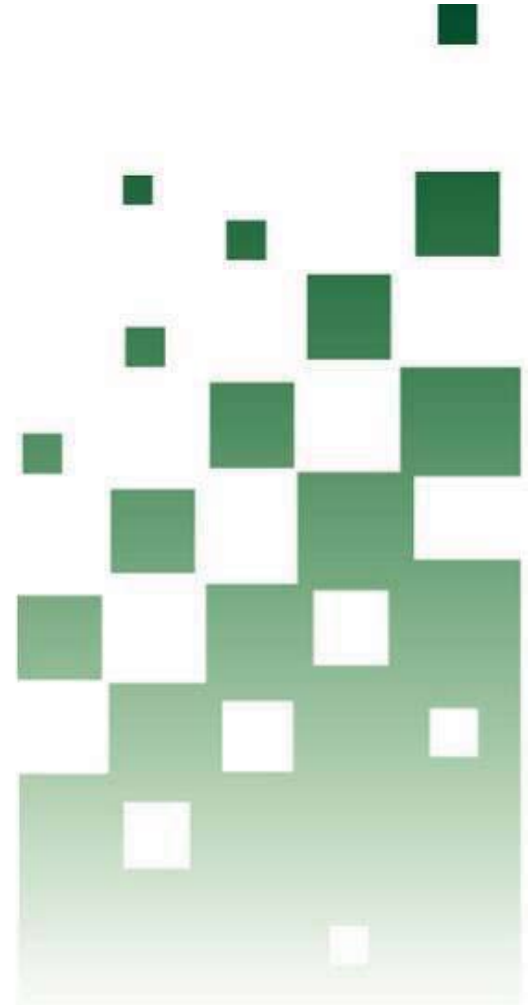


Higher Education Credit Ratings Global Risk Comparison & Outlook

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US Public Finance, Moody's

Healthcare, Higher Education & Not-for-Profits



Agenda

- ◆ Role of Credit Ratings in Municipal and Global Capital Markets
- ◆ The Past vs. the Future: Benign Markets Compared with Credit-Sensitive Markets
- ◆ Higher Education Ratings Outlook

Role of Ratings in Capital Markets

- ◆ Opinions about credit risk
- ◆ Expressed in 21 alpha-numeric codes:
 - ◆ **Aaa** **Aa1,2,3** **A1,2,3** **Baa1,2,3**
 - ◆ **Ba1,2,3** **B1,2,3** **Caa1,2,3** **Ca, C**
- ◆ Ratings explained & supported by research reports
 - ◆ At time of debt offering
 - ◆ Periodic monitoring updates
 - ◆ Industry/sector research
- ◆ Assess ability & willingness to pay debt to measure:
 - ◆ Default Risk
 - ◆ Loss in case of default
 - ◆ Rank ordering of financial strength

Ratings in the Municipal Market

◆ Various Expectations of Ratings:

- Unbiased
- Predictive & timely and not lag events
- But focus on medium term, avoid fluctuations
- Provide for remote possibilities
- Yet permit economic execution of market activity

◆ Other uses in Public/NFP Sectors:

- Report Card--Quality of Financial Management
- Rank Order of Financial Strength

Users of Ratings in Capital Markets

- ◆ Tax-exempt Mutual funds
- ◆ Wealth Management units of Banks, Insurance Co's
- ◆ Underwriters and financial advisors
- ◆ Retail brokers & individual investors
- ◆ Lenders—Commercial Banks, Leasing companies
- ◆ Swap Counterparties—DPCs (Derivative Product Cos.)
- ◆ Hedge Funds, Taxable Mutual funds
- ◆ Suppliers—e.g. Johnson Controls, Barnes & Noble
- ◆ Regulatory bodies
- ◆ Borrowers—financial planning, benchmarking

Relatively Few Defaults in the Municipal Market Among Moody's Rated Bonds since 1970

Moody's-Rated Defaults				
Sector	1970- 2000	2001- 2008	Total	%
General Obligation*	1	1	2	4.5%
Local Government - Other	3	1	4	9.1%
Public Power Utility	2	0	2	4.5%
K-12 & Higher Education	1	0	1	2.3%
Healthcare	10	8	18	40.9%
Housing Projects	2	15	17	38.6%
Grand Total	19	25	44	100%

