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INVESTORS SERVICE

SPECIAL COMMENT

Annual Sector Outlook for U.S. Higher Education for 2010

Outlook Remains Negative for Higher Education Sector; Pressure Continues to be Greater for Private Universities than Public Institutions

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Moody's outlook for the U.S. Higher Education sector is negative. This outlook expresses Moody's expectations for the fundamental credit conditions in the industry over the next 12 to 18 months and does not speak to the expected balance of rating changes during this timeframe.

Since Moody's revised its outlook for the higher education sector to negative in January 2009, many of the immediate risks, largely created by liquidity and balance sheet stress, have moderated. Most colleges and universities have benefited from a partial recovery in equity markets, and some have acted to increase their liquid assets as well as reduce debt structure risks. Nevertheless, Moody's is maintaining a negative outlook for the sector as we enter a period when more fundamental and cumulative risks of weakened student demand and donor support are likely to become evident. The threat of renewed balance sheet and liquidity stress as well greater regulatory scrutiny also remain present. Moody's believes that the uncertainties facing private higher education institutions pose more significant concerns for credit stability, while the significant challenges encountered by public institutions may be addressed with less impact on credit quality.

One year ago, Moody's assigned a negative outlook to the higher education sector based on a number of factors that created immediate-term risks. These factors included the broad impact of investment losses on operations and philanthropy, the illiquidity of balance sheets, volatility in debt markets and debt structures, as well as building pressure on tuition and financial aid. In September 2009, we reported that immediate pressures on the U.S. higher education sector were easing as values in the public equity markets rose, enrollments were generally stable, and access to capital markets and liquidity facilities had improved. However, we also reported that 29% of rated private colleges and universities that responded to a Moody's survey expected net tuition revenue to decline in fiscal year (FY) 2010.

In comparison to the historic stability of the sector, higher education institutions are now operating in a context of greater uncertainty, reduced financial flexibility, and increased competitive pressures. In our opinion, boards of trustees and management teams now must develop multiyear plans on the assumption of reduced resources and less ability to predict future revenues. Constraints on income could impose near-term stress as revenues may decline faster than expenses can be adjusted. Reduced wealth levels are likely to result in less investment in facilities and programs at both higher rated institutions that are heavily dependent on endowment income, as well as heavily tuition-dependent colleges. Current pressures affect the private and public higher education sectors differently, with even more diverse impacts on individual institutions. Most rated colleges and universities now face the need for stronger governance and management, as well as better disclosure to investors, donors and regulators that can affect future financial position.

Outlooks for Independent K-12 Schools and Other Not-for-For Profits Also Remain Negative

Moody's has not published separate outlook reports for the independent K-12 sector or the very diverse not-for-profit organization sector in recent years. Over the past year, we published medians reports for FY 2008 for each of these sectors in which we highlighted weaknesses already developing from pressures associated with economic conditions. (See reports entitled "Not-for-Profit Medians Show Weaker Balance Sheets for FY 2008" from December 2009 (#121523) and "Independent K-12 School Medians for Fiscal Year 2008 Highlight Credit Challenges" from September 2009 (#119842)).

In our view, many of the same challenges affecting the higher education sector also impact the independent K-12 schools and other not-for-profit organizations. However, their vulnerability may be heightened as their services may be viewed as more "discretionary" expenses than higher education. With some students and their families facing more constrained economic circumstances, independent schools could see similar uncertainty in tuition pricing and enrollment as private colleges and universities and greater competition with public school alternatives. Similarly, cultural institutions may experience lower attendance and membership. Organizations in both sectors could also suffer from the reduced philanthropic capacity of donors, which could lower operating performance and capital investment. Investment losses across both sectors will weaken financial resources and the coverage of debt and operations as well as the contribution of investment income to operating revenues.

