Moody’s Approach to P3 Projects in Higher Education

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Moody’s Investors Service
Agenda

- Overview of Moody’s and Higher Ed Team
- Rating Approach for Colleges & Universities
- Student Housing: Higher Ed’s Favorite P3
- Other P3s and Potential Credit Impacts
Portoflio Summary:  
700 Rated Organizations

- **Private Higher Education:** Nearly 300 organizations with $39 billion of outstanding debt; Average rating of A3

- **Public Higher Education:** Approximately 200 organizations with $65 billion of outstanding debt; Average rating of A2

- **Community Colleges:** Approximately 60 organizations with revenue debt (a joint analysis with regional analyst)

- **Not-for-Profit Organizations:** More than 80 organizations with $7.6 billion of outstanding debt; Average rating of A1

- **Preparatory Schools:** 59 organizations with $1.4 billion of outstanding debt; Average rating of A2

- **Public University Affiliated Foundations:** 7 foundations with $550 million of debt
Rating Distribution of Moody’s-Rated Private and Public Colleges and Universities
(excludes Insured-only, LOC-backed & privately rated)
Modest Rating Volatility: Private Colleges & Universities

<table>
<thead>
<tr>
<th>Year</th>
<th>Private College Upgrades</th>
<th>Private College Downgrades</th>
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<tbody>
<tr>
<td>2001</td>
<td>15</td>
<td>5</td>
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<td>2006</td>
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Upgrades Outpaced Downgrades

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Upward Ratings Trend: Shows Strength of Public Universities

Almost All Downgrades are "Stories"
Key Credit Trends Facing Sector

- Changing Demographic Environment
- Flattening of Federal Research Funding
- Increasingly Complex Debt and Investment Management Strategies
- Evolving Relationship Between Public Institutions and Sponsoring States
- Growing Governmental Scrutiny and Potential for Increased Regulation
- Balance of Power Between Faculty, Administration, Board in Increasingly Market Based Industry
Moody’s “Big Picture” Approach

- Accounting treatment is less important than economic motivations
  - *Off-Balance Sheet does NOT equal Off-Credit*

- Legal requirements are often surpassed by universities if it’s strategically and financially important to them

- Indirect support of a project more likely than direct payment of debt service
A Note on Moody’s Existing Ratios

- Direct, Indirect and Comprehensive Debt

- Indirect Debt includes:
  - Capitalized Operating Leases
  - Difference b/t PBO and Fair Value of Defined Benefit Pension Plans
  - Debt associated with projects not directly issued by university (ie. privatized student housing)
Review of Privatized Student Housing: Higher Ed’s Favorite P3
Privatized Student Housing: Moody’s Rated Transactions

- Moody’s rates 53 housing transactions; $1.8 billion of debt
  - 27 ($1.2 billion) based on underlying credit quality
- Majority at public universities
  - Speed of construction
  - Avoidance of higher cost labor requirements
- Almost all rated in the Baa category
  - Would not get to Baa if University wasn’t stronger
Privatized Student Housing: Often **ON CREDIT**

- Housing is core to operations, market position and mission of most institutions

- Projects usually on university land, often on core campus; Universities don’t move & treat land as “endowment-like”

- University often has some operational role (marketing, management, referrals, etc.)

- University owns the building after financing

*See Moody’s: “Privatized Student Housing & Debt Capacity”, Oct. 2006*
Privatized Housing: Opportunity Costs

- University foregoes a typically high-margin business of student housing
- University foregoes an element of pricing flexibility and future competitive pricing ability
- University foregoes some control of a component of campus life that provides competitive differentiation
Discounting the University Contribution?

- University brings a lot to the table:
  - *Your students*
  - *Your land (often)*
  - *Your name*

- Almost ZERO chance of a privatized housing project achieving investment grade if the University wouldn’t on its own
**Varying Impact of Privatized Housing Debt**

**Various Degrees of Affiliation**

- **Weak**
  - No University involvement in management, marketing or directing students
  - University does not receive residual cash flow or project at end of financing term
  - No direct/indirect assistance

- **Average**
  - University involved in management and marketing
  - University receives residual cash flow and/or project at end of financing term
  - Ground lease between the foundation and university
  - University or affiliated foundation owns underlying land

- **Strong**
  - All components of average plus 1 or more:
    - Interim loan to construct the facility eliminating construction and lease up risk
    - Support agreement
    - First fill policy
    - Rent guarantee
    - Direct management of facility
    - Non-compete clause
When Things Go Wrong: History of Troubled Projects*

- **Take Direct Control and Financial Obligation**
  - Texas State University System

- **Provide Direct Financial Support**
  - University of Colorado

- **Limited Support**
  - University System of Maryland

- **No Support**
  - Joliet Junior College

*See Moody’s : “Privatized Student Housing and University Support”, Jan. 2007
The New Frontier:
Other P3s Outside of Higher Ed
Government and Infrastructure P3’s

- Strong and increasing interest from governments in various structures
  - Government Procurement (paid for hitting milestones)
  - Concession w/o Market Risk (paid as long as asset is “available”)
  - Concession w/ Market Risk (paid based on utilization and fee collections)
  - Recent Examples: Chicago Skyway; Indiana Toll Road; Texas SH121
Why Higher Ed Perspective on P3’s is Different Than Government Perspective

- Higher Ed is Market-Driven, Not Election-Driven
  - Private & public sector in head-to-head competition
  - Public appropriations continue decline as % of rev
  - Competitive strategies are essential to future success

- Higher Ed Pricing determined by Supply & Demand; Toll Rates Ultimately Set by Elected Officials

- Higher Ed customers have many choices; Users of Government-owned monopolies have little choice

- Long Term Reputation is Essential to Universities; Short-term Reputation is Essential to Elected Officials
Other Versions of Partnerships

- Partnering for core facilities:
  - With City: ice rink, library, etc.
  - With Private Developers: research facilities and research parks
  - With Other Institutions: shared or co-located facilities

- Partnering for non-core facilities:
  - Commercial development
  - Retirement communities
New Frontiers?

- Excess real estate strategies
  - Ie. “monetize an asset”
- Monetization of other revenue streams:
  - Ie. ICR, royalty securitization
- External equity investment in projects
- Asset sale, lease-back models
Key Questions Moody’s Will Ask

- Is this a financial transaction or a strategic project? (short-term vs long-term)
- How “core” is the project to the mission, market position, and operation of the University?
- What benefits does the University gain from the proposed structure of the financing?
- What would the University likely do if the project were to struggle/fail?
How Core is the Project?

- Academic & Basic Research Buildings
- Auxiliary-Housing, Parking, Dining
- Student College Towns/Tech Parks
- Retirement Communities w/ Academic Links
- Retirement Community-Unaffiliated
- Non-adjacent Real Estate
Measuring Impact on Debt Capacity

Academic Buildings
Research Buildings
Student Housing
Sports Facilities
Campus Parking
Tech Research Parks
Student Village/Retail
Retirement Community
Market-Rate Housing

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Q&A

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