

Your Taxes Support For-Profits as They Buy Colleges (Update3)

By Daniel Golden

March 4 (Bloomberg) -- ITT Educational Services Inc. paid \$20.8 million for debt-ridden Daniel Webster College in June. In return, the company obtained an academic credential that may generate a taxpayer-funded bonanza worth as much as \$1 billion.

ITT Educational, the U.S.'s third-biggest higher education company with a market value of \$3.8 billion, may increase it by 26 percent, or \$1 billion, within five years because of the purchase of 1,200-student Daniel Webster in Nashua, New Hampshire, according to Michael Clifford, an investor in Del Mar, California, who has participated in the acquisitions of four nonprofit colleges. At least 75 percent of new revenue would come from access to the more than \$100 billion a year in financial aid the U.S. hands out to college students, he said.

Key to tapping that money is Webster's regional accreditation, which is the same gold standard of academic quality enjoyed by Harvard University and helps students transfer course credits from one college to another. Daniel Webster's accreditation was its "most attractive" feature to ITT Educational, said Michael Goldstein, an attorney at Dow Lohnes, a Washington law firm that has represented the company.

"Companies are buying accreditation," said Kevin Kinser, an associate professor at the State University of New York at Albany, who studies for-profit higher education. "You can get accreditation a lot of ways, but all of the others take time. They don't have time. They want to boost enrollment 100 percent in two years."

Exploiting Loopholes

The nation's for-profit higher education companies have tripled enrollment to 1.4 million students and revenue to \$26 billion in the past decade, in part through the recruitment of low-income students and active-duty military. Now they're taking a new tack in their quest to expand. By exploiting loopholes in government regulation and an accreditation system that wasn't designed to evaluate for-profit takeovers, they're acquiring struggling nonprofit and religious colleges -- and their coveted accreditation. Typically, the goal is to transform the schools into online behemoths at taxpayer expense.

For-profit education companies, including ITT Educational Services, based in Carmel, Indiana, and Laureate Education Inc., in Baltimore, have purchased at least 16 nonprofit colleges with regional accreditation since 2004, according to corporate announcements and filings with the U.S. Securities and Exchange Commission. Jack Welch, the former chief executive of General Electric Co., and Michael Milken, the U.S. junk bond pioneer, have invested in for-profit companies that bought or formed partnerships with nonprofit, regionally accredited schools.

Academic Status

By acquiring regional accreditation, trade and online colleges gain a credential usually associated with the traditional academic culture of liberal arts, faculty scholarship and selective admissions. Normally the accreditation process takes about five years and requires evaluations by outside professors. The regional bodies examine financial stability, academic rigor and commitment to “teaching, learning, service and scholarship,” according to the Web site of the Commission on Institutions of Higher Education, which accredits colleges in New England.

Enrollment at Grand Canyon University, a Christian college in Phoenix bought by investors in 2004, has soared to 37,700, as of Dec. 31, up from 1,500, said Brian Mueller, chief executive of Grand Canyon Education Inc. Ninety-two percent of students now take classes online, according to the company’s most recent 10-K. Bridgepoint Education Inc., based in San Diego, has boosted enrollment of two regionally accredited colleges it bought in 2005 and 2007 to 53,688 students as of Dec. 31, up from 400 combined, according to a company filing. Ninety-nine percent of those students take courses exclusively online.

Growth Potential

Daniel Webster “could parallel Grand Canyon or Bridgepoint’s growth curve,” said Clifford, who was part of the investor group that purchased Grand Canyon.

ITT Educational rose two cents, or less than one percent, to \$109.80 at 4:15 p.m. today in Nasdaq stock market trading. The company rose 2.5 percent in the 12 months ended today.

ITT Educational declined to comment for this story. The company plans to open more Daniel Webster campuses and also expand online offerings, Kevin Modany, ITT Educational’s chairman and chief executive officer, said in a Feb. 22 presentation to analysts. The company expects to introduce programs including accounting, education and health sciences, he said.

Daniel Webster will attract more students “a little on the higher end” in income whose tuition would be paid by private employers rather than federal financial aid, Modany said.