Tuition Pricing and Enrollment Uncertainty Now Fundamental Risk

The experience of many of our rated private and public colleges and universities for the fall 2009 enrollment cycle highlighted the emerging instability of net tuition pricing and enrollment patterns affecting the higher education market. Traditionally, tuition setting and financial aid allocation had been a relatively routine process for most institutions, with a fairly predictable outcome in terms of net tuition and fee revenue, acceptances, and matriculation levels. As a result of economic challenges affecting students and their families, however, many private colleges and universities revised their policies for the past cycle in order to ensure enrollment. Enrollment at public institutions increased as students chose what is often a lower-cost education option.

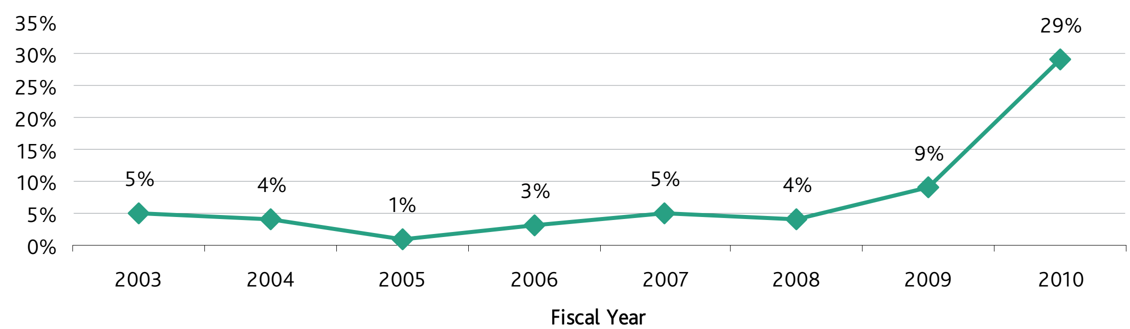
*Net Tuition Pricing: I*n Moody's opinion, the ability of private colleges and universities to increase net tuition revenue at historic rates is clearly weakened. Even prior to the current economic downturn, public scrutiny of annual boosts in tuition had been growing, and pressure now felt by families may constrain their willingness to pay rapidly increasing rates in the future. We believe, however, that the reduced growth in net tuition revenue, while manageable for one to two years, is likely to become an increasingly challenging factor for management at most private higher education institutions, particularly those in the A and Baa-rated categories. Most vulnerable to credit pressure are institutions in these rating categories that rely on this source for 70% or more of operating revenues and face significant fixed costs for debt service costs. Colleges and universities with higher debt service burdens (e.g., annual debt service over 6% of operating expenses) will face the greatest challenges.

For public colleges and universities, Moody's believes the planned increases to Pell Grant awards could bolster net tuition revenue as long as the anticipated growth in the Pell Grants are fully funded by the federal government and not crowded out by competing spending needs. In FY 2009, Pell Grants represented 14% of undergraduate student aid.[1] However, we also expect continued political pressure in many states to limit the number of out-of-state students who attend public higher education institutions in order to preserve capacity for state residents. Out-of-state students typically pay up to two times the amount of tuition as in-state residents. Limiting out-of-state enrollment restricts the opportunity to increase revenues without great impact to operating expenses.

In fall 2009, Moody's conducted a survey of our rated private and public higher education institutions to gain an early understanding of how current economic conditions may impact net tuition revenue in FY 2010 ("New Tuition Challenges at Many Private U.S. Universities", dated October 2009). Results of that survey indicated that 29% of private college and university respondents anticipate lower net tuition revenues in the current year, a significant increase over recent years when less than 9% of private institutions reported a decline. Figure 1 shows this trend since FY 2003.

FIGURE 1

Percent of Rated Institutions with Annual Declines in Net Tuition Revenue



**Data for Fiscal Years 2009 and 2010 are estimated based on Moody's Enrollment Survey*

Across the private institutions, a median increase in net tuition and fee revenue of just 2.4% was expected this year, compared to a median increase of 5.4% in FY 2009. This slow growth in net tuition revenue reflects greater price sensitivity on the part of students and their families, who may have experienced changed economic circumstances such as decreased household net worth, less willingness to borrow, and more widespread and sustained unemployment. Additionally, private institutions boosted spending on financial aid in order to ensure enrollment, with a median increase of 9.3% of spending from sources other than endowed funds.

