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# **2014 Outlook for US Higher Education**

**University of Minnesota  
December 12, 2013**

# Moody's Rates Over 500 Universities

## Includes vast majority of sector debt

- » Over **230 public universities**, with approximately \$118 billion of outstanding debt
  - » Median rating of A1 by number of institutions, Aa2 weighted by rated debt
- » More than **280 private colleges and universities**, with close to \$83 billion of outstanding debt
  - » Median rating of A2 by number of institutions, Aa2 weighted by rated debt
- » Nearly **70 community colleges with \$4.4 billion** of revenue-backed debt
  - » Median rating of A2 by number of institutions, Aa3 weighted by rated debt
  - » Tax-backed debt rated by local governments team
- » Around **115 not-for-profit institutions**, \$13.5 billion of rated debt
  - » Median rating of A1 by number of institutions, median rating of Aa3 weighted by rated debt
- » Approximately **40 independent K-12 schools**, \$1.2 billion of debt
  - » Median rating of A1 by number of institutions, Aa3 weighted by rated debt

Source: Moody's Municipal Financial Ratio Analysis, ratings as of September 30, 2013.

# Multiple Factors Drive Ratings

Moody's ratings are based both on a university's current risk profile as well as our expectations of the future.

## Market Position

- Competitive position: enrollment, research, patient care, philanthropy, faculty
- Position in global, national, state higher education framework

## Management and Governance

- Strategic, financial and capital planning
- Policies and procedures
- Risk management and mitigation
- Depth and quality of management team and board

## Operating Performance

- Revenue and expense trends and prospects
- Sufficiency of net revenues to pay both debt service and also strategically invest in facilities and programs

## Financial Reserves And Liquidity

- Current and projected level of financial reserves
- Liquidity and availability of reserves
- Other sources of liquidity

## Debt and Other Liabilities

- Current and projected levels of debt
- Other obligations: leases, pensions, post-retirement obligations, swaps
- Need for future capital investment

## Debt Structure

- Interest rate and liquidity risk
- Debt service schedule (amortizing, bullet, etc)
- Legal structure: security package and covenants

# 2014 Outlook for US Higher Ed

**Outlook Horizon:** 12-18 months

## Key Drivers

1. Slowly growing revenue eclipsed by pressure to increase expenses
2. Heightened competition, including changing delivery and business models
3. Flat to declining governmental funding and apportionment may not be predictable
4. Political scrutiny and increased regulatory oversight add uncertainty

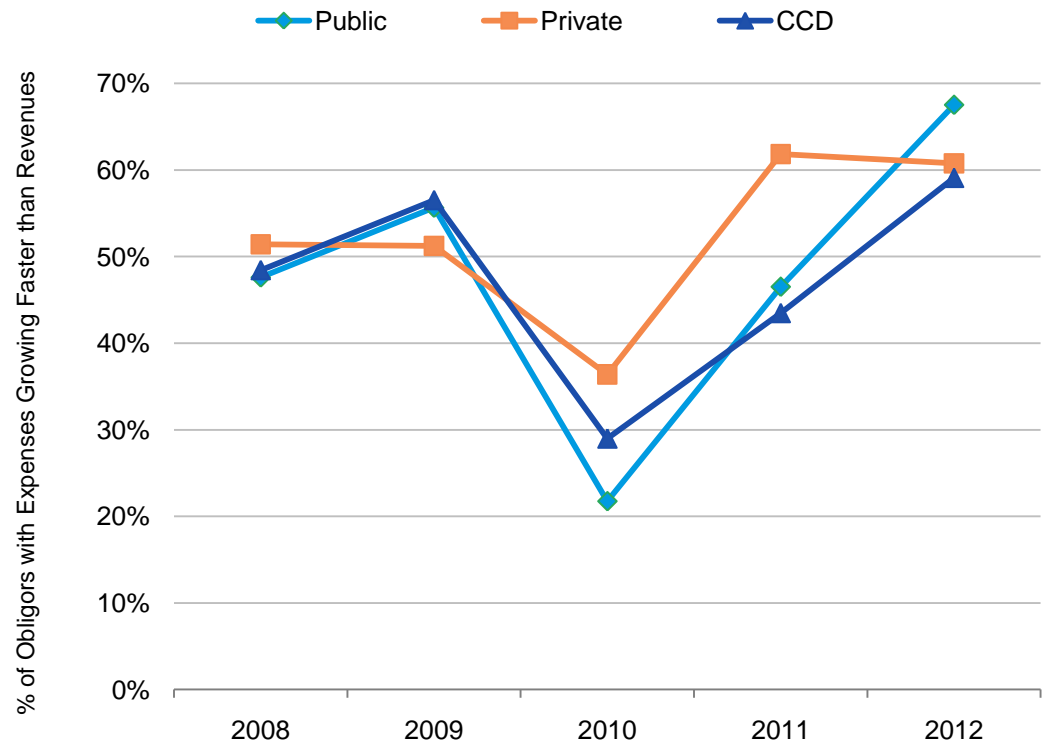
## Counterpoints

1. Proven adaptability to weak economic conditions
2. Fundamental demand for higher education is still high
3. Stronger earnings by educational attainment

# Revenue Growth Slows While Expense Pressure Builds

- » Operating margins expected to contract
- » Continued focus on affordability will result in weak net tuition revenue growth
- » Value of higher education questioned as student loan default rates continue to rise
- » Investments and Philanthropy: Better returns, but volatile; increasing global competition for philanthropy

