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Special Comment

Campus Real Estate: A Financial Asset?

Introduction

Moody's has recently broadened its view of the value of campus real estate as a potential financial asset. While historically we have not given any quantitative value to campus real estate when calculating the financial resources of a college or university, in certain select cases we may now include a portion of an institution's campus assets in our calculation of their financial strength.

In this Special Comment, we discuss our approach to analyzing campus real estate. We also provide an illustration of one institution, New School University, whose campus real estate is a contributing factor in its bond rating.

Why Hasn't Moody's Historically Incorporated Real Estate

Our general approach has been, and in most cases will continue to be, to give no direct credit for campus real estate in our analysis of an institution's financial strength. This is based on several factors:

- **Going Concern:** Since most ratings are for institutions that are expected to continue operating, there is the assumption that they will need to use their facilities. Therefore, the value of the real estate only becomes relevant in a bankruptcy or severe financial stress situation.

- **Alternative Use:** The vast bulk of college or university buildings are not traditional office or apartment buildings, but rather are specifically designed as classroom buildings, student residence halls, research facilities, libraries, etc. As such, the alternative use of such facili-
ties to anyone other than another educational institution is unclear. Also, the location of most buildings, in the midst of a university campus, further limits the alternative use of facilities.

- **Liquidity:** Campus real estate is highly illiquid compared to cash and investments. Even if a building could be sold, this would likely take months if not years to accomplish.

- **Lack of Reliable Information Regarding Market Value:** The value of real estate as carried on the financial statements of an institution typically does not reflect its current actual market value. Since most colleges and universities do not get regular appraisals of their property, it is difficult to know the true value of campus real estate.

- **Integrated Utilities:** Most campuses have shared utility networks, making it difficult to sell off an individual building that lacks its own utilities.

There may be additional obstacles to the treatment of real estate as a financial asset. For example, the marketability of buildings with historic designations may be limited due to regulations on the use and alteration of these facilities. There are also certain markets where development of campus land or the sale of the real estate could be heavily opposed by the surrounding community, in which case we believe political environment could limit liquidity over a medium-term time frame.

While we have not historically included campus real estate in our calculations of financial assets, Moody’s has in some cases qualitatively incorporated the potential value of real estate in our ratings. For certain urban institutions, ratings are higher than their pure financial ratios would suggest, reflecting this non-quantitative approach as well as other factors that provide urban universities with more flexibility than their rural counterparts.

**When Will Real Estate Be Incorporated?**

In order for Moody’s to incorporate campus real estate as a financial asset, the property needs to meet certain criteria, corresponding to the factors outlined above:

- **Alternative Use:** Since in most cases it is unlikely that another higher education institution will be purchasing the assets, they must have demonstrable use to potential non-academic purchasers.

- **Liquidity:** There would have to be a reasonable expectation that the property could be sold within a medium-term time frame, typically defined as within two years.

- **Separability:** Assuming that the institution is a functioning concern, buildings or portions of the campus would need to be saleable without affecting the ongoing operation of the college or university.

- **Appraisal or Reasonable Assessment of Market Value:** We would need to get some reasonable estimate of market value, typically through a formal appraisal or through specific information regarding the real estate market in the campus area.

**Headquarters Facilities for Not-For-Profit Organizations**

Another scenario where we sometimes incorporate real estate into our financial analysis relates to not-for-profit organizations, many of whom own and occupy headquarters facilities in vibrant real estate markets such as New York City, Washington, DC, suburban Maryland or northern Virginia. Many of these headquarters facilities are high-quality office complexes. In these cases, in a financial stress situation where the institution’s operations shrink, the real estate could plausibly be converted into a financial asset several different ways. The organization could either generate a revenue stream by renting out portions of their office building to other institutions, or, in an extremely stressful scenario, the organization could even liquidate their building and move to smaller, rented quarters. A mortgage pledge on such marketable, transferable headquarters can contribute to credit quality and a higher credit rating.
How Will Real Estate Be Incorporated?

