



U.S. Higher Education: Key Credit Challenges and the Need for Adaptation

Presented by:

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Agenda

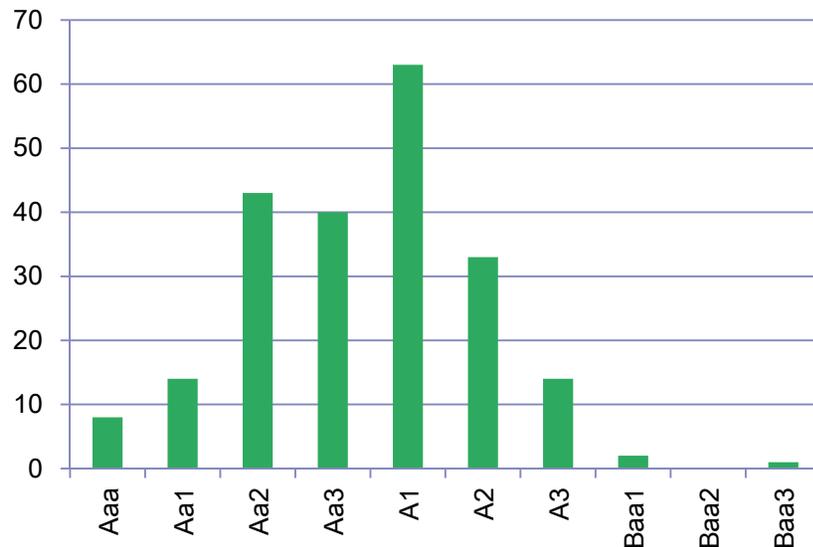
- Overview of Moody's Higher Education Portfolio
- U.S. Higher Education Rating Methodology
- Mixed Higher Education Outlook for 2011 and Key Credit Challenges
- New Realities and the Need for Adaptation
- Reasons for Optimism
- Questions and Answers

Higher Ed Ratings: Public Universities Rated Higher, but More Aaa-Rated Privates

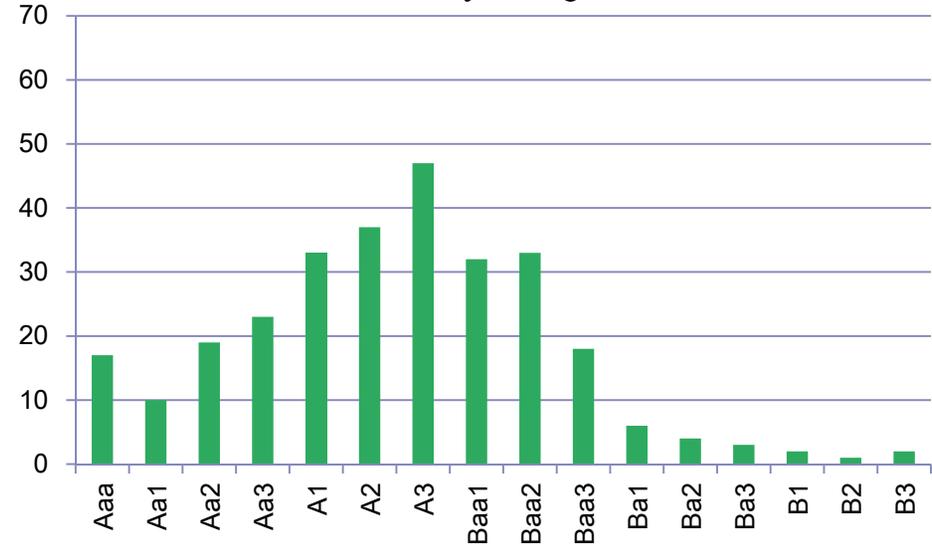
- » Moody's currently rates 226 public colleges and universities in the U.S.
- » Median rating of A1 by number of institutions
- » Median rating of Aa2 when weighted by debt

- » Moody's currently rates 288 private colleges and universities in the U.S.
- » Median rating of A3 by number of institutions
- » Median rating of Aa3 when weighted by debt

U.S. Public University Rating Distribution



U.S. Private University Rating Distribution



Higher Education in New England

Snapshot of Moody's Ratings in New England

- 50 rated private colleges and universities (Aaa to B1); enrollment ranging from <1,000 students to >25,000 students
- Several large public universities, including flagships and systems

A Challenging Landscape: Supply and Demand

- Strong Supply: Northeast is a highly competitive region for higher education
- Pressure on Demand: Challenging demographic forecasts for the number of high school graduates
 - Out of state recruitment is highly competitive (FL, CA, AZ)
 - You can *recruit* out of state, but can you *retain*?