## Expense Growth Exceeds Revenue Growth

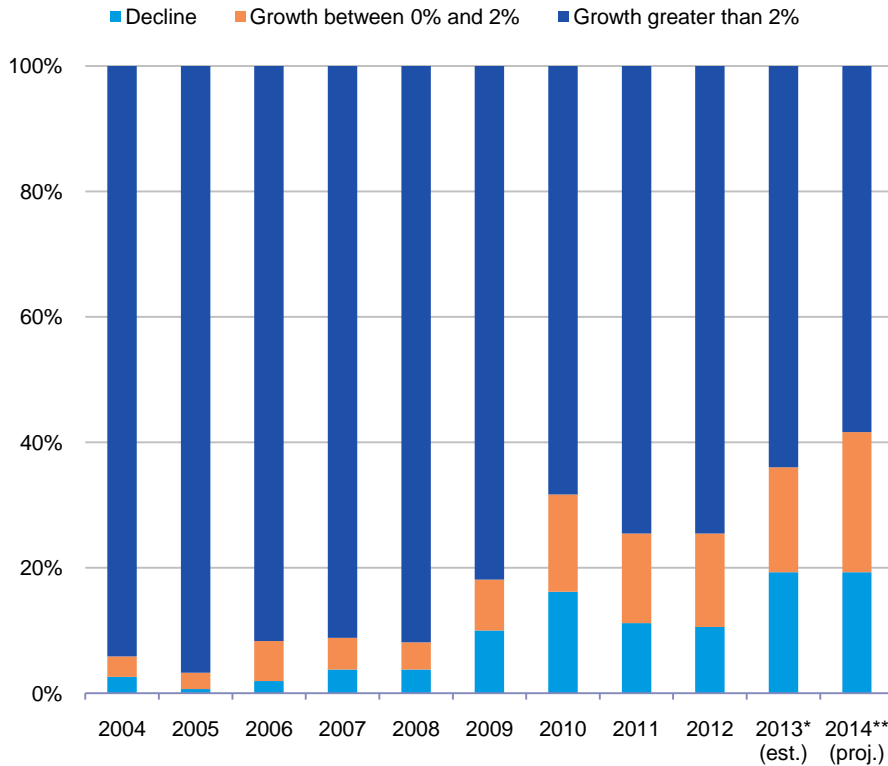


Source: Moody's Municipal Financial Ratio Analysis

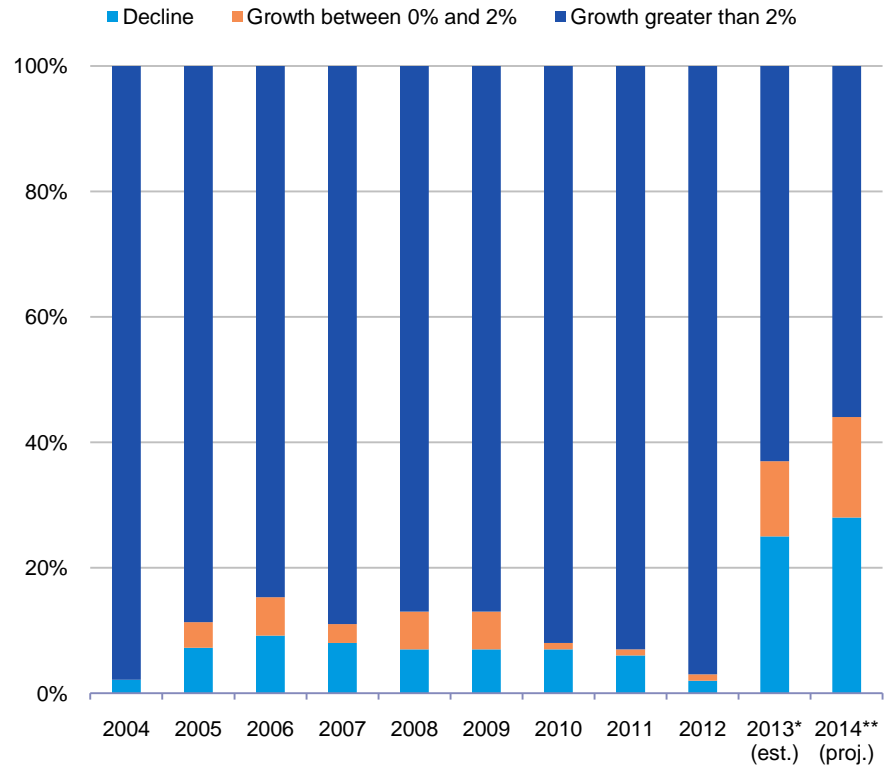
# Weak Net Tuition Revenue Growth for Large Majority

## Net tuition revenue declines anticipated in FY 2014

### Private Universities



### Public Universities

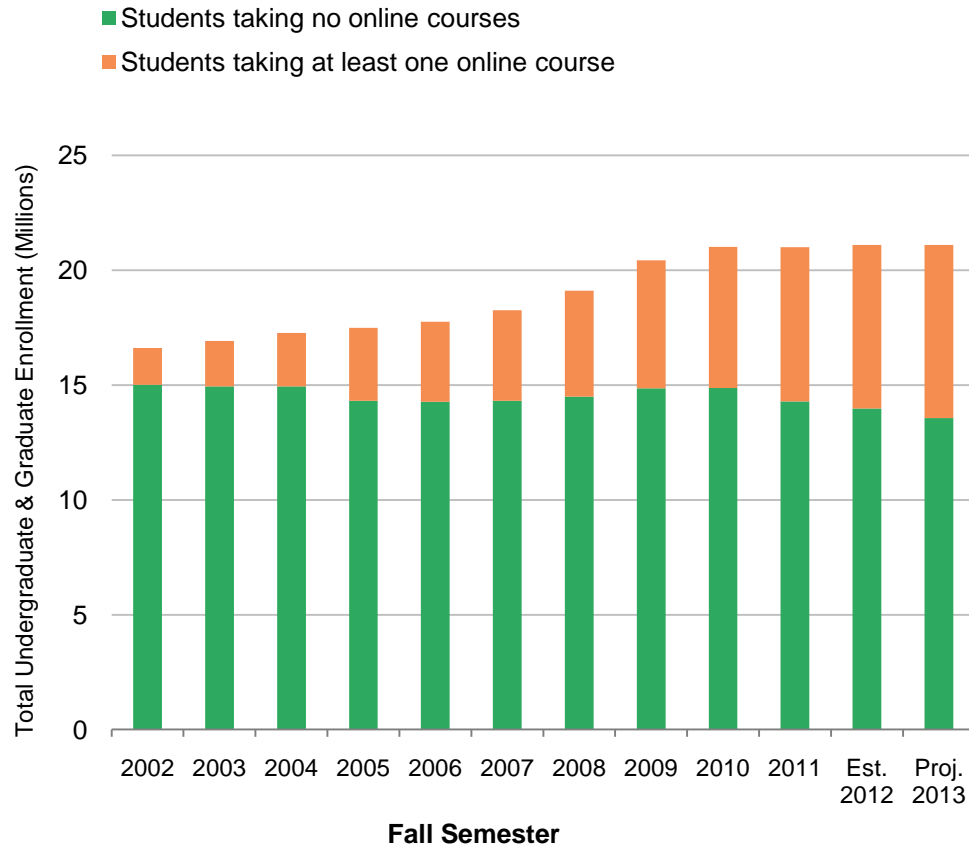


Note: FY 2004 to FY 2012 data are actuals. \*FY 2013 estimated; \*\*FY 2014 projected

Source: Moody's Municipal Financial Ratio Analysis (FY 2004 - FY 2012); Moody's 2013 Tuition Survey (FY 2013 - FY 2014)

# Changing Business Models Increase Competition

## Growing Penetration of Online Courses



- » Traditional model is less sustainable in highly price-sensitive market
- » Focus on efficiency of delivery
  - On-line
  - Competency based
  - Shorter time to completion
  - Stacked degrees
- » MOOCs and other content-sharing delivery models are evolving
- » Unbundling of services at universities and not-for-profits

Source: Babson Survey Research Group, Sloan Consortium - Changing Course: Ten Years of Tracking Online Education in the US, Jan 2013; Estimate – Moody's

# Government Funding Will Remain Constrained

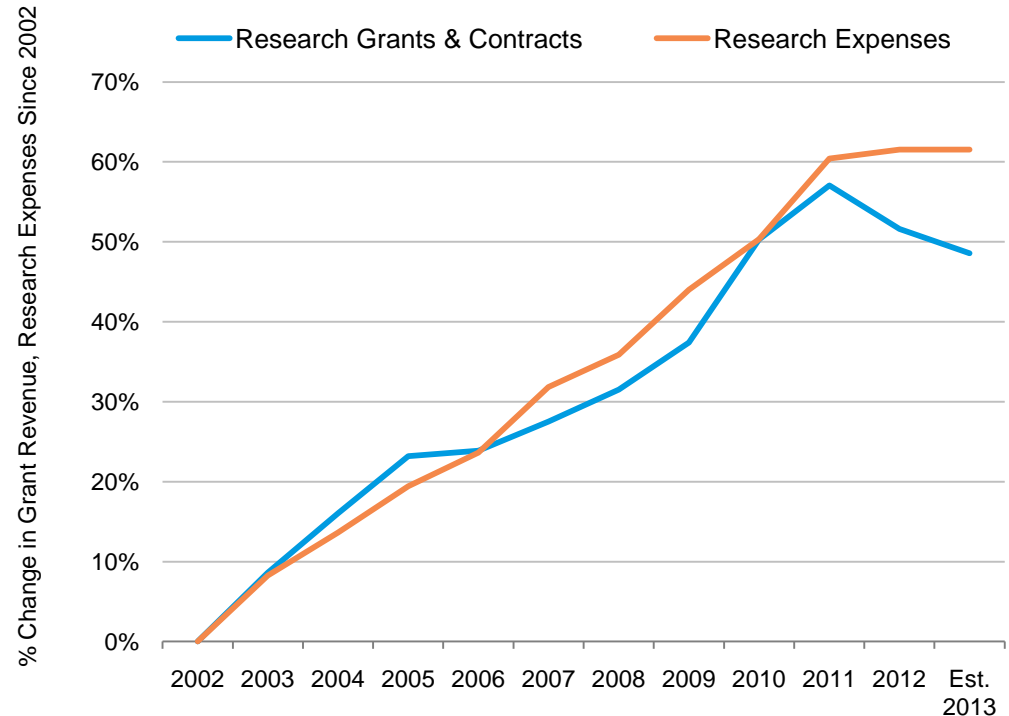
## Federal Budget Prioritization

- » Debt ceiling & budget negotiations add uncertainty
- » Higher Ed Act reauthorization scheduled for 2014 may impact federal financial aid

## Research

- » Funding expected to be cut annually for 10 years through sequestration
- » Growing competition for non-governmental funds
- » Expense cuts lagging
- » Research is beginning to compete for fundraising

## Research Expense Growth Outpaces Growth in Grants



Source: Moody's Municipal Financial Ratio Analysis; Estimate – Moody's  
Research Universities are defined universities with over \$500 million in operating revenue and either \$150 million in grants & contracts or more than 15% of revenue from grants & contracts  
Change is dollar weighted, from FY 2002 to 2013