New Regulations

The U.S. Department of Education, which doled out \$129 billion in federal financial aid to students at accredited postsecondary schools in the year ended Sept. 30, is examining whether these kinds of acquisitions circumvent a federal law that new for-profit colleges can’t qualify for assistance for two years, Deputy Undersecretary of Education Robert Shireman said in a telephone interview.

Under federal regulations taking effect July 1, accrediting bodies may also have to notify the secretary of education if enrollment at a college with online courses increases more than 50 percent in one year.

“It’s an area that we are watching closely,” Shireman said. “It certainly has been a challenge both for accreditors and the Department of Education to keep up with the new creative arrangements that have been developing.”

Immediate Benefits

Buying accreditation lets the new owners benefit immediately from federal student aid, which provides more than 80 percent of revenue for some for-profit colleges, instead of having to wait at least two years. Traditional colleges are also more inclined to offer transfer credits for courses taken at regionally approved institutions, making it easier to attract students nationwide.

The six nonprofit regional accrediting bodies, which rely on academic volunteers, bestow the valuable credential with scant scrutiny of the buyers' backgrounds, Barmak Nassirian, associate executive director of the American Association of Collegiate Registrars & Admissions Officers in Washington, said in a telephone interview.

While accrediting bodies treat these purchases as changes of ownership, the acquisitions, in reality, create new colleges that should be required to earn certification from scratch, Kinser said.

Maintain Mission

For accreditation to continue once the college is sold, the buyer must promise not to change its mission, Steven Crow, former executive director of the Chicago-based Higher Learning Commission, the largest regional body, said in a telephone interview. Once accreditation is maintained, the acquirer seeks permission, which is usually granted, to start branch campuses and online programs, Crow said.

"You knew by month six they would come back to you with a new game plan," said Crow, now a consultant to publicly traded Corinthian Colleges Inc., based in Santa Ana, California. It acquired regionally accredited San Francisco-based Heald College on Jan. 4.

Obama administration officials have recently questioned whether the accreditation system is effective in protecting academic standards. Accrediting decisions lack transparency and take too long, Undersecretary of Education Martha Kanter said in a Jan. 26 speech in Washington to the annual meeting of the Council for Higher Education Accreditation.

Considering Termination

The inspector general of the Education Department in December urged the agency to consider terminating recognition of the Higher Learning Commission, which has approved more for-profit colleges than its counterparts around the country.

The inspector general criticized the commission's decision to accredit Career Education Corp.'s online American Intercontinental University, citing concerns about how much time students spent in class. The approval was appropriate, the commission and Hoffman Estates, Illinois-based Career Education said.

More vigilance by the Education Department and accrediting groups is likely to slow enrollment growth and the share prices of higher education companies that rely on acquisitions, said Clifford. While publicly held postsecondary education companies rose 29.9 percent in the 12 months ended March 3, they lagged behind the S&P 500, which increased 60.7 percent over the same period, said Jeffrey Silber, an analyst for BMO Capital Markets in New York. The shortfall reflected investors' fears of tighter federal regulation of for-profit colleges, Silber said.

Accreditation's Worth

Regional accreditation is worth \$10 million to a for-profit acquirer, Clifford said in a telephone interview. That's how much it would cost to start a regionally accredited college, a process that can take 10 years and has only a 50-50 chance of success, he said. On top of the \$10 million, buyers typically pay \$23,000 to \$50,000 per enrolled student, making the purchase of Daniel Webster a bargain, Clifford said.

Clifford and his fellow investors popularized the strategy of acquiring nonprofit colleges with regional accreditation by purchasing Grand Canyon University in 2004 and building online enrollment.

Grand Canyon "is the same institution," Mueller said in an e-mail. "It was important to the new leadership group that the mission of providing a high-quality Christian-based education remain intact."

Grand Canyon, which went public in November 2008, derived 83 percent of its revenue from federal financial aid in 2009, according to a company filing.