1 College Board, "2009 Trends in College Pricing", October 20, 2009.

Despite the larger extent of projected declines in net tuition revenue for the current year, private higher education institutions have displayed resilience to market challenges during this severe economic downturn. Over 70% of survey respondents expected at least flat or higher net tuition revenue this year. Further, while institutions are spending more on financial aid, this increase demonstrated flexibility to adjust the allocation of resources over a short time frame that was largely successful in maintaining enrollments this year.

FIGURE 2

Key Metrics That May Influence Willingness to Pay Tuition

	2006	2007	2008	2009
Change in Household Net Worth 1, 2	8.1%	1.9%	-14.2%	2.9%
Change in Median Sales Price of Existing Single-Family Homes 1, 3	-3.6%	-4.2%	-14.9%	-4.0%
Unemployment Rate - December 4	4.4%	5.0%	7.4%	10.0%

(1) Change figure represents annual change between last quarter of previous and current year except in 2009, when it represents change between third quarter of 2009 and fourth quarter of 2008

(2) Source: Federal Reserve Board: Flow of Funds; Moody's Economy.com

(3) Source: National Association of Realtors: Real Estate Outlook; Moody's Economy.com

(4) Source: Bureau of Labor Statistics

The vast majority of private higher education institutions depend on tuition and auxiliary charges such as room and board for a significant share of operating income. Across our rated borrowers, private higher education institutions display greater dependence on these sources, with net tuition and auxiliary revenue comprising a median 73.3% of Moody's calculated operating revenue in FY 2008 as calculated by Moody's. Reliance varies by rating category, with institutions rated Aaa lowest at 23.1% and increasing to 83.8% for institutions rated in the Baa category. Data for FY 2009 is still being gathered as financial statements are completed.

By contrast, public colleges and universities are less dependent on net tuition and auxiliary revenue, with the highest median share in FY 2008 at 41.5% for institutions rated in the A category. Most public institutions still benefit from a significant public subsidy, operate at much greater economies of scale, and enjoy a pricing advantage in comparison to private institutions. For FY 2008, the median net tuition per student (after financial aid and including Pell Grant revenue) across all rating categories of public colleges and universities was $6,128 versus $19,158 for private institutions.

In our fall 2009 survey, public institutions reported far less pressure on net tuition and fees than private colleges and universities. An overwhelming majority, 92%, of public college and university respondents anticipated increased net tuition and fee revenue for the current year. Nevertheless, the median change is projected at 4.8%, which is below the median change of 7.8% in the prior year. We believe this slower increase reflects the response of public higher education institutions to economic conditions and the natural tension public colleges and universities face between increasing tuition to support operations and carrying out their core public missions of affordability and accessibility.

Enrollment: Moody's also sees much uncertainty in enrollments at private colleges and universities as well as pressures from strong growth in demand at public institutions over the near term. As we have noted in prior reports, the population of high school graduates peaked in FY 2008. Projections anticipate a decline in annual high school graduates through FY 2014, and then an increase beginning thereafter that will bring the number in FY 2022 essentially back to the FY 2008 level. The distribution of the changes is not even across the U.S., however, with the South and West expected to grow and the Midwest and Northeast expected to decline.[2] Participation rates will also affect enrollments. Between 1972 and 2006, the share of high school graduates attending college rose to 66% from 49%.[3] Given the countercyclical nature of higher education and economic conditions, enrollment will likely continue to grow at public institutions and graduate schools until the U.S. economy stabilizes and hiring resumes.

