Rising Energy Costs: No Credit Impact Expected for Higher Education Institutions Due to Budget Adjustments and Other Measures

Summary Opinion

While rising energy costs are challenging some institutions, we do not believe these increasing costs pose a significant credit risk given the flexibility many institutions have in adjusting their budgets, along with proactive measures at their disposal to address rising costs.

According to a voluntary survey conducted by Moody’s, rated institutions expect energy costs to continue to grow by 25% in 2006. As expected, institutions located in the Midwest and Northeast, where energy costs consume a larger portion of operating budgets due to wider seasonal variations in energy use compared to other regions, are bearing the brunt of the burden of rising expenses. Institutions have shown wide flexibility in addressing rising costs, ranging from budget adjustments, conservation measures, establishing contracts, and passing on costs to students via additional fees and surcharges.

Moody’s maintains ratings on 547 four-year public and private colleges, universities, and independent schools, with approximately $121 billion in total debt outstanding.

Survey Design

The voluntary survey was limited to three questions:

1. What percentage of the operating budget do energy costs compose?
2. What utility cost increases do you expect in 2006?
3. What budget adjustments have you made in light of rising energy costs?

Survey Response

Out of 547 institutions surveyed, 157 responses were received or 28.7% of the credits in the four-year public, private, and independent school portfolios. Independent schools had the highest response rate, with 33.9%, while 27.6% of private colleges and 21.8% of four-year public universities responded. Although the sample size is less than half of all rated institutions, the fairly balanced response allows us to observe overall energy and regional trends in the industry.
Utility Expenses Rise, And Trend Is Expected To Continue In 2006

Across the board, as a result of increases in energy prices, utility expenses comprised 3.8% of operating budgets in FY 2005. Energy price increases still loom in the future, with respondents expecting overall energy costs to increase by approximately 25% in FY2006, compared to FY2005. According to survey responses, the main factors driving this trend are the natural gas and heating oil markets, with survey respondents expecting increases of 44.1% and 39.6% respectively in FY 2006. Electricity costs also claim a share of the increase, with respondents expecting a 16.4% jump in 2006.

Scale Of Increase Depends On Location; Midwest, Northeast Have Greatest Exposure

The impact of rising energy prices on operating budgets may vary by region. Regulatory environment, distribution, and local weather all play into how much a given region is affected. Also, institutions in different regions may face different costs, depending on their mix of fuels. In addition, although all regions face similar price increases, regions with stable average temperatures have lower volatility and fluctuation in demand. Colleges and universities located in the Midwest and Northeast expect 32.8% and 24.0% utility expense increases in 2006 respectively, whereas institutions in the South and the West foresee budget increases of 20.8% and 15.8%, respectively.

Energy costs as a percentage of budgets varied modestly across the industry, depending on institution type. Energy costs composed 3.72% of four-year public university budgets, 3.13% for private colleges, and 3.53% for independent schools.

COLLEGES AND UNIVERSITIES HAVE DIVERSE APPROACH TO ACCOMMODATE RISING ENERGY COSTS IN OPERATING BUDGETS

In the face of rising costs, institutions have responded in kind, with 74.5% of respondents making budget adjustments and taking other measures. Besides allocating a larger budget for utilities, institutions have responded as follows:

- **Conservation:** conducting energy audits, hiring energy utilities to review their utility infrastructure, and investing in energy saving equipment.
- **Increase fees and tuition:** some schools have passed on higher costs directly to students in the form of tuition increases or utility surcharges.
- **Price stability:** a growing number of schools are exploring long term forward contracts to avoid the uncertainty of the spot market.
- **Budget adjustments:** to offset unexpected increased utility budget allocation, universities are replenishing or establishing contingency and energy reserve funds, holding staff levels flat, implementing reductions in administrative and support areas, and curtailing discretionary spending.
- **Alternative energy:** several schools are currently exploring alternative energy resources, including wind turbines and biomass boilers.
Overall, responses indicate a wide range of both short term and long term flexibility in addressing energy related risks. Although utility expenditures could potentially lead to tighter operating margins, the varied responses show that institutions are adjusting to higher energy costs. According to the survey, energy costs are now expected to compose 4.75% of institutional budgets in FY 2006, compared to 3.8% in FY 2005.

**Conclusion**

The survey results reflect the immediate flexibility at the disposal of institutions, allowing them to weather increased energy costs with no significant credit impact expected. Although institutions expect utility costs to increase by 25% in 2006, and even higher in the Northeast and Midwest, these costs still represent a relatively small proportion of institutional budgets. We believe most colleges and universities will be able to adjust their budgets and longer range plans to absorb the rising costs. Consequently, we do not expect rising energy costs to materially affect operating performance or credit quality.