*Jefferson County W&S defaulted as well as the G.O.; counted as one default

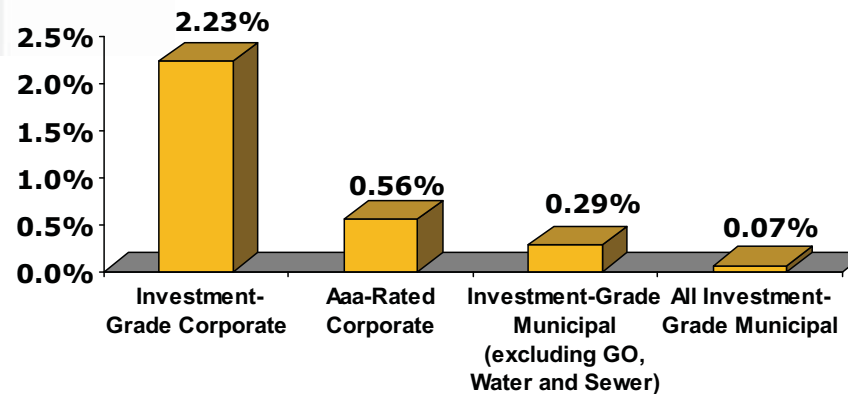
1970-2008 Municipal Default Rates In Perspective

◆ Corporate Defaults:

- 500+ corporate defaults in North America since 2000 versus just 25 municipal defaults

◆ Unrated Municipal Defaults:

- Many more defaults, probably >1%



Do Municipal Ratings Reflect Lower Risk?

- ◆ Municipal ratings already higher than corporate ratings--reflecting lower credit risk of borrowers
 - Average municipal rating across all sectors is A1
 - Average corporate rating across all industries in Baa range
 - Far more Aaa and Aa ratings in municipal market
- ◆ Should ratings be even higher to more closely align risks of global corporate and municipal markets?
 - Moody's has been evaluating consistency of its rating scales across all franchises for a decade
 - We are committed to one “global” scale that fundamentally aligns risk consistently for all investors and borrowers

How Might Higher Education Be Affected?

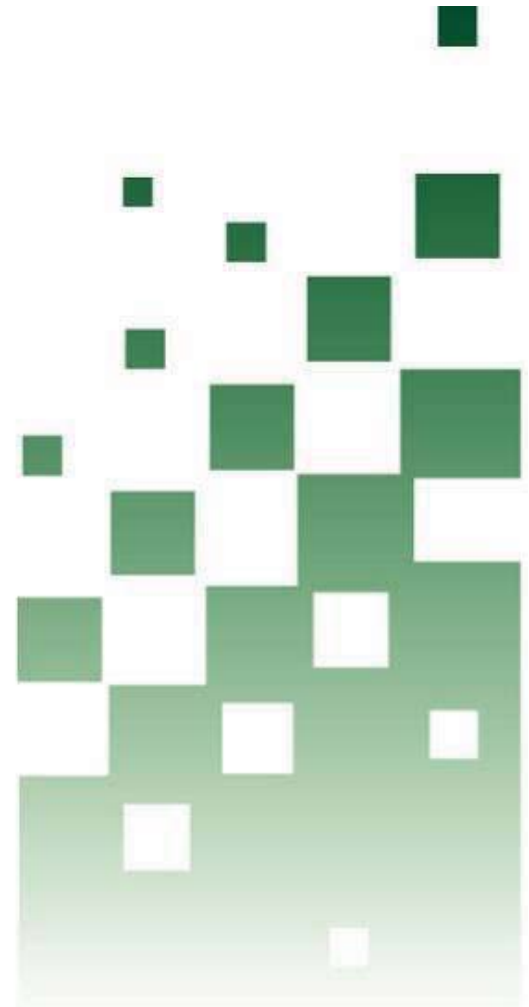
- ◆ Varying concepts to arrive at rating consistency:
 - Default risk
 - Recovery (loss) in case of default
 - Expected loss rates
 - Use rating distribution to reflect different expected loss:
 - Higher ratings in one municipal sector (states) than another sector (health care or private higher education)

