THE ROAD TO Aaa

Three Recent Upgrades Reflect Strengthening of Top-Tier of the Private University Sector

Summary

Moody's believes that the credit quality of top-tier private higher education institutions will further strengthen based on continued excellent student demand and increasing endowment levels driven by above industry average investment returns and fundraising. The magnitude of additional borrowing and spending for strategic initiatives will likely determine which universities’ ratings are upgraded.

Three Recent Upgrades to Aaa Highlight Sector Strengthening

Over the past several months, three private higher education institutions—Northwestern University, Swarthmore College, and Washington University—have garnered Moody’s highest Aaa rating, joining 15 other private colleges and universities whose financial strength places them among the elite private institutions in the nation.

The upgrades of these three universities reflect two factors: the continued credit strengthening of a cadre of institutions who are already among the wealthiest and most selective in the country coupled with specific factors that have led these three particular institutions to stand out from their peers. Over this same time frame, we have reviewed other highly rated private colleges without taking similar rating actions.
The three institutions which were recently upgraded to Aaa share several common characteristics in addition to outstanding student demand and premier reputations. These include:

- Strong financial management that has contributed to consistent and sustained superior operating performance through prudent budgeting and conscious decision making on the necessary level of strategic programmatic spending.
- Relatively predictable debt levels due to rational capital planning that prioritizes core capital projects necessary for sustaining student and research competitiveness as well as the ability to tap a mix of sources (operating cash flow, gifts, and debt) for capital investment.
- Above-peer financial resource growth driven by strong operations providing cash flow reinvested in reserves, as well as fundraising that, given more manageable capital plans, can be targeted for endowment growth.

<table>
<thead>
<tr>
<th></th>
<th>Northwestern University</th>
<th>Washington University</th>
<th>Swarthmore College</th>
<th>Aaa Median</th>
<th>Aa Median</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total FTE Enrollment</td>
<td>14,242</td>
<td>11,832</td>
<td>1,479</td>
<td>5,780</td>
<td>2,811</td>
</tr>
<tr>
<td>Freshman Acceptance Rate</td>
<td>30%</td>
<td>21%</td>
<td>19%</td>
<td>19%</td>
<td>35%</td>
</tr>
<tr>
<td>Freshman Yield Rate</td>
<td>41%</td>
<td>32%</td>
<td>40%</td>
<td>61%</td>
<td>35%</td>
</tr>
<tr>
<td>Total Financial Resources ($ millions)</td>
<td>4,721</td>
<td>5,610</td>
<td>1,314</td>
<td>3,859</td>
<td>736</td>
</tr>
<tr>
<td>5-year % Growth in Resources</td>
<td>41%</td>
<td>34%</td>
<td>38%</td>
<td>18%</td>
<td>9%</td>
</tr>
<tr>
<td>Total Debt ($ millions)</td>
<td>689</td>
<td>995</td>
<td>187</td>
<td>282</td>
<td>135</td>
</tr>
<tr>
<td>Total Revenues ($ millions)</td>
<td>1,257</td>
<td>1,751</td>
<td>116</td>
<td>598</td>
<td>144</td>
</tr>
<tr>
<td>Average Gift Revenue ($ millions)</td>
<td>136</td>
<td>125</td>
<td>25</td>
<td>119</td>
<td>30</td>
</tr>
<tr>
<td>Expendable Financial Resources/Debt (x)</td>
<td>5.7</td>
<td>4.6</td>
<td>6.3</td>
<td>9</td>
<td>4.4</td>
</tr>
<tr>
<td>Expendable Financial Resources/Operations (x)</td>
<td>3.4</td>
<td>2.8</td>
<td>11</td>
<td>8.8</td>
<td>3.2</td>
</tr>
<tr>
<td>Average Operating Margin</td>
<td>11%</td>
<td>8%</td>
<td>6%</td>
<td>6%</td>
<td>3%</td>
</tr>
<tr>
<td>Average Operating Cash Flow Margin</td>
<td>17%</td>
<td>16%</td>
<td>19%</td>
<td>16%</td>
<td>12%</td>
</tr>
<tr>
<td>Average Annual Debt Service Coverage</td>
<td>9.7</td>
<td>6</td>
<td>1.9</td>
<td>6</td>
<td>3.3</td>
</tr>
</tbody>
</table>

Northwestern University: Debt includes recent borrowing, FY2005 (8/31) financial data
Washington University: Debt includes recent borrowing, FY2006 (6/30) financial data
Swarthmore University: Debt includes recent borrowing, FY2006 (6/30) financial data
Median data based on FY2005 data
5-year % Growth in Resources: for Medians, reflects % change in Median Total Financial Resources between FY2001 and 2005
Above Average Endowment Returns Contribute to Credit Improvement

Over time, we believe that there may be additional upgrades for some of the most elite private institutions in the country. We anticipate that the ability of these large endowments to invest in a broad diversity of asset classes, some of which may have liquidity characteristics that are more challenging for less wealthy institutions, will continue to contribute to above industry average investment returns and increasing wealth concentration in the sector. We see little risk to demand for these highly reputable institutions, many of which have extraordinarily deep pools of qualified applicants willing to pay full price to attend. For many of these institutions, financial aid programs are modeled to meet institutional objectives on socio-economic diversity rather than to meet enrollment targets.