We expect that the incorporation of real estate into our financial analysis will be done on a case by case basis, after dialogue with individual institutions. It is most likely that we will feel comfortable incorporating certain campus real estate assets associated with institutions in vibrant urban areas with no clearly defined campus boundaries. It is significantly less likely that we will incorporate real estate as a financial asset for traditional liberal arts colleges on contiguous campuses set apart from their local communities, rural institutions, or urban universities in economically depressed areas. In no cases will we incorporate public university real estate as a financial resource, given the typical need for multiple layers of governmental approval to sell the property, which is often owned by the state.

Moody’s calculates three levels of liquidity in assessing the financial strength of an organization: immediately available for any use (unrestricted), unrestricted funds plus those available over a medium-term time frame (expendable), and expendable funds plus any permanently restricted resources (total). In cases where we incorporate a portion of campus real estate as a financial asset, it will most commonly be in the expendable or total resource categories, not as unrestricted reserves, given the expectation that at least some time will be required to liquidate.

The Value of A Mortgage Pledge

Our view of the value of a mortgage pledge on campus real estate to bondholders is also affected by the above assessments. For most credits rated in the A category or higher, we believe a mortgage pledge provides limited incremental credit strength, and the mortgage will rarely, if ever, result in a higher rating. For credits in the Baa or lower categories, where longer-term risks are higher, we believe that a mortgage pledge can favorably impact credit quality. The value of the mortgage pledge depends on the ability of an institution to separate all or part of its campus while remaining an ongoing concern and on the potential marketability of campus assets in a bankruptcy situation.

Our View Of Endowment Real Estate

Many institutions also have a real estate investment component to their endowment. Our view of these assets depends on the diversity of the holdings and the purpose for which they are held. For example, we would view a diversified pool of real estate assets held purely for investment purposes as equivalent to other alternative assets within an institution’s endowment, and as part of an overall investment strategy, recognizing that real estate is less liquid than publicly traded stocks and bonds.

However, if endowment real estate includes such assets as faculty or graduate housing around the campus, or strategic investments in property close to the campus either to protect campus boundaries or for future potential growth, we could view these assets as more akin to campus real estate. In these cases, we may choose either to move the real estate from the institution’s unrestricted liquidity calculations to expendable or total resources, or even to reclassify the asset(s) as regular property, plant, and equipment, thereby removing them from resource calculations altogether.

Factors Leading Moody’s to Treat Campus Real Estate as a Financial Asset

- Campus is located in a thriving real-estate market.
- Campus property is not contiguous; buildings are interspersed with commercial and/or residential properties.
- Campus buildings have alternate non-educational use (office buildings, apartments, etc.).
- There is a reasonable expectation that buildings can be sold within a reasonable time frame.
- Each building has independent utilities.
- There is a reliable methodology for estimating campus real estate value (specific appraisal or comparable cost per square foot).
Our treatment of debt associated with endowment real estate follows the same analytical construct. Debt associated with real estate investment trusts or incurred on a non-recourse basis for assets that are not strategically important to the institution is not likely to be incorporated as part of an institution’s debt load. Debt associated with individual properties located around campus boundaries and held for strategic reasons could be incorporated either as direct or indirect debt of the institution, depending again on specific situational assessments.

Case Study: How New School University’s Campus Real Estate Factored Into Its Rating

The New School University, located in Manhattan, is an example of an institution whose campus real estate is highly marketable, and is a contributing factor in the University’s A3 rating. Located primarily in Greenwich Village, with satellite locations in other parts of New York City, the New School’s campus is situated in a prime residential and commercial real estate market. The campus buildings are not contiguous, although most of them are located within a radius of several blocks. Most of the buildings are remodeled commercial or residential structures that could be relatively easily reconfigured back to commercial or residential use. There is little question that these buildings would have significant value on the open market. Another highly attractive feature of the New School’s inventory of buildings is that each building has its own utilities; there is no shared campus grid for steam or chilled water. This would make it easier to sell off individual properties in the event of a significant enrollment decline or other credit deterioration.

When incorporating the potential value of the New School’s real estate as a financial asset, Moody’s applied a case-specific discount to the appraised value of the campus real estate, and then analyzed the University’s financial profile both including and excluding the real estate assets. The discount was applied to reflect the potential volatility of Manhattan real estate, the time necessary for sale, and the need for a base amount of facilities for the University to operate as an ongoing concern. The discount rate that Moody’s would apply to an institution’s real estate assets is situational, and could vary widely depending on specific circumstances.