- ◆ Loss in case of default likely to vary widely among sectors in municipal market:
 - Government general obligations lowest post-default loss
 - Health Care/Housing without mortgages highest loss
 - Higher education likely between these

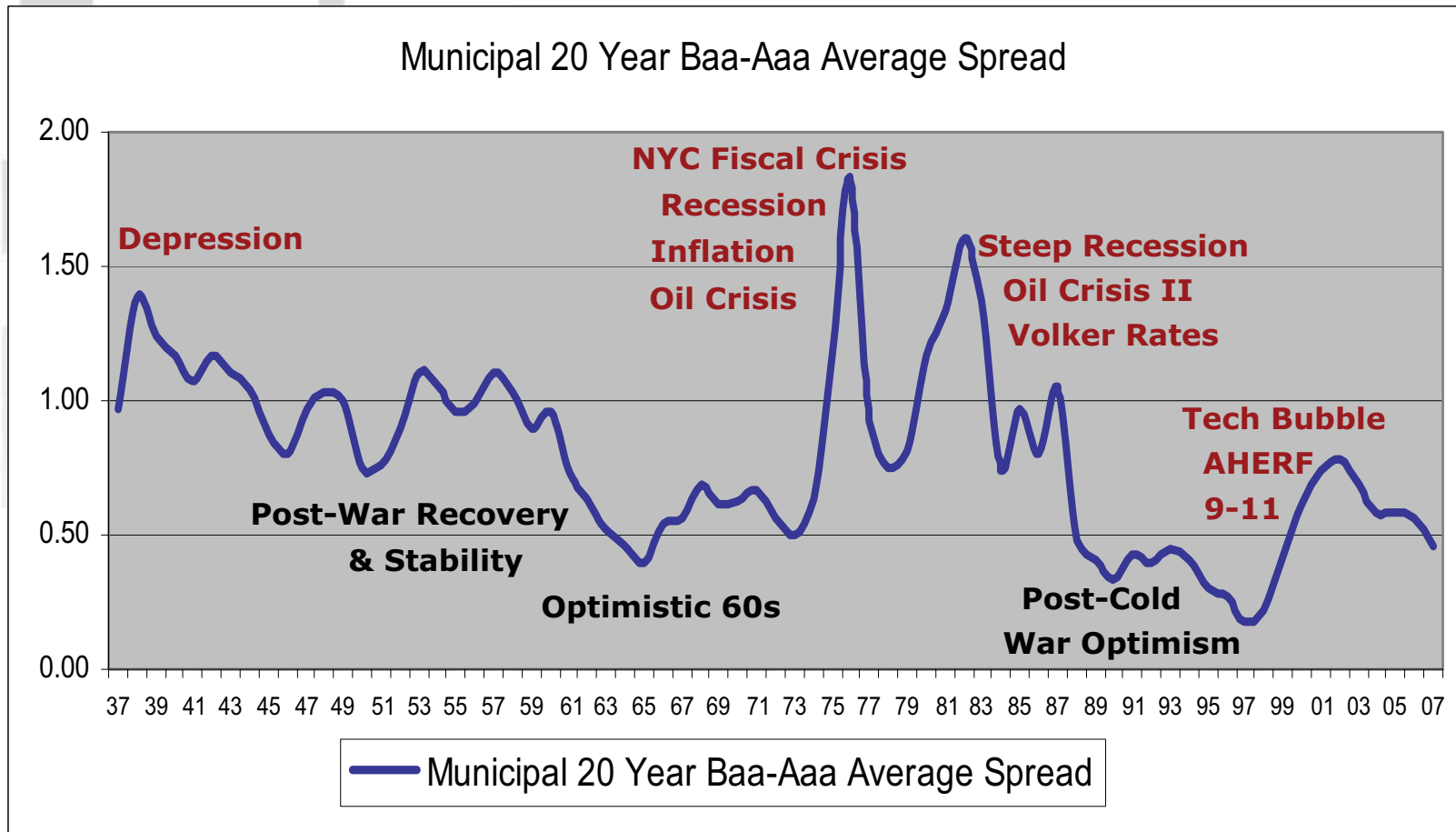
What is Moody's Plan for Global Ratings?