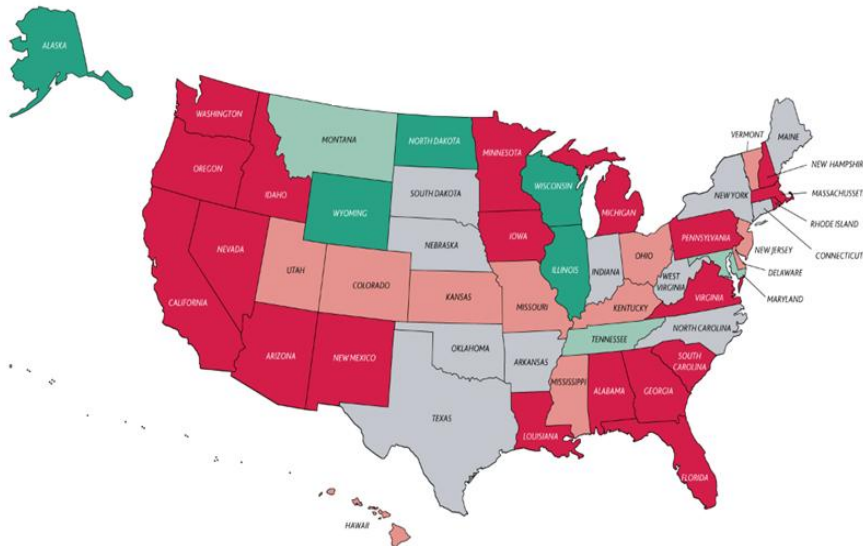


# Government Funding Will Remain Constrained, cont.

## State Support Mixed

Five-Year Change in State Funding FY 2008 - 2012

- Grew more than 15%
- 5% to 15%
- -5% to 5%
- -15% to -5%
- Declined more than 15%



- » State operating support as a percent of total revenue continues to decline
- » Some states require that universities hold resident tuition flat in exchange for increased appropriations
- » Performance based funding models being explored nationally

Source: Moody's Municipal Financial Ratio Analysis

# Political and Regulatory Pressures Add Uncertainty

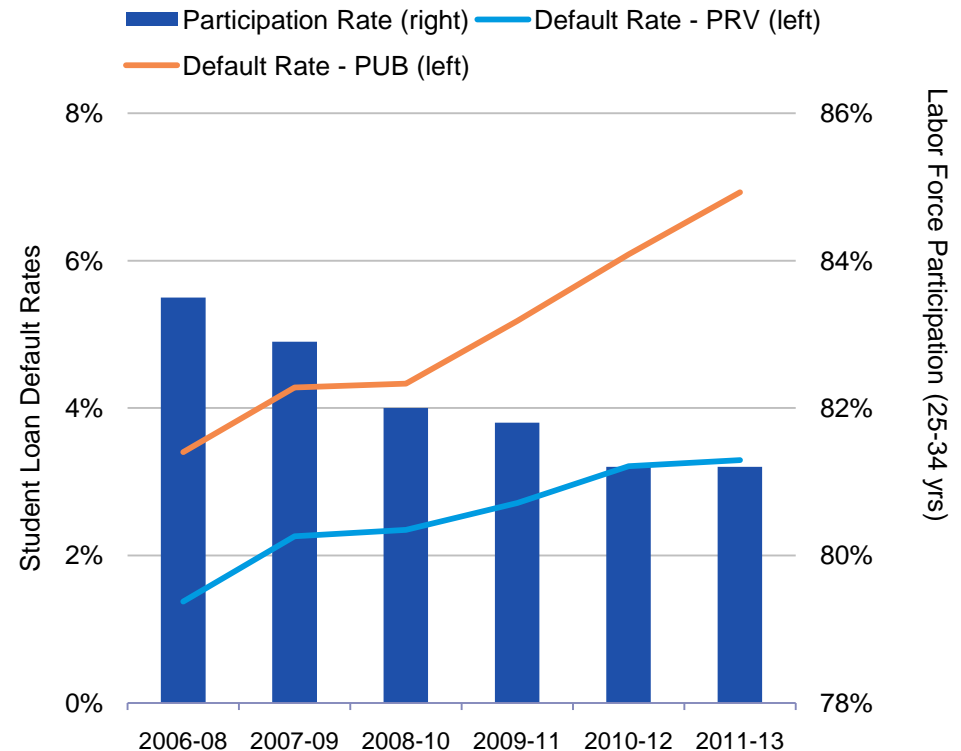
## » Proposed Federal Higher Ed Scorecard

- College ratings system to be implemented in 2014, focusing on outcomes
- Expected to keep pressure on access and affordability

## » Push for Greater Regulation

- Continued pressure by accreditation bodies via sanctions

## Student Loan Defaults Rise as Labor Participation Remains Suppressed



Source: US Department of Education; US Bureau of Labor Statistics

# What Could Change the Outlook to Stable for Higher Education and Not-for-Profits?

- » Indication that revenue growth will stabilize to a level that matches or exceeds expense growth
- » Demonstrated ability to generate cash flow sufficient to invest in facilities expansion and renovation

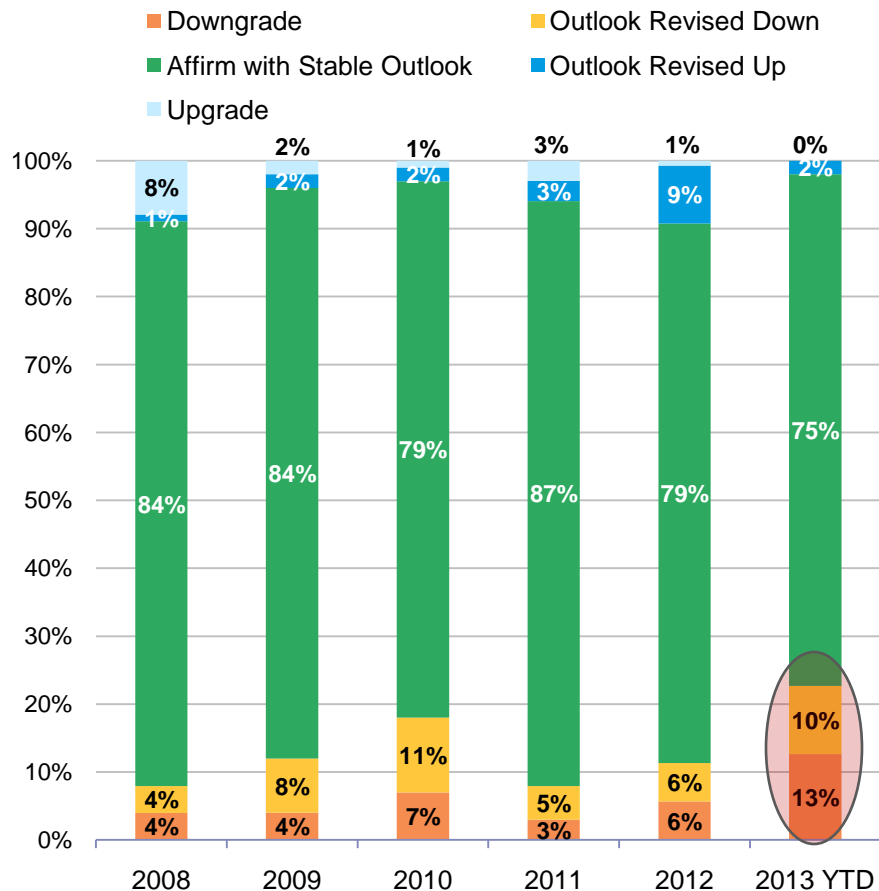
## KEY RATIOS FOR FY 2012 SUPPORT NEGATIVE OUTLOOK

Percent of portfolio with:	Revenue growth > expense growth	Operating cash flow margin < 10%	Capital spending ratio < 1.0
<b>Public Universities</b>	32%	35%	23%
<b>Private Universities</b>	39%	23%	32%
<b>Community Colleges</b>	41%	38%	26%