Bridgepoint, Ashford

Bridgepoint Education bought the regionally accredited Franciscan University of the Prairies in 2005 and Colorado School of Professional Psychology in 2007. It renamed them Ashford University and University of the Rockies, respectively, and refocused them online. Ashford gained 86 percent of its revenue from federal student aid in 2009 and University of the Rockies got 85 percent, according to a 10-K filing by Bridgepoint, which went public in April.

"There are several meaningful continuities" from the colleges before they were acquired, including campus athletic and social events, Shari Rodriguez, a Bridgepoint spokeswoman, wrote in an e-mail.

Clifford participated in the 2008 purchase of Myers University in Cleveland, which was renamed Chancellor University. Chancellor attracted Welch as an investor last year and named its new online management institute after him. Welch collaborated with faculty in developing curricula for a master's program in business administration, Clifford said.

'Something New'

"We chose to work with Chancellor University because it gave us the flexibility to start something new," Welch said through a spokeswoman, Betsy Linaberger. "As a for-profit venture, we have the resources to invest in the student experience and the very best faculty, and we want to provide a high quality business education."

Knowledge Universe Learning Group, chaired by Milken, entered into a partnership in 2007 with regionally accredited Sierra Nevada College in Incline Village, Nevada, agreeing to provide as much as \$15 million in return for an opportunity to share in online revenue, Geoffrey Moore, a senior adviser to Milken, said in an e-mail. The company is a unit of Santa Monica, California-based Knowledge Universe Inc., of which Milken is co-founder and chairman. Knowledge Universe Learning Group has three seats on the nonprofit college's nine-member board, Moore said.

'Existing Character'

"This partnership preserved the existing character of Sierra Nevada College," he said. "That was important to us and the college."

A 2006 regulatory change fostered online growth and made takeovers more attractive, said Silber, the BMO analyst. That year, Congress eliminated a rule prohibiting colleges that offered more than half of their courses online from receiving federal financial aid.

ITT Educational Services Inc. didn't buy Daniel Webster just for its 52-acre red-brick campus and science and technology programs including training pilots and air traffic controllers.

"Regional accreditation was very important" to the company, said Goldstein, co-leader of the higher education practice at Dow Lohnes. "I don't think there's any question that was the most attractive element."

Of the \$20.8 million purchase price, \$20.6 million went to pay off the college's debt, according to an ITT Educational 10-Q filing.

Making Changes

ITT Educational Services, which was spun off from ITT Corp. in the 1990s, wasted no time making changes at Daniel Webster. It renovated a main building and razed a dilapidated dormitory. It also dismissed one fourth of the staff, fired President Robert Myers, and has been accused by faculty members of misleading the New England accreditor, the Commission on Institutions of Higher Education, based in Bedford, Massachusetts.

"ITT didn't really have much interest in anything other than having acquired a regionally accredited institution," said Myers, now president of the New England Culinary Institute in Montpelier, Vermont. "If I had it to do all over again, I wouldn't have gone anywhere near ITT. The fundamental nature of the college has changed."

"We're making fantastic progress with the cultural assimilation" of Daniel Webster, Modany said in a Jan. 21 call with analysts. "Things are going really well there, great group of staff and faculty, and everybody is getting on board."

'Something Different'

Barbara Brittingham, director of the Commission on Institutions of Higher Education, declined to comment on its approval of the Daniel Webster sale.

In general, "when these institutions are bought, they are not at the moment successful in the financial sense or they wouldn't be for sale," Brittingham said. "There's an understanding that whoever buys them is going to want to do something different."

Accreditation is higher education's way of regulating itself. The nonprofit associations set standards on financial stability, governance, faculty and academic programs and use volunteers from college presidents to professors to assess quality. It is a peer review system: a marketing professor is more likely than a poet to evaluate a business school.

For more than a century, regional organizations have evaluated most public and private universities. Starting in the 1950s, leaders of for-profit colleges, which were then ineligible for regional approval, established seven national accrediting bodies for career education and training. The regions dropped their for-profit ban in the 1960s.

Cachet, Credits

Apollo Group Inc.'s University of Phoenix, whose enrollment of 455,600 makes it the nation's second-largest university behind the State University of New York system, is accredited by a regional body, the Higher Learning Commission. Students enrolled at both regionally and nationally accredited colleges can receive federal grants and loans.