- ◆ Remain committed to global rating consistency
- ◆ We have assigned a couple of dozen global scale ratings to municipal debt offerings over past several years
- ◆ We have paused in our release of new global scale ratings and will not release any new ones during this pause
- ◆ Will review existing global scale ratings
- ◆ Big changes to consider—A New Credit Era?
 - Loss of Aaa-insurers
 - Riskier debt structures & swaps coming home to roost
 - Higher cost of bank capital; tighter covenants
 - Liquidity stress in many parts of the market
 - Weakened state government finances creates broad uncertainty
 - Increased globalization of higher education

BENIGN MARKETS & CREDIT SENSITIVE MARKETS

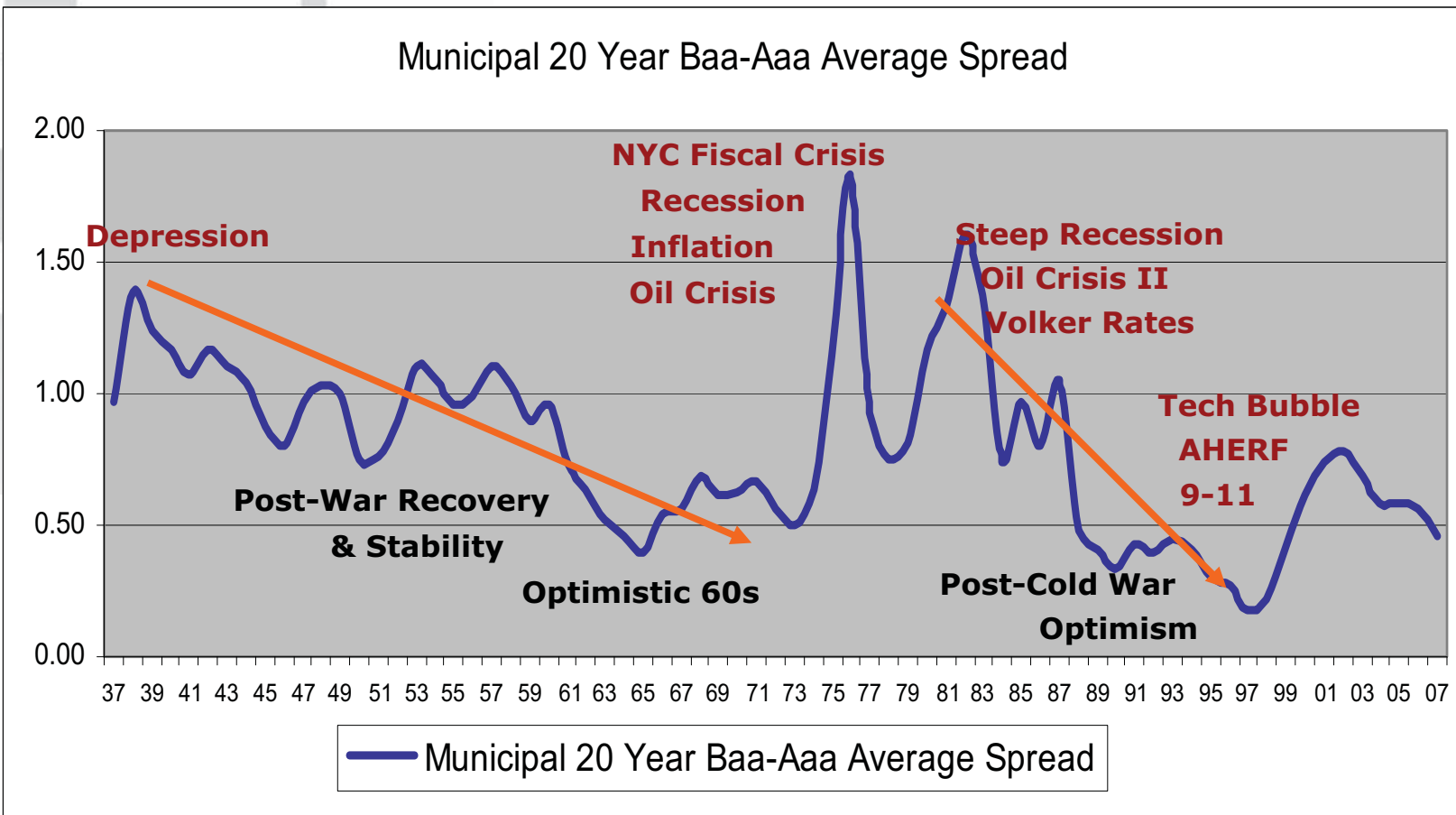


Credit Spreads Signal Level of Confidence & Investor Sensitivity to Credit Risk



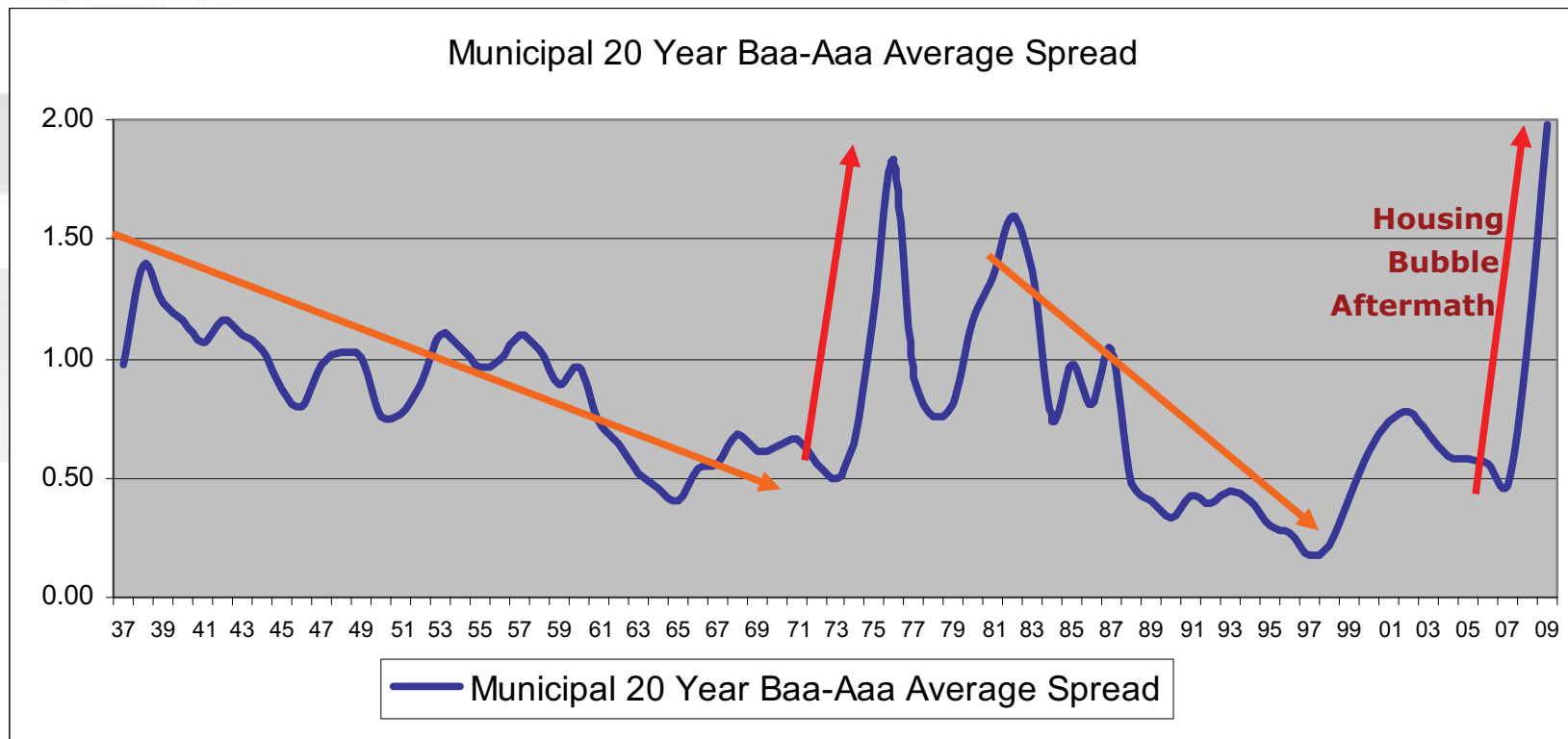
Source: Moody's

Credit Spreads: Recovery of Confidence Tends to Be Gradual and Lengthy