Moody's U.S. Not-for-Profit Private and Public Rating Methodology

- Updated rating methodology published in August 2011

- 5 broad rating factors in rating assessment:
 - Market position
 - Operating performance
 - Balance sheet and capital investment
 - Governance and management
 - Legal security and debt structure

- Introduction of a scorecard with a weighted quantitative grid and notching for qualitative factors

Governance & Management: Key Underpinning for a Rating

➤ Governance

- Diversified boards with sector expertise and philanthropic capacity
- Strong accountability and oversight of management
- Use of self-assessment, benchmarking, term limits and strong conflict of interest policies

➤ Management

- Mix of veterans and newcomers
- Detailed, multi-year financial planning
- Realistic benchmarking—peers vs. aspirants
- Commitment to disclosure to all constituencies

Higher Education Outlook – A Look Back over Past Few Years

Moody's Sector Outlook: our expectation for fundamental credit conditions over the next 12-18 months; not a prediction of expected rating changes during this period

2009 & 2010: Negative Outlook for All Sectors (private/public universities, K-12, and other not-for-profits)

- Increased pressure on tuition and financial aid
- Broad impact of investment losses on operations and philanthropy
- Illiquidity of balance sheets, amplified by alternative investments
- Volatility in debt markets as well as debt structures
- More credit pressure for private universities than public universities

January 2011: Mixed Outlook for U.S. Higher Education

- Outlook revised to stable for diversified market leading universities
- Maintenance of negative outlook for majority of tuition and state-dependent universities

Mixed Outlook for U.S. Higher Education in 2011: Business Diversity is a Key Stabilizing Factor

Factors Associated with Stable Outlook

- Market leaders with top-ranked academic programs and global reputations supporting pricing power
- Multiple business lines, typically with no one source accounting for more than 50% of revenue
- Consistently strong demand from top quality students and faculty
- Generous philanthropic support, low dependence on state funding, and diversified research funding
- Strong balance sheet providing good support for debt and operations as well as ample liquidity
- Management and governance teams focused on long-term sustainability

Factors Associated with Negative Outlook

- Moderately selective to non-selective institutions with a regional student draw
- Moderate to weak pricing power and more limited ability to grow net tuition
- Less diversified business lines with heavy reliance on student charges and/or state appropriations
- Small, if any, fundraising or research enterprises
- Modest endowments or limited liquidity providing little support for operating budget and debt
- Typically small or medium-sized enrollments and lack of economies of scale

Critical Credit Factors Facing Higher Education Today

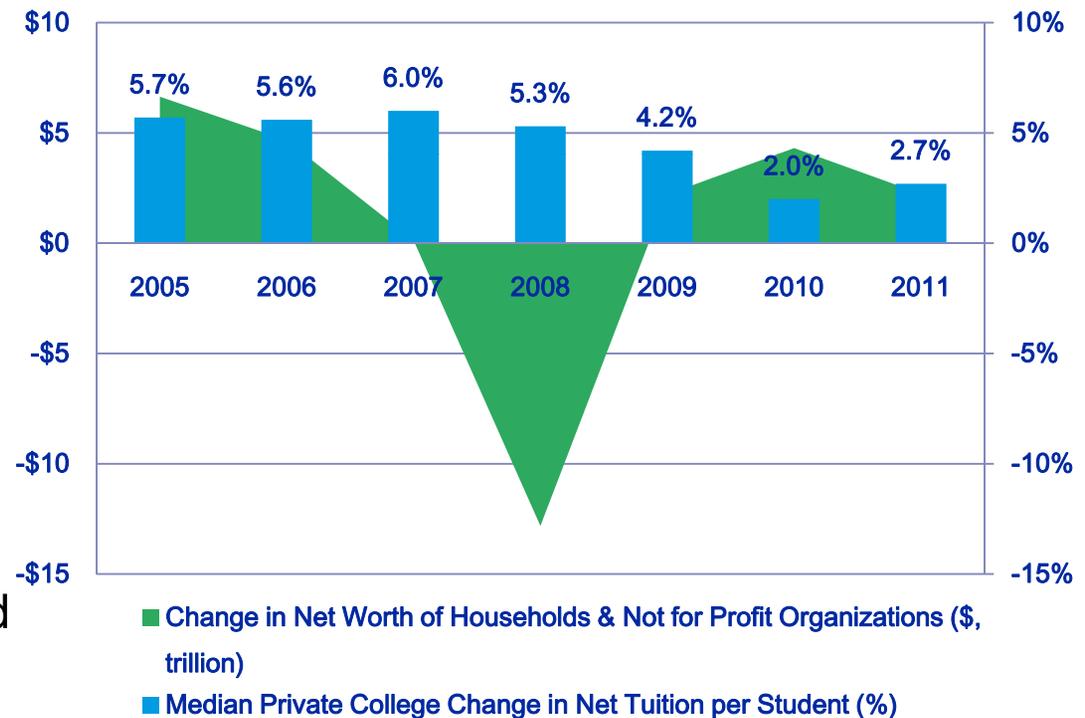
- Negative revenue pressures on all fronts:
 - Growing resistance to tuition increases
 - Lower gift revenue
 - Declining federally sponsored research
 - Cuts in state funding to public universities

