funds Act (UPMIFA).

Eligibility for Title IV funds comes with strings. Colleges must maintain accreditation, comply with complex state and federal regulations, and submit to annual audits. Any violation can lead to heightened cash monitoring, increased scrutiny, credit-support requirements or full termination of eligibility. Most crucially for restructuring professionals, filing for bankruptcy is, in itself, an automatic disqualifier from Title IV participation. Under § 102(a)(4)(A) of the HEA, filing for bankruptcy renders an institution presumptively ineligible for Title IV funding, regardless of its accreditation status or financial viability, and ineligible to participate in federal student aid programs.¹ Losing access to Title IV funding is essentially a death sentence for a college.

This reality creates a sharp divergence from a typical corporate insolvency strategy. Chapter 11, which is often used to preserve operations and renegotiate debt, is usually off the table for colleges that want to continue academic

operations. Besides losing access to Title IV funding as the result of commencing a chapter 11 case, the Bankruptcy Code specifically excludes eligibility to participate in a program authorized by the HEA, accreditation status or licensure as an educational institution from property of a bankruptcy estate.²

Further, the automatic stay afforded to a debtor by the Bankruptcy Code provides exceptions to the stay with respect to actions taken by third parties related to accreditation, licensure and eligibility to participate in programs authorized under the HEA.³ As a result, restructuring must occur through out-of-court workarounds, negotiated mergers, receiverships or — if all else fails — out-of-court wind-downs or chapter 7 liquidations. The window to act is narrow; once accreditation has been threatened or enrollment drops due to adverse media coverage, the collapse can be rapid and irreversible.

Parallel to Title IV is the system of institutional accreditation. To qualify for federal aid, a school must be accredited by an agency recognized by the U.S. Department of Education. These accreditors evaluate not only academic quality, but also governance, financial stability and student-support services. If a school is perceived to be in financial distress, especially if it announces closures, layoffs or program eliminations, it could be placed on probation or required to submit teach-out plans. Losing accreditation disqualifies the institution from receiving Title IV funds and might result in a cascading decline in enrollment, funding and operations.

State licensing adds yet another layer. Each state has its own education apparatus that authorizes institutions to operate within its borders. Like accreditors, states require notification of material changes and might impose their own wind-down rules, especially in connection with teach-outs, student records and facility closures. In some states, attorney general oversight is also triggered.

Insolvency professionals quickly discover that many struggling colleges might appear asset-rich on paper due to significant endowments, property holdings or donor funds, but they are cash-poor and liquidity-constrained, largely due to the legal structure of institutional funds and the rules governing their use.

In 1972, the National Conference of Commissioners on Uniform State Laws introduced a model statute known as the Uniform Management of Institutional Funds Act, which was later updated and reissued as the UPMIFA. The UPMIFA has since been adopted, with some variation, in nearly every U.S. state and governs how nonprofit institutions invest, spend and modify the terms of their endowment funds.

Under the UPMIFA, endowment funds are typically categorized as permanently restricted (such as a named scholarship), temporarily restricted (such as a capital campaign gift) or unrestricted. Even within restricted categories, institutions are expected to manage these funds prudently, investing them with a long-term view and spending them only at sustainable levels.

¹ See 20 U.S.C. § 1002(a)(4)(A).

² See 11 U.S.C. § 541(b)(3).

³ See 11 U.S.C. § 362(b)(14)-(16).

Critically, colleges cannot repurpose or spend restricted funds for general operating expenses unless they receive donor approval, or approval from the state attorney general or through a court proceeding invoking the doctrine of *cy pres* (a legal doctrine that allows a court to modify the purpose of a charitable gift when the original purpose is impossible or impractical to carry out, in order to fulfill the donor's general intent as closely as possible).

Causes of Insolvency

The current wave of higher-education insolvencies is not the result of a single economic downturn or policy shift. Rather, it reflects a confluence of structural, demographic and political pressures that have steadily eroded institutional resilience, particularly among small, tuition-dependent colleges.

One of the most significant long-term headwinds is demographic. The number of U.S. high school graduates is shrinking due to a "birth dearth" that began after the 2008 financial crisis. This is particularly acute in the Northeast, Mid-Atlantic and Midwest, where many small private colleges are clustered and tend to have smaller endowments.

The current demographic trend in the U.S. shows a marked shift in population from these areas to the Southeast, Southwest and West. With fewer students in the traditional 18-24 age cohort, schools in demographically depleted areas are competing more aggressively for a smaller pool of potential students, often through unsustainable tuition-discounting. The result is systemic overcapacity in the sector: There are simply too many schools for too few students.