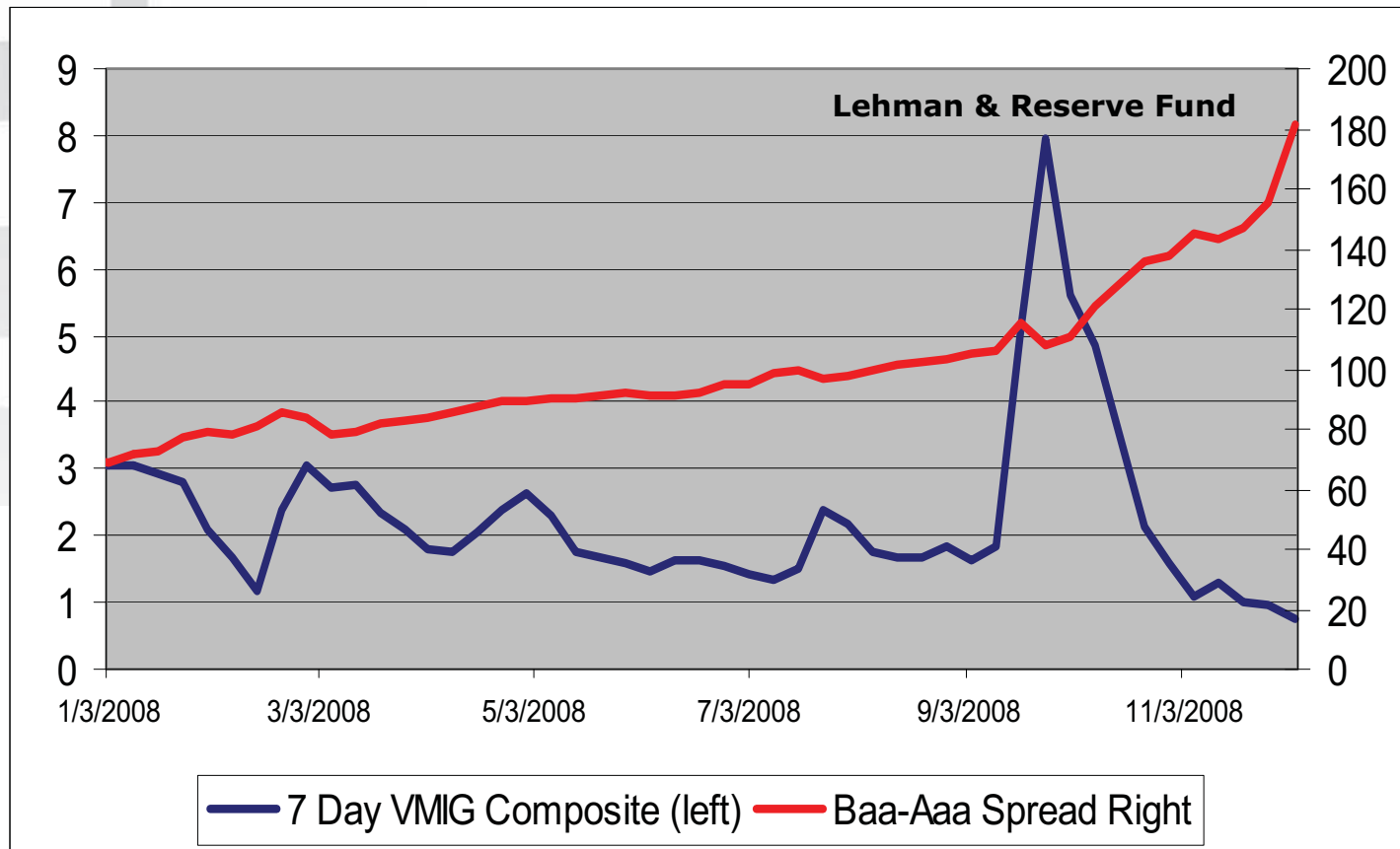
Source: Moody's

Credit Spreads: Loss of Confidence is Quick Long Spreads Now @ Historic Highs



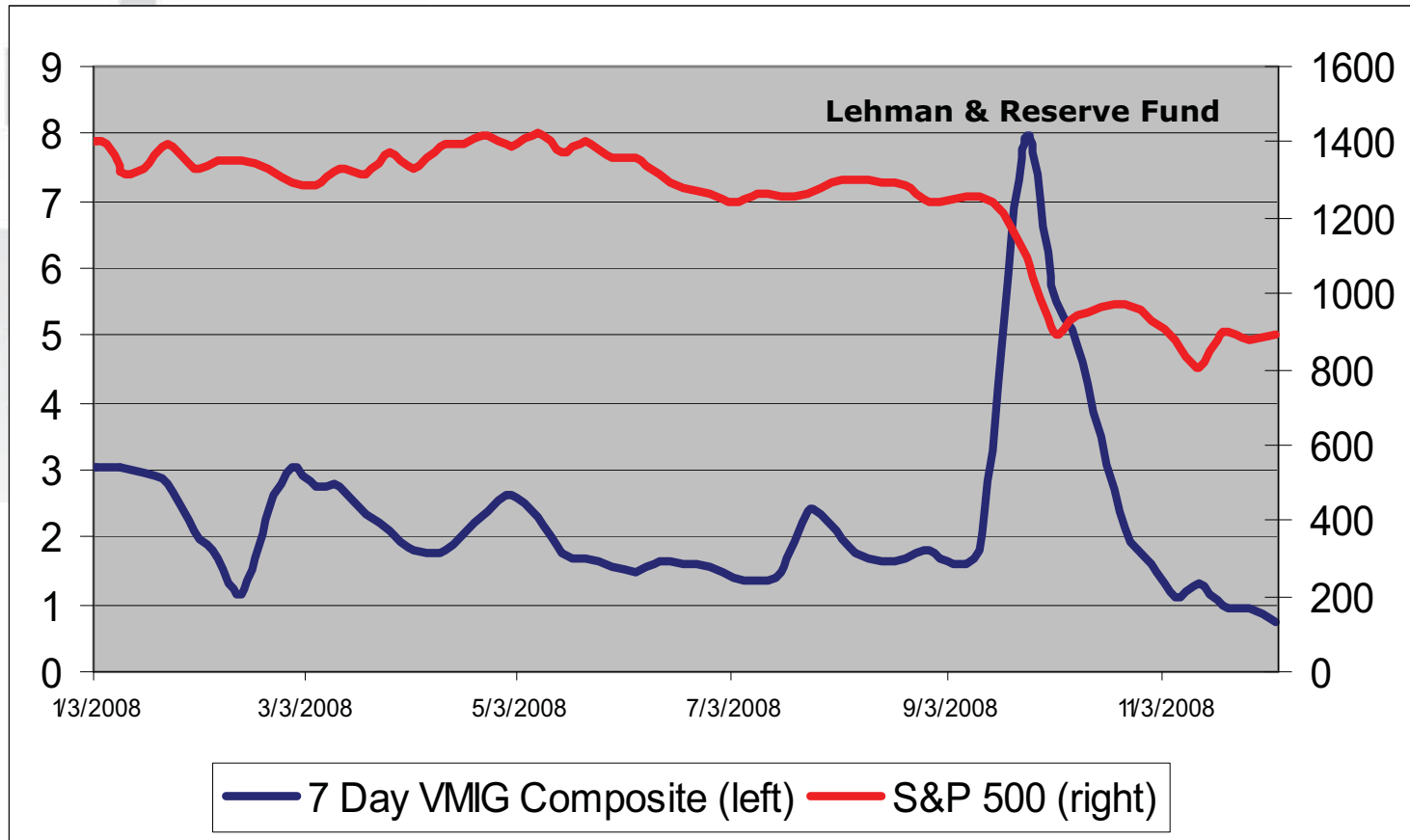
Source: Moody's

Focus on 2008...Credit/Liquidity Top Concerns Short-rates Settle Down, Long Spreads Get Wider