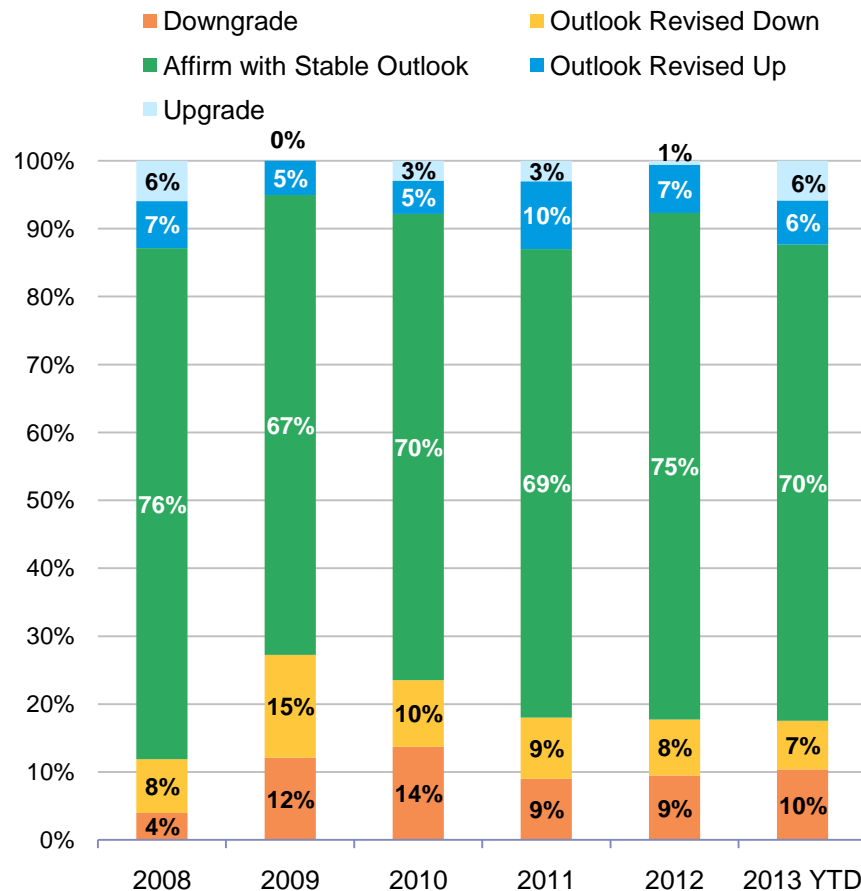
Source: Moody's Municipal Financial Ratio Analysis

# Ratings in Practice: Relative Stability, But Some Negative Trend, Especially at Public Universities

## Public University Rating Activity



## Private University Rating Activity



Source: Moody's; represents rating activity from Jan 1, 2013 to November 25, 2013.



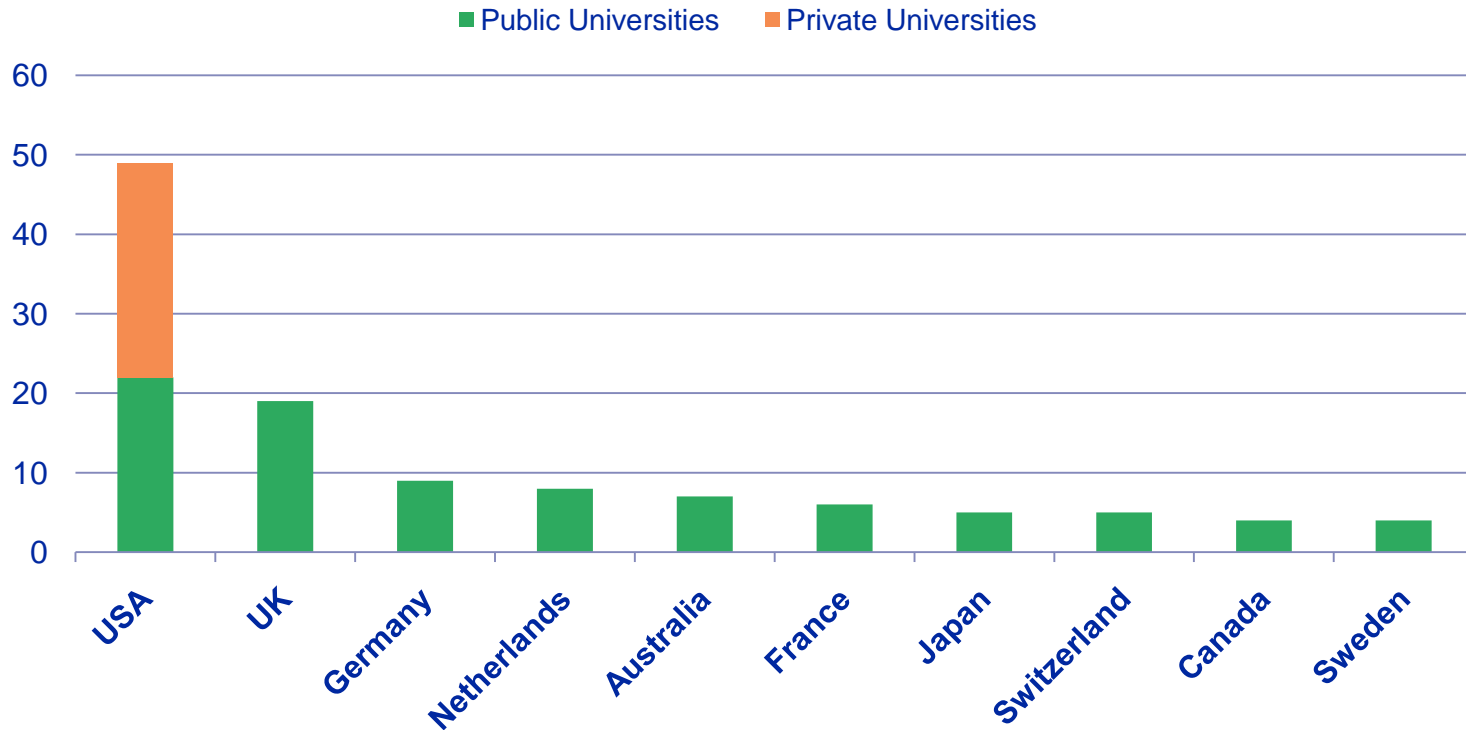
# Focus on Public Research Universities

# Core Strengths of Public Research Universities

- Market Reputation Leaders
- Larger Scale of Operations and More Diversified Revenues
- Greater Wealth
- Flexibility to Cut Spending