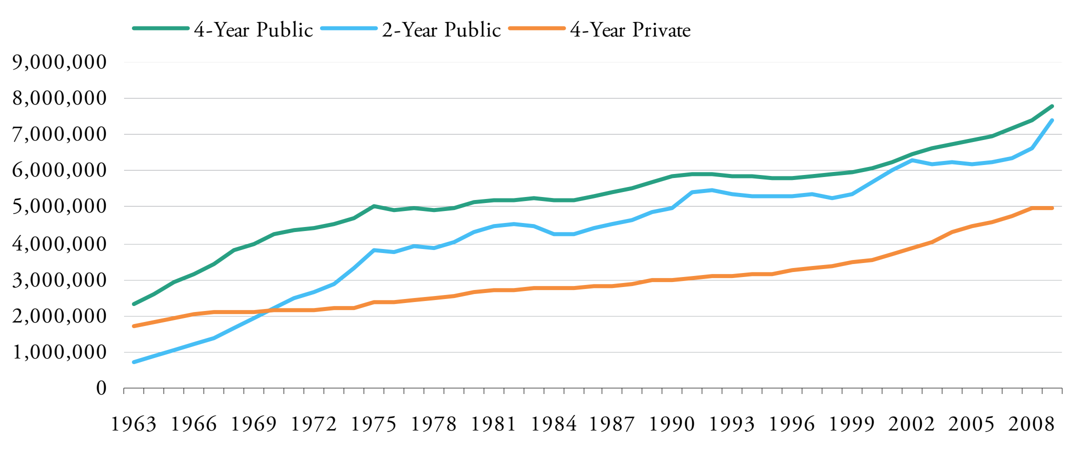
Among the private higher education institutions that participated in Moody's fall 2009 survey, enrollments were basically stable, with an increase of 0.8% overall. We believe this stability depended in large part on both the pricing decisions made by these institutions described above as well as deliberate increases in the percent of first-year applicants accepted. Of survey respondents, 68% reported an increase in the share of applicants accepted, and the median selectivity rate of 60.8% for fall 2009 in comparison to 57.1% for the previous year. Moody's expects greater uncertainty and difficulty in enrollment management at private colleges and universities in upcoming cycles as competitive shifts continue among institutions.

Public institutions reported in Moody's survey that full-time undergraduate enrollment had risen 2.3% for fall 2009 over fall 2008. Across all 4-year public higher education respondents, 82% experienced a larger undergraduate enrollment. Growth in enrollments at community colleges has been most dramatic within the higher education sector. Between fall 2008 and fall 2009, headcount enrollment grew 11.4% across the nation.[4] Reflecting the economic downturn, the increase was greater among full-time students (16.4%) than part-time students (7.1%). Over the past two years, enrollment at community colleges has increased 16.9%, with full-time enrollment up 24.1% and part-time enrollment rising 11.4%. Moody's recently reported on the impact of this enrollment growth at community colleges ("Community Colleges Face Challenge of Strong Growth", dated January 2010).

This trend of current increases in enrollment at 4-year public institutions and community colleges and leveling of enrollment at private colleges and universities is displayed in Figure 3 below.

FIGURE 3

Total Fall Enrollment Trends for U.S. Higher Education 1963-2009



SOURCE: U.S. Department of Education, National Center for Education Statistics; Projected Fall 2008 and 2009 data based on Moody's estimates assuming same growth rate in enrollment patterns as occurred during recession of 2002-2003 and American Association of Community Colleges "Community College Enrollment Surge" - December 2009

[2] Western Interstate Commission for Higher Education and Moody's Investors Service, "Demographic Trends Indicate Continuing Student Demand for Most Colleges and Universities", June 2006.

[3] National Center for Education Statistics.

[4] American Association of Community Colleges "Community College Enrollment Surge," December 2009.

While enrollment increases at public institutions are likely to boost tuition revenues, they also create further demands. Facilities may be used much more, requiring greater maintenance and earlier replacement, and operating expenses could increase as additional faculty may be required. Likewise, for in-state students, greater enrollment that is not accompanied by rising state appropriations can actually create greater budget pressures over the long-term.

Pressure on Other Key Revenue Sources Likely to Continue for All Institutions

In addition to the pressure already being experienced on net tuition primarily for private colleges and universities, Moody's believes there may also be uncertainty in other key sources of revenue for higher education institutions over the intermediate term.