- Balance sheet risks:
 - Investment volatility, more limited liquidity
 - Heightened debt structure risks
 - Capital needs

All Universities Face Increased Tuition Pressure

- Political and public pressure to improve affordability
- Moderation of tuition increases
- Expanded financial aid budgets
- Strong competition from lower-priced alternatives
- Need to become more efficient including use of online delivery of classes and degrees

Slowed Net Tuition Growth Lags Steep Decline in U.S. Net Worth



Source: Change in Net Worth 1980-2010 from Federal Reserve; 2011 Forecast from Moody's Analytics ; Median Net Tuition per Student from Moody's

State Budget Gaps Result in Higher Education Funding Cuts

- End of ARRA funding in 2011
- State budget gaps persist; lower tax receipts due to recession; depletion of state reserves
- Longer term increases in state funding have not kept pace with growth of operating budgets
- Larger public universities and systems better poised to take advantage of economies of scale and operational efficiencies
- Smaller regional publics are more reliant on state funding and compete more heavily with community colleges
- Instances of delays in cash funding from the state or late in the year appropriation cuts (Illinois and Arizona): adequacy of liquidity?

Heightened Competition for Research Funding and Philanthropic Support

Research Funding:

- ARRA funding for research provided temporary boost
- Flattening of federal research funding; increased competition
- Largest, nationally prominent research institutions best positioned for stable funding
- Increased focus on grant funding diversification including private funding sources, commercialization of research

Philanthropic Support:

- Gifts are down, but still a unique credit factor for the sector
- Likely to be stabilizing at lower base level
- Shifting donor priorities?

Balance Sheet Management: Liquidity and Debt Structure Still Carry Risk and Require Ongoing Attention

- **Liquidity**
 - Renewed focus on liquidity
 - Organization-wide assessment of sources/uses of liquidity
 - Past investment losses impact future endowment draws
- **Debt Structure**
 - Wave of bank agreements expiring in 2011
 - Swaps still negative, although reduced collateral posting requirements
 - Increased use of fixed-rate debt
- **Capital Planning**
 - Strong debt issuance in 2010, including BABs; slowdown so far in 2011
 - Careful re-evaluation of capital plans and prioritization of resource use

“New Realities” and the Need for Adaptation

Heightened price sensitivity		Reduced tuition increases; growth of financial aid budgets; need to demonstrate product value
Pressure on top-line revenue growth		Expense containment, operating efficiency
Long-term pressure on government funding		Business diversification; growth of alternative private revenue sources (research, gifts, tuition)
Increasing diversity of the student body		More flexible schedules (weekends, hybrid, 3 year B.A.)
Uncertainty about long-term endowment returns		More stress testing of long-range assumptions and enterprise risk management planning
More financial accountability placed on boards of trustees and management teams		Increased transparency to all constituencies

Reasons for Optimism

- Strong and resilient demand overall
- Long-term family planning and saving for college
- Good business model
- Few defined benefit pensions
- Philanthropy
- In most cases, room for expense containment and slowed capital investment

Questions & Answers

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