# Market Reputation Leaders: U.S. Research Universities Dominate Global Reputation Rankings

# Universities ranked in top 100 in at least one global rank [1]

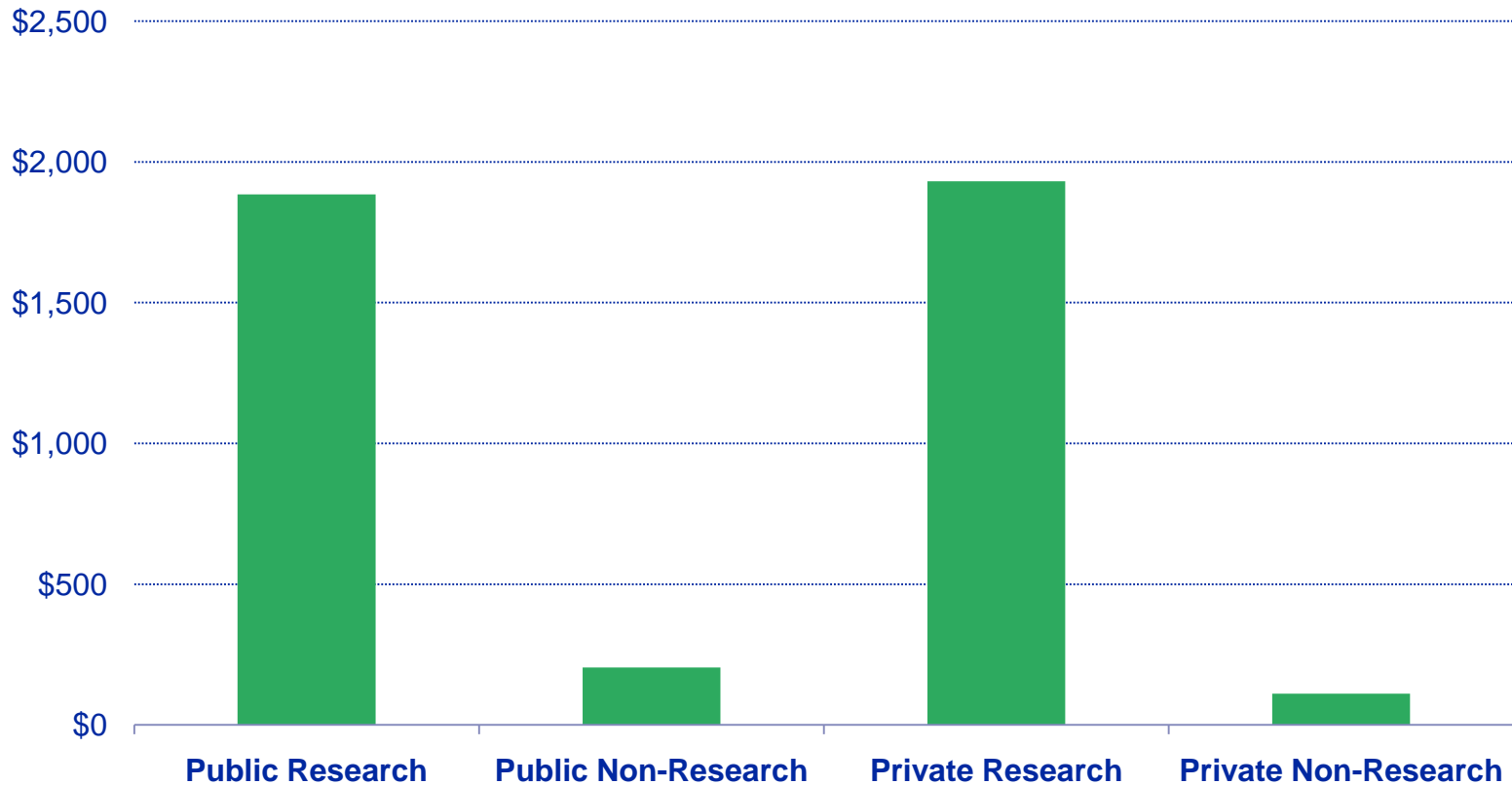


[1] Global Ranks include Times (UK), Shanghai, and US News

Source: Times (UK) World University Rankings; Shanghai World University Rankings; US News World University Rankings

# Research Universities Operate on a Larger Scale

Median total operating revenue (\$, million)



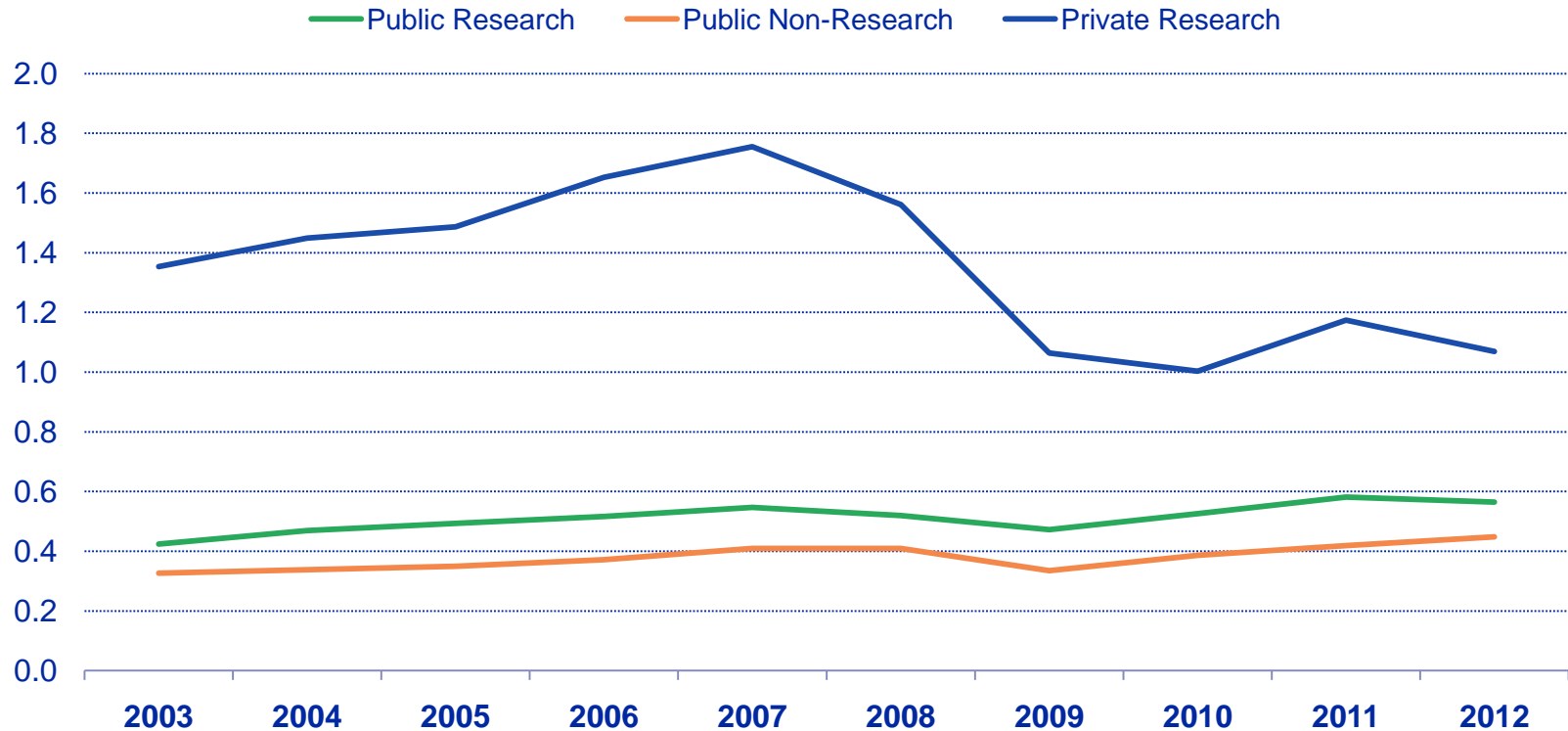
Source: Moody's Municipal Financial Ratio Analysis

Research Universities are defined universities with over \$500 million in operating revenue and either: \$150 million in grants & contracts or more than 15% of revenue from grants & contracts



# Research Universities have Larger Balance Sheet Cushions than Non-Research Peers

Median expendable financial resources-to-operations (x)