Gift Revenue: Although Moody's has not received FY 2009 financial data for all rated borrowers, it is clear that gifts to higher education declined in FY 2009 from the previous year by a meaningful amount. Our conversations with higher education institutions indicate that many revised their fundraising strategies during the past year to focus on annual giving to support ongoing operations and many have revised their targets for FY 2010 downward to better match updated expectations. While few report outright reneging on the payment of outstanding pledges, some institutions received requests to lengthen payment periods and extended the timing for donor solicitation efforts.

Following the last major economic downturn after the bursting of the tech stock bubble in 2001-03, philanthropy to higher education stalled, but still grew weakly. However, home prices were increasing during that period. Given the magnitude of the losses in stocks and home values, a rapid rebound in private giving now seems unlikely. We believe the best annual giving campaigns are likely to remain roughly stable in FY 2010 from FY 2009, but that the momentum of capital campaigns and endowment campaigns will be difficult to rebuild in the near-term.

Gifts provide widely varying amounts to operating revenues and capital plans for Moody's rated higher institution borrowers, but in our opinion all may experience the impact of reduced giving over at least the near term. In FY 2008, gifts accounted for a median 6.4% of operating revenues for private colleges and universities in FY 2008 and ranged from 5.2% for Baa-rated institutions to 10.6% for Aaa-rated institutions.

For the institutions that rely depend on gifts to provide funding for ongoing operations, we expect the experience of reduced philanthropy will be most pronounced. Over this past year, we have seen institutions delay capital projects or new programs that they expect to be supported by gifts. In Moody's view, these colleges and universities that can be flexible with plans to utilize gift funding are most likely to weather a prolonged decline in this revenue source.

Grants and contracts revenue: Flat funding for federal research in recent years was reversed by the infusion of $16 billion in funding through the American Recovery and Reinvestment Act of 2009 (ARRA, often referred to as the "stimulus bill"). These funds included $10 billion to be disbursed by the National Institutes of Health, which is a major research funding source for colleges and universities. While the distribution of funds is not complete, Moody's believes the additional funding will boost this revenue source for a significant number of our rated institutions. However, this impact may be short-lived and we expect that federal research funding may be challenging to grow over time in the face of other federal spending priorities and competition for available dollars. The impact on future operating performance will depend in large part on the ability of colleges and universities to curtail spending in concert with the reduced availability of sponsored research funds.

Both private and public higher education institutions rely on grants and contracts revenue to fund their research enterprises. Dependence on this source varies among each segment, with the more highly rated organizations in each segment typically the greatest beneficiaries of sponsored research funding. In FY 2008, Aaa-rated private institutions received a median 15.4% of operating revenues from this source, while public institutions rated Aa3 and higher registered a median of 19.3%. These figures represented a decrease of approximately 2% to 3% from the share provided as recently as FY 2004, as growth in federal research funding has been stagnant.

Can Public Colleges and Universities Adjust Quickly Enough to Declines in State Appropriations?

Moody's has previously commented on the general trend of decline in state appropriations as a percent of operating revenues for public universities. As of FY 2008, the median share of operating revenues contributed by state appropriations was 32.7%, with more highly-rated institutions being less dependent (Aaa and Aa1-rated public colleges and universities at median of 17.7% and Baa-rated at 42.9%). The trend toward reduced public funding of public university operating costs appears irreversible.

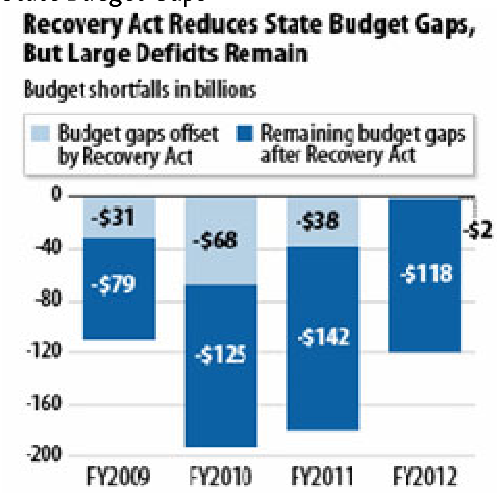
For FY 2009 and FY 2010, state appropriations to higher education were reduced as a result of economic conditions that quickly reduced the financial position of most states. Across all states for FY 2009, state appropriations were reduced on average by 1%. The change varied considerably, ranging from increases of 9% (Montana) and 8% (New York and Alaska) to decreases of 18% (Alabama), 15% (Arizona), and 13% (Florida).