Regional accreditation is important to for-profit colleges because students are attracted to its cachet and can transfer course credits more easily. Only 14 percent of nonprofit universities accept credits transferred from nationally certified schools, according to a 2006 study by the University Continuing Education Association, in Washington.

The six regional associations scrutinize takeovers of nonprofit colleges in advance, and then follow up afterward, accrediting officials said in telephone interviews. They could cite few, if any, cases in which they refused to continue accreditation, they said.

Heald Purchase

Corinthian Colleges' past difficulties with California state regulators didn't matter to accreditors when it purchased Heald Capital LLC, parent company of Heald College, for \$395 million. Corinthian, the country's seventh-largest higher education company by market value, has more than 100 campuses in North America, and had 106,052 students as of Dec. 31, including Heald, said Anna Marie Dunlap, a Corinthian spokeswoman.

Corinthian paid a \$6.5 million settlement in July 2007 to the California attorney general's office, over allegedly misrepresenting graduates' job placement rates and salaries. It also agreed to cease enrolling students in 11 programs at nine campuses. The Santa Ana, California-based Corinthian said in a 10-K filing that it didn't admit wrongdoing.

"We strongly disagreed with the Attorney General's conclusions, but we are pleased to have settled the matter," Dunlap said in an e-mail.

Exclusively Online

Regionally accredited Heald College had 11 campuses with 12,900 students, primarily in two-year health-care and business programs, as of Dec. 31. The college was nonprofit before its purchase in 2007 by Palm Ventures LLC, a Greenwich, Connecticut, investment company. Heald expects to start enrolling exclusively online students this year, Corinthian Chief Executive Peter Waller wrote in an e-mail.

The Accrediting Commission for Community & Junior Colleges in Novato, California, which certifies two-year institutions in California and Hawaii, approved the change in Heald's ownership.

"We judge the college we accredit," said Barbara Beno, president of the commission. "It would be unfair to say, 'Heald, you've been bought by a parent corporation that doesn't have as fine a track record as you do. Therefore, we'll condemn you,'" she said in a telephone interview.

Heald will "continue to meet ACCJC's accreditation standards and eligibility requirements," Waller said.

The scrutiny "doesn't remotely satisfy the sloppiest of due-diligence requirements," said Nassirian of the American Association of Collegiate Registrars & Admissions Officers. "There is no methodical review of who has bought the college. If the Cosa Nostra applied, you would think you'd take a look."

'Same Animal'

The nation's biggest regional accreditor is starting to take a closer look. The Higher Learning Commission, which certifies more than 1,000 colleges from Arkansas to Wisconsin, stiffened its rules on ownership changes last year.

Buyers must wait from one to four years to reapply for accreditation if the college won't stay "the same animal," President Sylvia Manning said in a telephone interview. The commission now charges \$10,000 for ownership changes to pay for more extensive research. New owners must be approved by its board, rather than at the staff level, Manning said.

The commission applied its newfound rigor to Mayes Education Inc.'s purchase of Waldorf College in Forest City, Iowa, putting the brakes on online expansion. A subsidiary of online privately held Columbia Southern University in Orange Beach, Alabama, Mayes agreed in May to buy the assets of Waldorf, an Evangelical Lutheran college with 500 students, for an undisclosed sum. The deal closed on Jan. 8.

Approval Condition

As a condition of approval, the commission stipulated that Waldorf can't offer online-only degrees at least until 2011-2012. Mayes Education plans to boost Waldorf's enrollment to 2,300 students in three years through programs combining online classes with face-to-face instruction at temporary sites around the country, Jessica Brown, a spokeswoman for Columbia Southern, said in a telephone interview.

The sale "barely made it through" the commission, former Waldorf president Richard Hanson said in a telephone interview.

"Columbia Southern wanted to ramp up the online program quickly. The commissioners said, 'If we maintain accreditation, Waldorf has to remain the college we know.'"