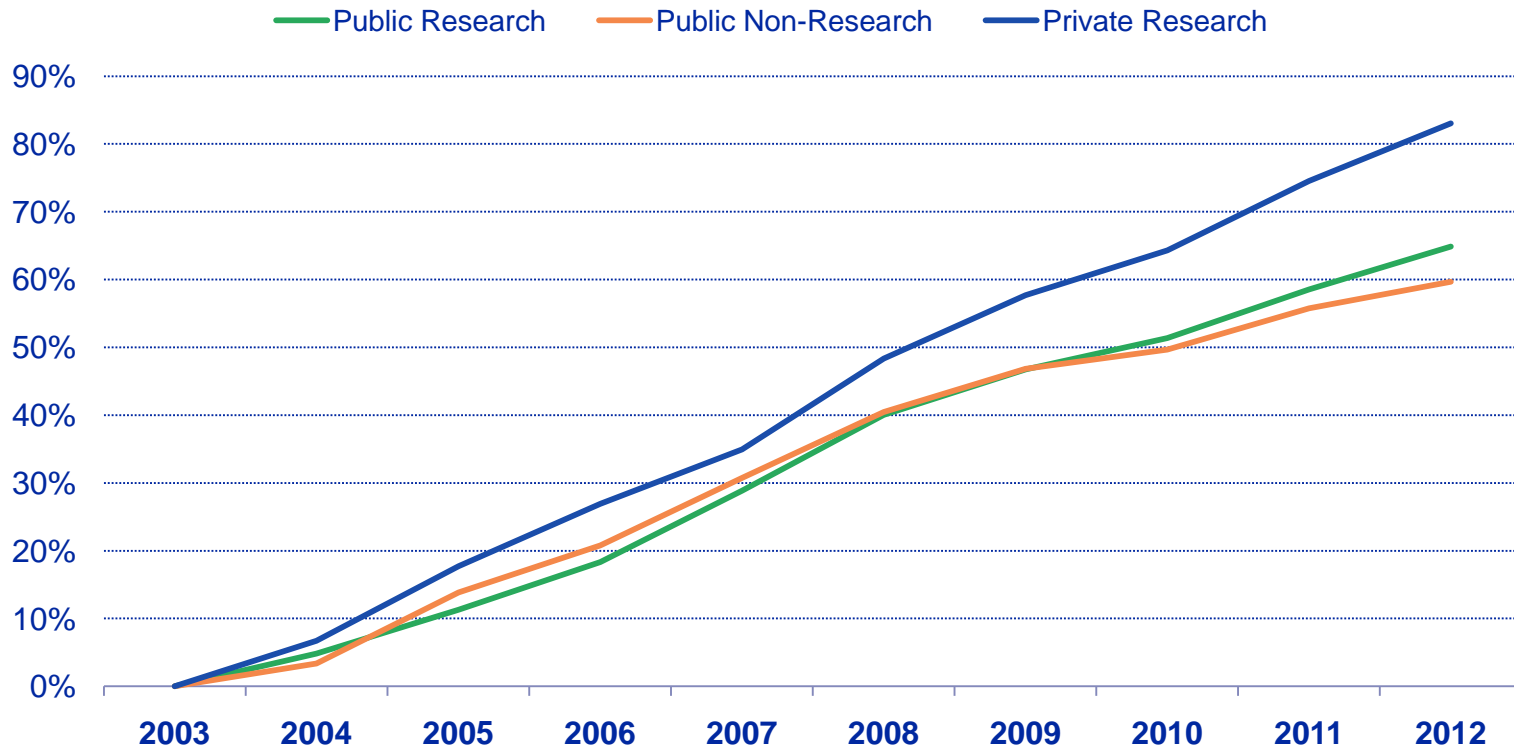


Source: Moody's Municipal Financial Ratio Analysis

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# Expenses have Grown Steadily, Though Not as Steeply as at Private Research Universities

Change in Total Expenses since FY 2003 (aggregate)



Source: Moody's Municipal Financial Ratio Analysis

Research Universities are defined universities with over \$500 million in operating revenue and either: \$150 million in grants & contracts or more than 15% of revenue from grants & contracts

# Appendix 1: University of Minnesota

# University of Minnesota Market Position Ratios

	2008	2009	2010	2011	2012
<b>FTE enrollment</b>	58,504	60,487	61,146	61,739	61,794
<b>First Year Accept Rate (%)</b>	57	55	54	52	55
<b>First Year Matriculation Rate (%)</b>	36	34	33	31	31
<b>Net tuition per student (\$)</b>	8,290	9,019	9,376	10,325	11,201
<b>Change in Net Tuition per Student (%)</b>	3.6	8.8	4.0	10.1	8.5
<b>Educational expenses per student (\$)</b>	32,859	34,667	33,649	32,997	33,708
<b>State appropriation per student (\$)</b>	12,793	12,098	10,768	10,194	9,266

Source: Moody's Municipal Financial Ratio Analysis

# University of Minnesota Operating Ratios

	2008	2009	2010	2011	2012
<b>Operating margin (%)</b>	1.2	-3.2	1.7	3.1	2.2
<b>Operating Cash Flow Margin (%)</b>	8.1	3.9	8.9	10.3	10.4
<b>Debt Service Coverage (x)</b>	2.8	1.6	3.0	4.5	3.0
<b>Return on net assets (%)</b>	-0.10	-9.0	6.3	10.4	3.4
<b>Return on financial resources (%)</b>	-1.8	-22.0	8.6	18.8	5.6
<b>% of Revenues Derived From:</b>					
<b>Student Charges</b>	28.8	29.7	30.4	33.0	34.7
<b>Grants &amp; Contracts</b>	30.0	29.6	33.3	34.1	33.4
<b>State Appropriations</b>	27.3	25.7	22.2	21.0	19.0
<b>Gifts</b>	4.6	4.7	4.3	5.0	4.8
<b>Investment Income</b>	2.9	3.1	2.8	2.8	2.8
<b>Other</b>	6.3	7.3	6.9	4.1	5.4

Source: Moody's Municipal Financial Ratio Analysis

# University of Minnesota Balance Sheet Profile

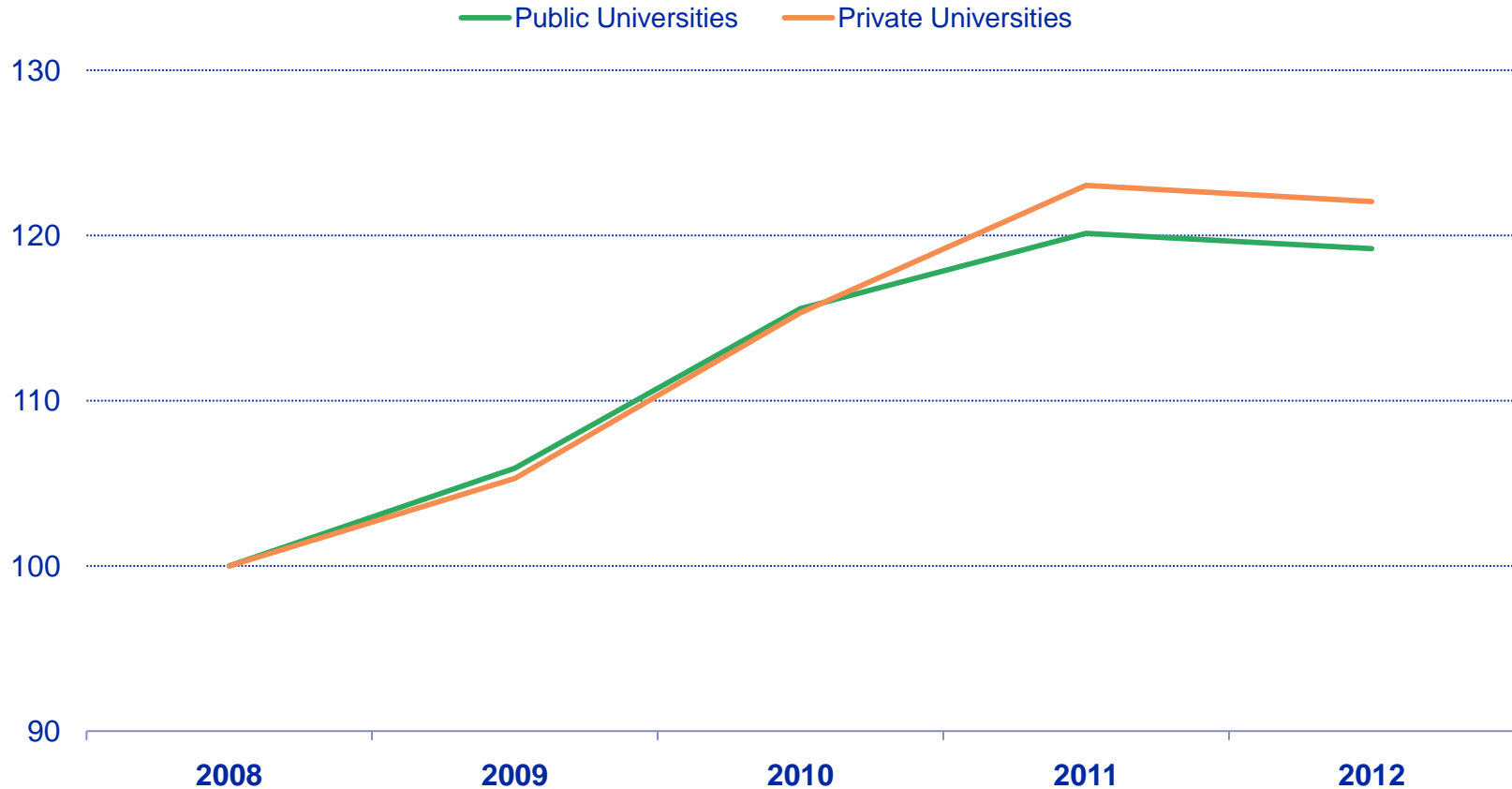
	2008	2009	2010	2011	2012
<b>Total Direct Debt (\$M)</b>	868.87	972.54	1150.14	1198.41	1215.55
<b>Total Financial Resources (\$M)</b>	3519.81	2745.04	2980.70	3539.79	3737.24
<b>Expendable financial resources to debt (x)</b>	3.00	1.90	1.80	2.10	2.20
<b>Debt-to-cash flow (x)</b>	4.60	12.52	4.99	4.49	4.53
<b>Debt to Operating Revenues (x)</b>	0.30	0.40	0.40	0.40	0.40
<b>Debt service to operations (%)</b>	2.92	2.35	2.98	2.37	3.60
<b>Capital Spending Ratio (x)</b>	2.40	2.10	1.60	1.40	1.40
<b>Expendable financial resources-to-operations (x)</b>	0.96	0.64	0.70	0.87	0.90
<b>Monthly Days Cash on Hand (x)</b>	N/A	80.95	92.53	110.00	129.28