State funding cuts accelerated in the current year, with FY 2010 state appropriations lower by an average of an additional 5%. Again, the experience in individual states has differed, with 10 states experiencing increases ranging from 1% (Connecticut) to 27% (North Dakota). The remaining states had either no growth in appropriations (Nebraska, Vermont, Colorado, and Maryland) or decreases of up to 20% (Ohio and Montana).[5] Moody's cautions that the funding situation in many states remains dynamic and additional cuts could still occur in the current year.

[5] University of Washington Office of Planning & Budgeting, as printed in the Chronicle of Higher Education.

FIGURE 4

State Budget Gaps



Source: Center for Budget and Policy Priorities

Federal stimulus funds provided under ARRA have backfilled the cuts in state funding to some extent. According to a report by the Obama Administration, state fiscal stabilization funds increased state support for higher education 3.3%, or $2.2 billion, in FY 2009 and by 5.0%, or $3.2 billion, in FY 2010.[6] The federal stimulus funds are scheduled to expire on December 31, 2010. Moody's is concerned that states may not have achieved fiscal stability by that time and will continue to target public higher education for expenditure reductions.

While we expect that public institutions will remain the lowest cost provider of higher education and therefore continue to generate enrollment demand, we recognize the risk that they will not be able to replace the reduced governmental funds in a short time period and therefore be pressured in their ability to maintain levels of service to their students and could generate lower levels of operating performance.

Investment Losses Lower Financial Resources, But Widespread Credit Deterioration Unlikely

Moody's rated higher education borrowers nearly universally suffered investment losses in FY 2009. These losses increased balance sheet leverage, lowered financial flexibility, dampened the appetite for additional capital investment, and reduced the amount of investment income available to support operating budgets. Significant near-term pressure on operating budgets for 2010 continues to affect many highly rated private colleges and universities that disproportionately depend on investment income and gains to fund their budgets. Investment losses in FY 2009 and a possible period of weaker future investment performance have repercussions across multiple years' operating budgets given the typical endowment spending policy that utilizes a set percentage of a three-year lagged average endowment value.

6 "Educational Impact of the American Recovery and Reinvestment Act" issued by the Domestic Policy Council Executive Office of the President in cooperation with the U.S. Department of Education, October 19, 2009.

Estimates project an average 19% decline in investment value across higher education institutions for FY 2009.[7] In addition to being the largest annual average percentage decrease since at least the 1970s, the loss will materially decrease the ratio of financial resources to debt, as debt has increased significantly in recent years. For private institutions, median outstanding direct debt expanded by 41% between FY 2004 and FY 2008, including a near doubling of the median amount for Aaa-rated privates over that period. Median direct debt for public colleges and universities grew 57% from FY 2004 through FY 2008. While Moody's does not anticipate widespread credit deterioration due to the impact of FY 2009 investment returns, the lower resource levels provide less financial flexibility to absorb negative surprises across a college's or university's operating and investing activities. Through December 31, 2009, we estimate that institutions had regained approximately 10% from June 30 valuations, which may limit the ongoing risk of last year's investment losses.

Capital investment will also decline as wealth levels are lowered due to investment losses, with the decline further fueled by reduced gift revenues for capital projects and potential long-term scarcity in the capital markets and therefore less ability to issue debt to finance facilities needs. Although investment in capital is important to maintain a competitive position for student and faculty recruitment, reducing or delaying capital spending in turbulent times also demonstrates sound management practice. Additionally, the heavy capital spending incurred by colleges and universities in recent years may diminish the need for immediate new investment. Between FY 2004 and FY 2008, the capital spending ratio (annual purchase of property, plant and equipment divided by annual depreciation expense) across the private segment of the higher education sector steadily increased from 159% to 215%, indicating that spending on new construction and facilities improvements was outpacing depreciation on existing facilities.