Columbia Southern wasn't the only for-profit that expressed interest in buying Waldorf, Hanson said. Another company that lacked regional accreditation also contacted him: ITT Educational Services.

ITT Educational, runs 120 nationally accredited technical institutes with 80,000 students, most of whom pursue associate degrees.

Graduation Rate

The cost of attending an ITT Technical Institute, including tuition, fees and off-campus room and board, was \$26,775 in 2008-09, according to the National Center for Education Statistics. Of students who entered ITT's two-year schools in 2004, 29 percent graduated. ITT derived 70 percent of its 2009 revenue from federal financial aid, according to a company filing.

ITT Educational is in the preliminary stages of seeking regional accreditation for its technical institutes through the Higher Learning Commission, which sent a team to visit the company in late 2009, a commission spokeswoman, Susan Van Kollenburg, said in an e-mail. The commission hasn't acted on this evaluation, she said.

Daniel Webster is ITT Educational's first regionally accredited campus. Founded in 1965 as the New England Aeronautical Institute, the college is tucked beside Nashua's municipal airport, and keeps its fleet of Pipers and Cessnas there. The campus includes an aviation center, a library, an administration building, classrooms, dormitories, and a student center called the Common Thread.

'Good Reputation'

Over the years, the college expanded from flight instruction into training air traffic controllers and airline managers, as well as teaching computer science, engineering, and business.

It has "a longstanding good reputation," said Gary Kiteley, executive director of the Aviation Accreditation Board International in Auburn, Alabama, which licenses the college's aviation programs.

Financially, Daniel Webster never enjoyed a cushion. With an endowment that peaked at about \$3 million in 2008, it relied on tuition revenue, Myers said. The airline industry's decline after 9/11 and the collapse of Internet stocks hurt enrollment in aviation and computer science, said former provost Michael Fishbein, who said he suffered a heart attack from the stress of keeping the college alive.

Red Ink

Just as trustees reached consensus on a strategic plan in 2008, fuel costs skyrocketed, and "we were running red ink again," Rodney Conard, the former chairman of the board, said in a telephone interview.

The Commission on Institutions of Higher Education and the U.S. Department of Education expressed concerns that Daniel Webster didn't meet their financial standards, placing its accreditation and eligibility for federal aid in jeopardy, according to a filing last April 23, by the college in a New Hampshire court.

ITT Educational contacted Myers in December 2008, he said. Modany visited Daniel Webster the next month, and the parties reached agreement in April. The acquisition would enable the company to target a more upscale audience, Modany told Wall Street analysts on April 23.

While ITT Educational's institutes drew unskilled "career changers," the regionally accredited college would appeal to "career advancers" seeking to enhance their capabilities, Modany said.

The Commission on Institutions of Higher Education approved the sale that same month.

'Public Interest'

"It's in the public interest to have these small institutions continue to function," said Bruce Mallory, a commission member and education professor at the University of New Hampshire in Durham. "If a proprietary school can come in, continue to provide the same level of education and assure viability, that's all for the better."

Modany promised to leave Daniel Webster's administrators in charge because they were experts in running a four-year residential college, Myers and Fishbein said. At a campus event introducing the ITT Educational chief executive to the college community, Modany said the company was growing and there would be ample job opportunities, said Myers.

Growing Suspicions

As Myers negotiated the sale, he came to suspect that the company wasn't being forthright about its intentions, he said. When he and Conard, who chaired the college's board of trustees, worked out at a YMCA a week before the June closing, they discussed canceling the deal, Myers said. Only after consulting colleagues did they decide to go through with it, he said.

"We had lots of conversations when it was on the table," said Conard, a management consultant. "Should we take it? We didn't have to take it. There was a point where we realized, they were going to be more businesslike about it. It didn't feel as comfy as we were hoping."

Going through with the sale was the right decision, Conard said.

"ITT is in this for the long haul, and I'm very comfortable with where they plan to take Daniel Webster," Conard said.

Another former trustee, Cathy Trower, went along with the sale as a last resort to save the college and honor commitments to students, she said.