Source: Moody's Municipal Financial Ratio Analysis

## Appendix 2: Additional Research Information

# Private Research Universities have had Slightly More Success Growing Research Funding in the Last Two Years

Total Research Grants & Contracts (Indexed; 2008 = 100)



Source: Moody's Municipal Financial Ratio Analysis

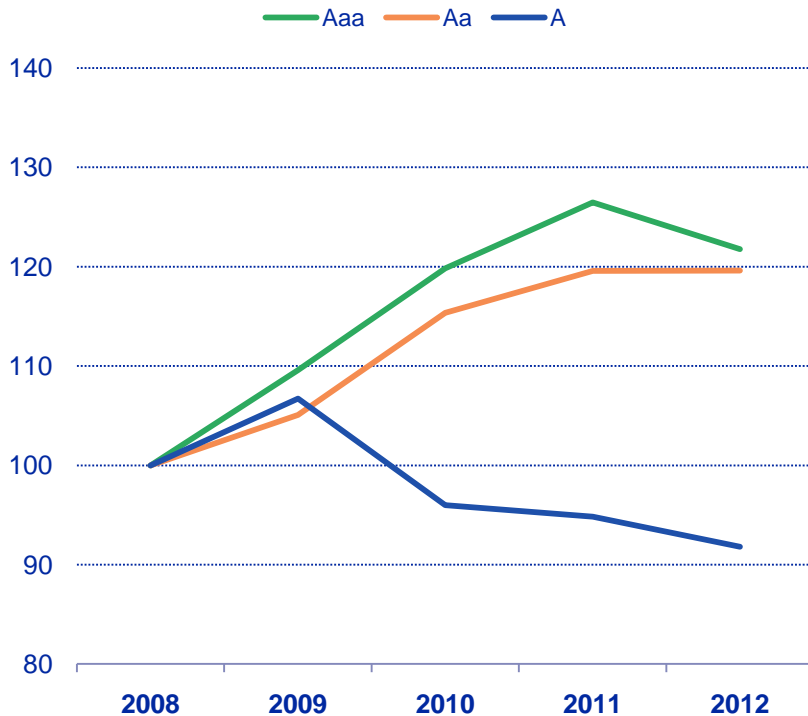
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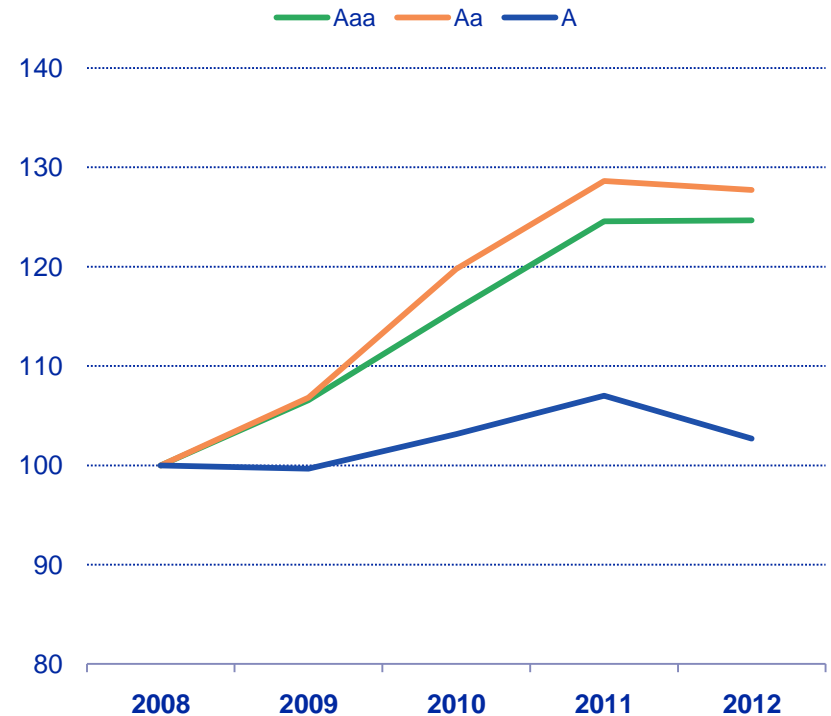
# Funding for Higher Rated Research Universities has Grown, While Funding for A-Rated has Stagnated or Declined

Total Research Grants & Contracts (Indexed; 2008 = 100)

Public Research Universities



Private Research Universities

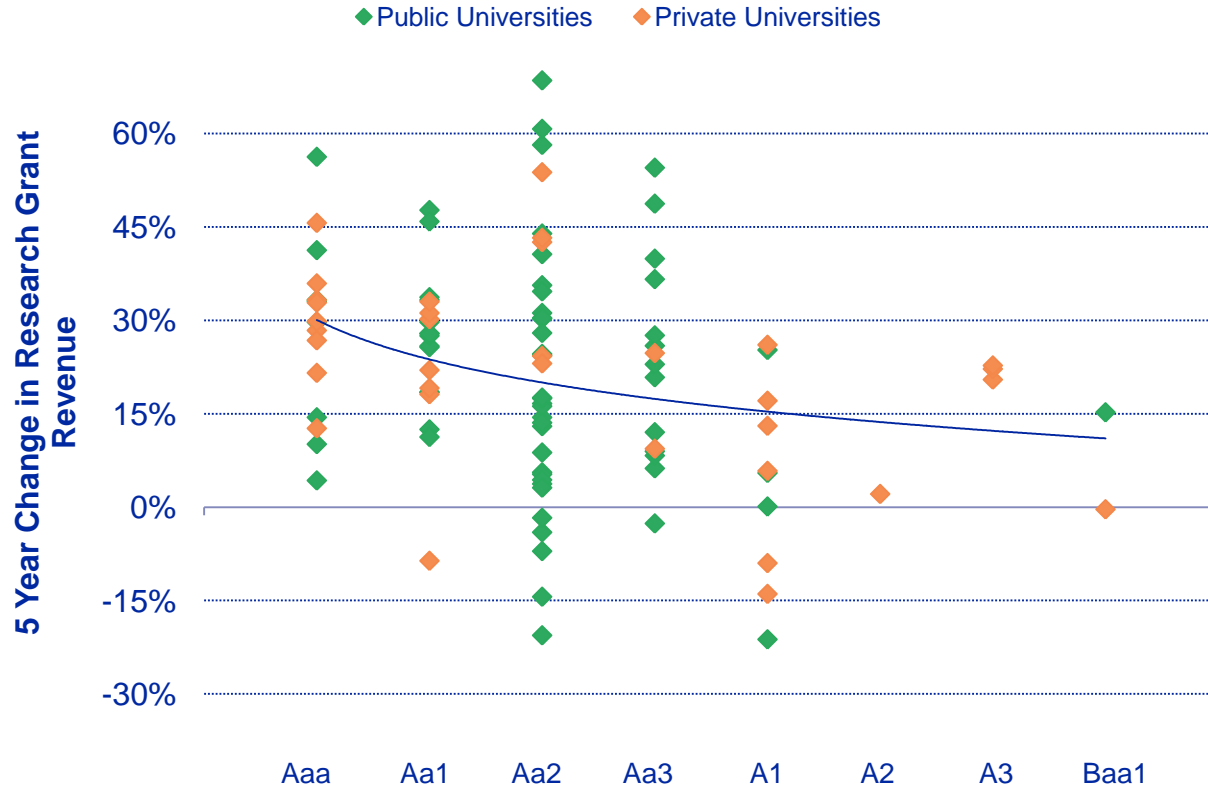


Source: Moody's Municipal Financial Ratio Analysis

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# Higher Rated Universities Typically have Stronger Growth in Research Funding