Indeed, the primary credit challenge that we see for most of these institutions is what appears to be continued extraordinary levels of capital and programmatic spending to enhance what are already leading reputations. Often, it is not clear from an external perspective that this level of spending is necessary to attract students, faculty, or research dollars or targeted in ways that meaningfully contribute to the not-for-profit mission of these organizations. This may lead to increasing public and governmental scrutiny on issues of efficiency and qualification for non-profit status. However, as competitor and peer institutions continue high levels of investment, pressure often builds from alumni, board members, faculty and students for similar levels of expenditures. Such high levels of spending could dampen balance sheet improvement and prevent upgrades for some institutions.

Overall Credit Quality for the Sector Remains Relatively Stable

Credit quality overall for the private university sector was stable in 2006, with 17 institutional rating actions affecting just 6% of the portfolio. This includes upgrades of 12 institutions and downgrades of five. All of the downgrades were of colleges which already had below investment grade ratings. Of the upgrades, four were of colleges rated in the Aa-range, four were of A-rated institutions, two were in the Baa-rating category, and two were below-investment grade.
Related Research

Private College and University Medians 2006, May 2006 (97546)
Capital Investment For Higher Education Institutions, December 2006 (101049)

To access any of these reports, click on the entry above. Note that these references are current as of the date of publication of this report and that more recent reports may be available. All research may not be available to all clients.

To order reprints of this report (100 copies minimum), please call 1.212.553.1658.
Report Number: 101603

Author
Susan Fitzgerald

Editor
Roger Goodman
John Nelson

Senior Associate
Natasha Kadochigova

Senior Production Associate
Charles Omegri

© Copyright 2007, Moody's Investors Service, Inc. and/or its licensors and affiliates including Moody's Assurance Company, Inc. (together, “MOODY'S”). All rights reserved. ALL INFORMATION CONTAINED HEREFIN IS PROTECTED BY COPYRIGHT LAW AND NONE OF SUCH INFORMATION MAY BE COPIED OR OTHERWISE REPRODUCED, REPACKAGED, FURTHER TRANSMITTED, TRANSFERRED, DISSEMINATED, REDISTRIBUTED OR RESOLD, OR STORED FOR SUBSEQUENT USE FOR ANY SUCH PURPOSE, IN WHOLE OR IN PART, IN ANY FORM OR MANNER OR BY ANY MEANS WHATSOEVER, BY ANY PERSON WITHOUT MOODY'S PRIOR WRITTEN CONSENT. All information contained herein is obtained by MOODY'S from sources believed by it to be accurate and reliable. Because of the possibility of human or mechanical error as well as other factors, however, such information is provided “as is” without warranty of any kind and MOODY'S, in particular, makes no representation or warranty, express or implied, as to the accuracy, timeliness, completeness, merchantability or fitness for any particular purpose of any such information. Under no circumstances shall MOODY'S have any liability to any person or entity for (a) any loss or damage in whole or in part caused by, resulting from, or relating to, any error (negligent or otherwise) or other circumstance or contingency within or outside the control of MOODY'S or any of its directors, officers, employees or agents in connection with the procurement, collection, compilation, analysis, interpretation, communication, publication or delivery of any such information, or (b) any direct, indirect, special, consequential, compensatory or incidental damages whatsoever (including without limitation, lost profits), even if MOODY'S is advised in advance of the possibility of such damages, resulting from the use of or inability to use, any such information. The credit ratings and financial reporting analysis observations, if any, constituting part of the information contained herein are, and must be construed solely as, statements of opinion and not statements of fact or recommendations to purchase, sell or hold any securities. NO WARRANTY, EXPRESS OR IMPLIED, AS TO THE ACCURACY, TIMELINESS, COMPLETENESS, MERCHANTABILITY OR FITNESS FOR ANY PARTICULAR PURPOSE OF ANY SUCH RATING OR OTHER OPINION OR INFORMATION IS GIVEN OR MADE BY MOODY'S IN ANY FORM OR MANNER WHATSOEVER. Each rating or other opinion must be weighed solely as one factor in any investment decision made by or on behalf of any user of the information contained herein, and each such user must accordingly make its own study and evaluation of each security and of each issuer and guarantor of, and each provider of credit support for, each security that it may consider purchasing, holding or selling.

MOODY'S hereby discloses that most issuers of debt securities (including corporate and municipal bonds, debentures, notes and commercial paper) and preferred stock rated by MOODY'S have, prior to assignment of any rating, agreed to pay to MOODY'S for appraisal and rating services rendered by it fees ranging from $1,500 to $2,400,000. Moody's Corporation (MCO) and its wholly-owned credit rating agency subsidiary, Moody's Investors Service (MIS), also maintain policies and procedures to address the independence of MIS's ratings and rating processes. Information regarding certain affiliations that may exist between directors of MCO and rated entities, and between entities who hold ratings from MIS and have also publicly reported to the SEC an ownership interest in MCO of more than 5%, is posted annually on Moody's website at www.moodys.com under the heading “Shareholder Relations — Corporate Governance — Director and Shareholder Affiliation Policy.”

This credit rating opinion has been prepared without taking into account any of your objectives, financial situation or needs. You should, before acting on the opinion, consider the appropriateness of the opinion having regard to your own objectives, financial situation and needs.