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ITT Educational Scrutiny From U.S. Regulators Joined by Lenders

By John Lauerman and Janet Lorin

For-profit college ITT Educational Services Inc. (ESI), already under pressure from the U.S. Education Department, is facing stricter terms from lenders that could put its operations at risk.

Last week, ITT Educational disclosed an agreement with creditors that would push its loans into default should the government delay access to student-aid funds, the lifeblood of for-profit colleges, by more than five days. On Aug. 4, the company's market value shrank by almost half and ITT said Chief Executive Officer Kevin Modany will step down in February.

ITT Educational's woes come in the wake of the collapse of Corinthian Colleges Inc., which has 72,000 students and \$1.4 billion in annual federal student aid. While Congressional leaders call for greater oversight of education companies, the impact of Corinthian's demise is spreading industrywide as lenders impose more stringent conditions and in some cases higher loan rates.

"Sometimes it can be a vicious circle," said Joseph D'Angelo, a partner at Carl Marks Advisors in New York who consults on education borrowing and lending. "Certain abrupt actions by the Department of Education can make what looks like a manageable situation look much more dire."

A delay of more than five days wouldn't automatically lead to an ineligibility of Title IV financial-aid funds for ITT Educational, said Nicole Elam, a spokeswoman for the company, in an e-mail.

MODANY'S DEPARTURE

Modany's departure announcement coincided with a 46 percent drop in ITT Educational's shares after the company said a deal fell through to raise as much as \$119.1 million by selling and leasing back real estate. Modany is leaving for "personal reasons" that have nothing to do with the company's health, Elam said. Modany declined to comment. The move appears abrupt, said Trace Urdan, an analyst with Wells Fargo Securities in San Francisco.

"A couple of weeks ago I took a redeye and looked up to see an ITT ad with Modany as pitchman," said Urdan, who covers education companies. "That's not a guy who's preparing to spend more time with his family."

The company named John E. Dean, a board member since 1994, as executive chairman. Dean is a principal of the public affairs firm Washington Partners LLC and has been special counsel to the Consumer Bankers Association, a trade group.

ITT Educational, based in Carmel, Indiana, is facing investigations

of its marketing by a group of state attorneys general, and the Consumer Financial Protection Bureau has sued the company over its loan practices. A separate suit by the New Mexico attorney general claims the company violated marketing and advertising laws at its Breckinridge School of Nursing and Health Sciences.

SENATORS' DEMANDS

Six Democratic U.S. senators -- including Tom Harkin of Iowa, chairman of the Committee on Health, Education, Labor & Pensions, and Majority Whip Dick Durbin of Illinois -- wrote the Obama administration Aug. 5 demanding better protection for students at financially troubled for-profit colleges. The letter cites ITT as one of a number of schools where students and their federal aid are at risk.

"It is absolutely critical to protect these students from a repeat of Corinthian," they said in the letter.

ITT Educational is working with all its regulators, including the Education Department, and has taken steps to be prepared for any regulatory action, said Elam, the spokeswoman.

LOAN PROGRAM

The CFPB's suit, filed in February, alleges that ITT Educational encouraged students to use private, high-cost loans to repay temporary loans offered through the college. Robert Shireman, a former Education Department deputy undersecretary, said ITT's loan program was a point of interest at the agency before he left in 2010.

"People would point to it as an indicator that there's something questionable going on," said Shireman, a board member of the Institute for College Access & Success, a student debt advocacy group. "It was the most obvious problematic piece."

Elam said when the CFPB suit was filed that ITT Educational believes "the bureau's claims are without merit and that we intend to vigorously defend ourselves against the charges."

Education Department scrutiny of the company's loan program heightened after accounting issues were raised by a Securities &



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Exchange Commission review that began last year. For years, ITT accounted for its private loan program as a separate entity controlled by a trust. The SEC said that ITT now controls the trust and must restate its financial reports going back to February 2013.

DEADLINE MISSED

Because of the restatement, the company missed a July 30 deadline for providing data on its administration of student loans to the Education Department. The information is required to remain eligible for federal student aid, which made up about 80 percent of ITT Educational's revenue in 2012.

ITT Educational rose 9 percent yesterday in New York trading to \$8.52. The shares have declined 75 percent this year.

Education Secretary Arne Duncan has powers, rarely used, to impose sanctions on struggling colleges, including the for-profit industry, Shireman said. These powers -- called limitation, suspension and termination, or L, S and T -- were used when the Department imposed a 21-day delay on Corinthian's access to student aid, effectively forcing the company to close or sell all of its 107 schools.

"The secretary could put on an even more severe sanction if he wanted to" on ITT, Shireman said. "They are definitely in that category where there are enough questions where the secretary has the option of using L, S and T."

The department is closely monitoring developments at ITT, said Denise Horn, an agency spokeswoman.

CASH POSITION

ITT is in communication with the department and the delay is related only to the restatement required by the SEC, not to the company's administration of federal student-aid funds, Elam said. Wells Fargo's Urdan said that ITT's cash position would permit the company to weather the 21-day delay on funds that the department imposed on Corinthian. However, a filing from July 30 shows that ITT would be considered in default on its credit covenants if the government delays access to student-aid funds by more than five days, an action less severe than it took with Santa Ana, California-based Corinthian.

The July 30 amendment names a group of eight lenders, led by JPMorgan Chase Bank NA as administrative agent. Jessica Francisco, a spokeswoman for the bank, declined to comment.

A default might push ITT Educational toward losing eligibility for federal aid, Urdan said. The loan amendment guarantees that if ITT Educational receives a sanction and the company fails, it lenders will be paid off in cash and assets, Urdan said.

LOAN ELIGIBILITY

"They are in a much, much stronger financial position than Corinthian," he said in a telephone interview. "But their creditors, having watched what happened with Corinthian, have put this stipulation in."

In the event of a default, ITT has a number of ways to make sure it remains eligible for government grants and loans, Elam said. The company could negotiate with its current lender, seek new lenders, or explore additional alternatives for resolution with the Education Department, she said.

Urdan said the department is unlikely to impose a sanction. The agency has already seen the disruption to students caused by closing Corinthian, he said.

"They don't have any interest in doing actual harm," he said. "The Education Department can't keep shutting down schools and not face some backlash."

LENDING SCENARIOS

Concern about Education Department sanctions still threatens for-profit colleges in the market for loans, which companies need for low-enrollment periods and working capital, said D'Angelo, the lending consultant. He said he would advise bankers to put amendments into their loan agreements with education companies that are similar to the one ITT Educational agreed to.

"Right now, I don't think any lender feels protected when you see the capriciousness that the Department of Education acted with" in Corinthian's case, he said. "You don't want to be in a situation where you're lending into a scenario where you don't know what the outcome will be because you don't know what the Department of Education will do to the school next."

The threat of increased regulation and the Education Department's abrupt actions have doubled the cost of capital for some schools, D'Angelo said.

The Department's actions on Corinthian are directly related to the necessary oversight when there are serious indications of fraud or non-compliance with federal regulations, said Dorie Nolt, a department spokeswoman.

"As we always do, we are fulfilling our responsibility to ensure effective administration of Title IV programs for students and taxpayers," Nolt said.

Shireman recalled hearing an education industry analyst saying in 2010 that it felt like the scrutiny of for-profit colleges was in the third inning of a nine-inning game.

"It feels like we're closer to the ninth now," he said.