5 Year Change in Research Grant Revenue, FY 2008 - 2012

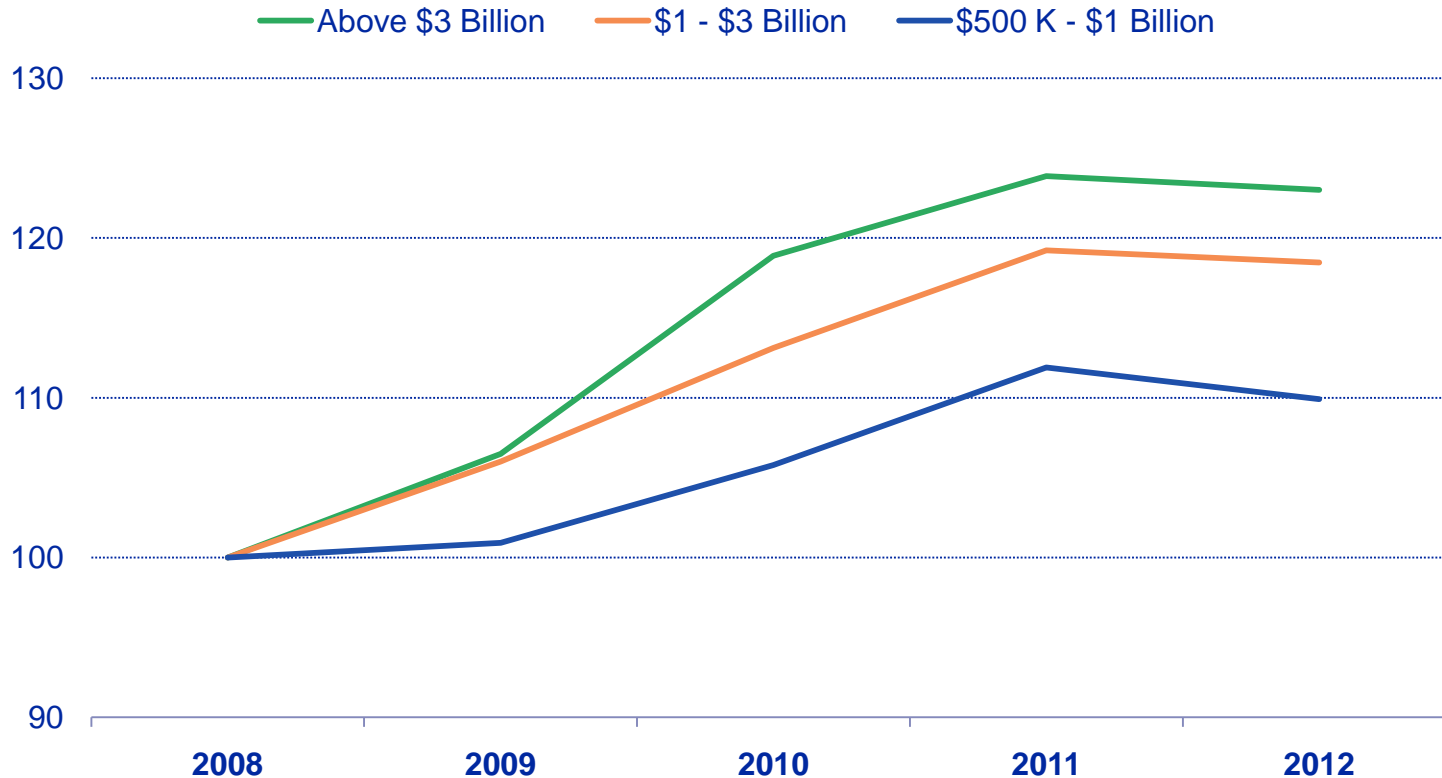


Source: Moody's Municipal Financial Ratio Analysis

Research Universities are defined as universities with over \$500 million in operating revenue and either: \$150 million in grants & contracts or more than 15% of revenue from grants & contracts

# Larger Research Universities have had More Success Growing Research Funding

Total Research Grants & Contracts, By Size of Operating Revenue (Indexed; 2008 = 100)

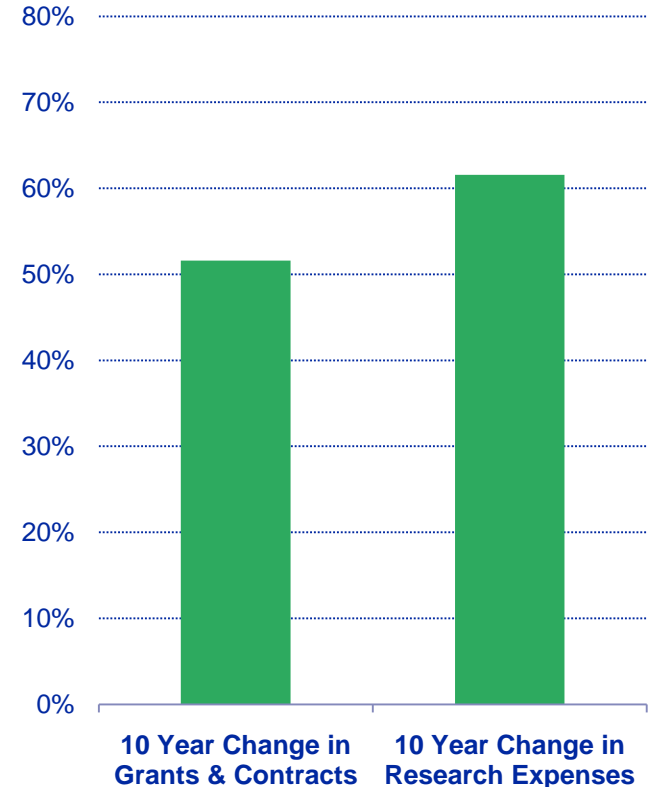
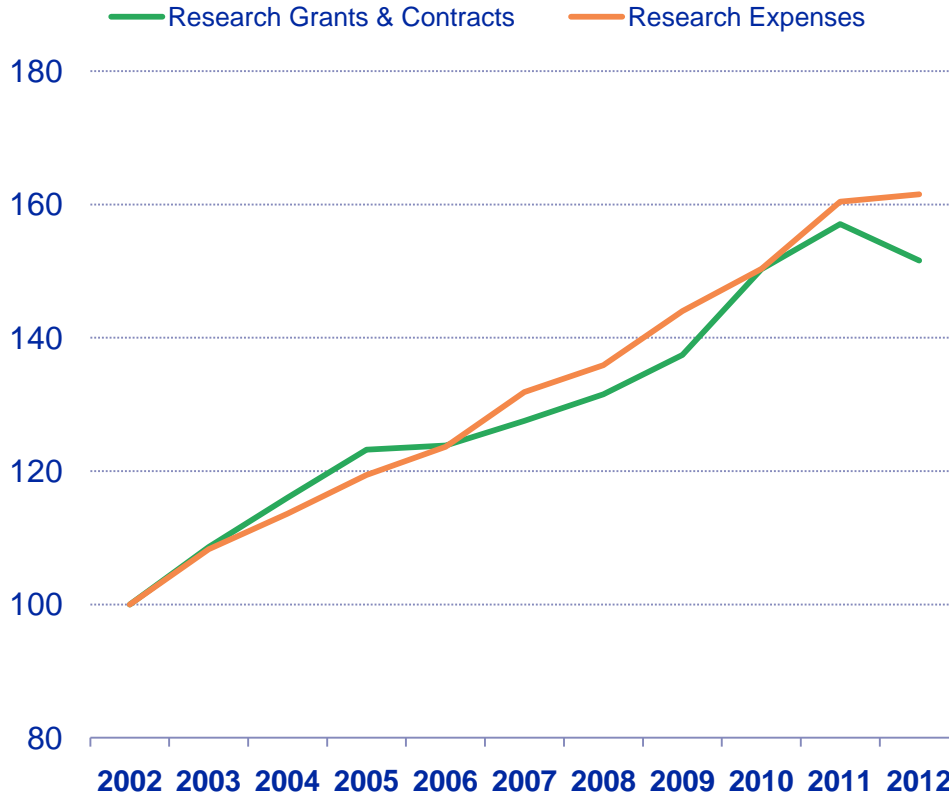


Source: Moody's Municipal Financial Ratio Analysis

Research Universities are defined universities with over \$500 million in operating revenue and either: \$150 million in grants & contracts or more than 15% of revenue from grants & contracts

# Research Expense Reductions Lag Cuts Research Grants and Contracts

Total Research Grants & Contracts, Expenditures (Indexed; 2008 = 100)



Source: Moody's Municipal Financial Ratio Analysis

Research Universities are defined universities with over \$500 million in operating revenue and either: \$150 million in grants & contracts or more than 15% of revenue from grants & contracts

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