Reduced investment values will also result in lower investment income available to support operating needs, since the endowment balances from which to spend have decreased. The most potentially significant impacts will be felt among private colleges and universities, and specifically among the more highly-rated institutions within the segment. Moody's has heard a variety of responses from borrowers of ways to minimize the impact of lower investment income, including extending the number of years over which the average balance is calculated, temporarily increasing the spending rate, issuing taxable debt and using the proceeds to supplement endowment distribution, and reducing expenditures.

As calculated by Moody's, Aaa-rated private institutions relied on investment income for a median 40.1% of operating revenue in FY 2008, with the share declining across rating categories to a median 4.8% for Baa-rated institutions. Among public colleges and universities in FY 2008, investment income comprised a median 5.5% of operating revenues for Aaa and Aa1-rated institutions, decreasing to 1.0% for Baa-rated colleges and universities.

In the public college and university segment of the sector, we anticipate higher capital spending in the near term as institutions may accelerate borrowing plans in reaction to growing enrollments, reduced state grants and to take advantage of the taxable Build America Bonds program that is currently scheduled to expire at the end of calendar year 2010. Despite the significant amount of issuance that has already occurred under that program ($4.5 billion for higher education borrowers in calendar year 2009)[8], we do not expect the balance sheet impact to any individual college or university to significantly affect credit quality.

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7 2009 NACUBO-Commonfund Study of Endowments, December 9, 2009.

8 J.P. Morgan.

Heightened Regulatory Risk Anticipated, With Uncertain Outcome

In Moody's opinion, regulatory risk for higher education institutions is rising, but the impact of additional scrutiny is not yet clear. At least two significant regulatory reviews by the federal government will be occurring during the outlook timeframe. We believe that greater focus on disclosure and transparency by higher education institutions would help address the concerns of government regulators and issues raised in their reviews.

As part of the Higher Education Act passed in 2008, the U.S. Secretary of Education is required to post lists on the Education Department's website beginning July 1, 2011 that show pricing data for various types of higher education institutions. These lists will include the 5% of institutions with the highest tuition and fees and the highest net price for the most recent academic year, the 5% of institutions with the largest percentage increase in tuition and fees and net price over the three most recent academic years, and the 10% of institutions with the lowest tuition and fees and net price for the most recent academic year. Institutions that appear on the lists of cost increases will be required to report to the Education Department on reasons for the increases and steps being taken to reduce them.

Another federal review that raises regulatory risk is the Internal Revenue Service's (IRS) current audit of 40 not-for-profit organizations. This audit follows questionnaires sent to 400 colleges and universities by the IRS in 2008, which asked the institutions about different issues, including their taxable operations and the investment and use of endowment funds. While the review is intended to focus on the tax-exempt status of the organizations being audited, we believe the spotlight on management and financial practices at higher education institutions has the potential to open other areas of concern with an uncertain outcome.

Management Responses May Need to be Accelerated

Higher education institutions have undertaken a variety of actions to respond to reduced resources. Budget savings have been pursued through means such as furloughs, suspending hiring, freezing salaries for at least a segment of employees, lowering or freezing retirement contributions, and eliminating discretionary expenses such as travel. Additionally, some institutions deliberately enrolled more or fewer students to increase revenues or decrease costs, intensified retention efforts, and asked donors to accelerate pledges or release restrictions on their gifts. Others entered into new bank operating lines of credit to ensure adequate revenues should projections fall short. Finally, many institutions suspended capital projects, both new projects and ongoing maintenance activity.

As indicated by the variety of actions undertaken, institutions acted quickly to address the abrupt revenue challenges. However, these efforts appear to be a fairly short-lived solutions that may help bridge some of the near-term uncertainty of pricing, enrollments, and investment valuations, but are unlikely to achieve long-term adjustments to a potentially fundamentally changed operating environment. In the context of reduced resources, we believe private and public colleges and universities will need to further position themselves with more lasting restructuring of their business models to ensure financial stability. During the period between FY 2004 and FY 2008, colleges and universities experienced significant growth in annual expenses, with public institutions increasing by a median 24% and privates by a median of 21%. For publics, the greatest increase was in the Aaa/Aa1-rated category, which saw 33% growth. For privates, Aa-rated institutions boosted spending the most during the period by growing a median 28%.