"A for-profit should not be able to buy accreditation," Trower, a research director at Harvard University's Graduate School of Education in Cambridge, Massachusetts, said in a telephone interview. "To me, that's almost like buying a degree and not actually earning it."

Duplicating Functions

In July, ITT Educational dismissed more than 20 Daniel Webster employees, Myers said. It believed they were duplicating functions that the company's corporate offices in Indiana could provide, two people familiar with the company's thinking said. ITT Educational also replaced Conard, Trower and the other trustees.

Appointees to the college's new board included Charles Cook, former director of the Commission on Institutions of Higher Education, which accredits Daniel Webster. Cook soon

resigned because of a potential conflict of interest with his position as a director of Corinthian's Heald College, he said in a telephone interview.

"I was never substantively involved with Daniel Webster," Cook said.

Questioning Changes

At the time of the firings, Myers was circulating a draft report questioning whether some of ITT Educational's changes were in accord with the standards of the accreditation commission, which call for a faculty role in curriculum and governance, he said.

"ITT came in and said, 'We only want faculty to teach,'" Myers said. "We'll develop curricula in Carmel, Indiana, and give them to you."

On August 5, ITT Educational ousted him, Myers said. Nadine Dowling, director of the Woburn, Massachusetts, campus of ITT Tech, became interim president.

In an unusual move in credential-conscious academia, ITT Educational also named an assistant professor without an advanced degree to a deanship. When Triant Flouris, who has a doctorate and has written four books, resigned as dean of aviation sciences, he was replaced by David Price, who only has a bachelor's degree.

Price is weeks away from completing a master's degree at Daniel Webster, and will enroll in a doctoral program in the coming academic year at President Dowling's request, he said in a telephone interview. "ITT has continued the strong emphasis we've always had on getting a higher degree," he said.

Fewer Worries

The biggest difference at Daniel Webster under new ownership is "worrying less," Price said.

"There are a lot of schools that would just go under, students would be out of a school, faculty and staff would be out of a job that they love passionately. I'm allowed to stay in the position I'm in because of ITT."

In November, faculty members told a team from the New England commission visiting the campus that ITT Educational had rewritten a college self-study report prepared by professors and staff for the accrediting group. Faculty members complained that the company's revisions glossed over inadequacies in such areas as governance, according to two people who attended the session.

When asked about the allegations concerning the self-study report, Richard Schneider, president of Norwich University in Northfield, Vermont, who chaired the team, said that in his experience colleges don't try to deceive accrediting bodies.

Facebook Group

About 450 people have joined a Facebook group entitled, "I went to Daniel Webster before it sold out," including Chad Los Schumacher, 20. After his sophomore year at Daniel Webster,

where he majored in homeland security and joined the paintball club, Los Schumacher transferred for the current academic year to Saint Leo University in Saint Leo, Florida.

“It was a very hard decision to come to, but I knew I could not stay there,” Los Schumacher said.

Los Schumacher was bothered by an ITT Educational policy that students receiving financial assistance through work-study programs sign an agreement that the company owned their intellectual output, he said.

“If I created the next Facebook or Twitter, it would be theirs,” Schumacher said.

Matthew McInnis, a flight operations major, stayed at Daniel Webster.

“A lot of big names in aviation have come through here and taught here,” the senior from Beverly, Massachusetts, said as he headed to the aviation center on Jan. 27. “Looking in the long term, the ITT buyout should add value. Hopefully, it will attract better professors and more students.”

Personnel Moves

The personnel moves took New Hampshire regulators aback, the officials said.

ITT Educational “did give me the sense they would continue as before,” said Kathryn Dodge, executive director of the New Hampshire Postsecondary Education Commission, in Concord, which approved the sale in May. “We did not expect to see the turnover in staffing happen when it happened.”

As a result of the Webster case, Dodge said, she is proposing to require colleges in ownership transition to outline plans for faculty and staff contracts and internal governance.

“It’s a cultural issue,” Dodge said. “Unless we’re extremely specific in our requests, for-profits aren’t as forthcoming as nonprofits.”

To contact the reporter on this story: Daniel Golden in Boston at dgolden@bloomberg.net

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