In addition, federal policy changes in recent years have added pressure. During this Trump Administration, several significant policy shifts have disproportionately impacted smaller and mid-tier institutions, including immigration restrictions on foreign students, a critical demographic for institutions located in otherwise demographically depleted areas who often pay full tuition.

Managing a Higher-Education Insolvency

In managing a higher-education insolvency, timing is everything. Unlike many commercial sectors where warning signs can prompt an orderly reorganization or bankruptcy process, the window in higher education between visible distress and institutional collapse is often shockingly short. A dip in enrollment, rumors of financial instability or a media leak can trigger a domino effect: Prospective students walk away, donors pull back, accreditors impose new conditions, and Title IV eligibility comes under review. As a result, revenue dries up just when liquidity is needed most.

For turnaround professionals, this reality underscores the critical importance of early involvement. Institutions rarely call for outside help until they are already in crisis, but by then, strategic options are limited and reputational damage might already be permanent. Getting in early means more than analyzing the numbers; it means building trust with leadership, understanding institutional governance dynamics, and crafting a plan that preserves stability while mapping a path forward.

One of the most overlooked aspects of a higher-education turnaround is the importance of reputation management. Colleges are community anchors, usually values-driven nonprofits and mission-based organizations. Students, faculty, parents, alumni, donors and the broader public hold a stake in the institution's legacy. These stakeholders are not just external parties; they are embedded in the institution's identity, making traditional cost-cutting or asset sales far more sensitive than in a typical commercial workout, which creates a uniquely complex decision-making environment. Any restructuring strategy must balance legal and financial imperatives with constituent-related factors: protecting student outcomes, preserving academic integrity, honoring donor intent and maintaining stakeholder trust.

How a restructuring is communicated can be the difference between a successful turnaround and a sudden closure. The moment that an institution is perceived as being "in trouble," future enrollment can dry up, prospective restructuring partners can walk away, and the relevant accrediting agency might demand a teach-out plan or impose enrollment caps.

Turnaround professionals should prioritize a transparent, but strategic, communications strategy from day one. This means coordinating messaging to internal stakeholders, such as board members, faculty and staff, as well as carefully managing external communications to students, alumni, regulators and the media. Messaging should focus on the continuity of the mission and a commitment to students, and should emphasize that proactive steps are being taken to ensure long-term viability. Even if a closure or wind-down becomes necessary, institutions that have managed their communications well are more likely to secure cooperative teach-out agreements and avoid any reputational fallout that could hinder leadership or affiliated organizations in the future.

In addition to messaging, early intervention allows for meaningful exploration of strategic alternatives, such as affiliations and mergers, shared-services agreements, sales of noncore assets or program consolidation. (These are not options that can be implemented quickly.) Academic-governance structures, faculty contracts (especially tenure protections) and state regulatory frameworks require time to navigate. More critically, even the most promising strategic alternatives are often constrained by lengthy approval cycles and multiple layers of stakeholder input.

Mergers or affiliations can take years to negotiate and implement, often requiring coordination among the diverse range of constituents of both institutions. Program consolidation, particularly when it involves eliminating majors or departments, can spark fierce internal resistance and might take years to fully implement. Even as strategic plans move forward, the institution might already be drifting into the gravitational pull of a financial death spiral.

Where standalone survival is unlikely, early engagement allows for an orderly wind-down out of court in cooperation with the state attorney general's office or possibly in a receivership. Institutions that begin teach-out planning while still accredited and operating have a far greater chance of protecting students, avoiding litigation, and preserving the reputations of both the institution and its leadership. Timely

planning can mitigate the risk of federal student loan discharge liability.

Under federal law, students who are unable to complete their programs due to institutional closure could be entitled to have their federal loans discharged.⁴ These “closed school discharges” can expose the institution, and potentially its leadership, to potential claims or investigations, especially where the Department of Education believes the closure was foreseeable and mishandled. Once Title IV eligibility is lost or accreditation is revoked, options narrow rapidly, and students, employees and creditors might be left scrambling.

Conclusion

Ultimately, higher-education institutions that manage to avoid the worst outcomes — abrupt closures, stranded students and reputational collapse — do so because they acted before the crisis, not during it. For turnaround professionals, this means being ready to lead with a steady hand, an understanding of the regulatory and emotional terrain, and a long-view mindset. In higher education, success is not just measured in numbers, but by the degree to which students, mission and legacy endure. **abi**

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⁴ See 34 C.F.R. § 685.214.