In addition to slowing expense growth going forward, higher education institutions may need to revise their business models to accommodate lower revenues and wealth. For example, private institutions will need to prove their value in the market place by pursuing heightened name recognition and creating more effective alliances, networks, and associations to achieve better economies of scale across many institutions. With student purchasing power likely stagnant, private institutions in particular will need to better portray their value to families. Public colleges and universities will need to demonstrate how they successfully accommodate additional enrollment within physical capacity constraints and potentially lower revenues while maintaining the quality of the student academic experience.

Finally, boards of trustees and management teams face the need to expand disclosure of financial and operating practices to donors, lenders, investors and regulators. With greater transparency, many colleges and universities are likely to benefit in terms of increased donations, better access to capital and less regulatory interference from efforts to build confidence among these constituent groups that can have such material impact on higher education's future financial position.

Liquidity Challenges Remain Despite Some Recovery from Early 2009

While immediate concerns about meeting liquidity needs have diminished, Moody's views access to liquidity as a continuing challenge. With the FY 2009 financial reporting cycle, Moody's has implemented new disclosure requirements for our rated higher education and not-for-profit borrowers that will aid in better understanding the liquidity truly available to them over differing time periods.

During the height of capital market disruptions in late 2008 and early 2009, equity investment values dropped significantly and many borrowers were required to post collateral under swap agreements. As a result, some of the most liquid investments held by higher education institutions were less available. While equity values have risen substantially and far less is now being posted as swap collateral, the prevalence of less-liquid alternative investments will continue to reduce overall liquidity from institutions' internal sources.

The ability to access external liquidity to fund operations or support variable rate debt also remains pressured. Facing capital constraints and greater aversion to risk, banks have pulled back on offering liquidity facilities. Where they are being offered, banks are frequently providing this support for lower dollar amounts and for shorter periods at increased cost. Additionally, banks have displayed less willingness to provide longer-term repayment periods for amounts borrowed under 364-day agreements.[9] We are specifically concerned that public colleges and universities may experience greater liquidity needs if state appropriations are further cut or delayed during the current year and in FY 2011.

The use of variable rate debt remains prevalent across Moody's rated higher education borrowers. Among private colleges and universities, 69% maintained variable rate debt as of end of FY 2008. This amount represented a small decline from 73% as of the prior year. Of the share with variable rate debt, 53% utilized variable rate structures for more than 50% of their total direct debt. The majority of these variable rate debt structures utilize bank liquidity support in the form of letters of credit or standby bond purchase agreements to purchase bonds that are tendered and not remarketed. While borrowers have reduced their variable rate debt exposure over the past year and the majority of new issuance has been in a fixed rate mode, we expect access to external liquidity to remain a key issue for many private and public colleges and universities given the continued use of variable rate debt and dependence on bank support, as well as the potential for revenue shortfalls.

9 Moody's Global Corporate Finance, "Challenges on the Horizon for Investment-Grade Liquidity", November 2009.

Moody's Related Research

Industry Outlook:

» Outlook Update: Immediate Pressures on U.S. Higher Education Are Easing, September 2009 (120018)

Median Report:

» Moody's Fiscal Year 2008 Private College and University Medians, May 2009 (117440)

» Moody's Fiscal Year 2008 Public College and University Medians, July 2009 (119172)

Special Comment:

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» U.S. Colleges and Universities Rating Roadmap: Focus on Special Risks During Recession & Credit Crisis, April 2009 (117008)

» U.S. University Balance Sheets Still Likely to Report Dramatic Declines for 2009, May 2009 (117364)

» U.S. Higher Education: Greater Disclosure and Transparency Will Likely Build Market Confidence During Credit Crisis, June 2009 (117348)

» New Tuition Challenges at Many U.S. Private Universities, October 2009 (120872)

» Community Colleges Face Challenge of Strong Growth, January 2010 (120643)

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