SOURCE: Moody's

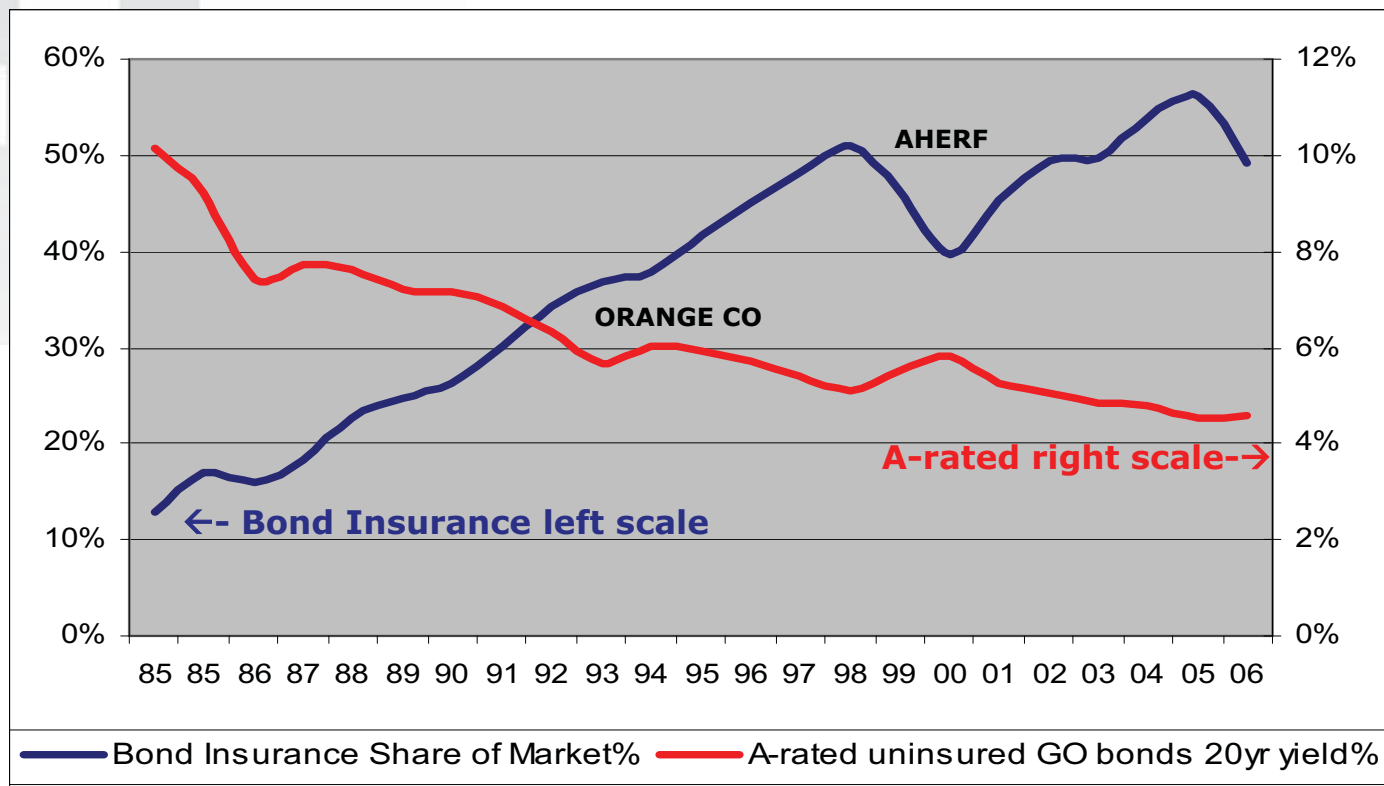
Focus on Credit Sensitivity in 2008... Lehman & Reserve Fund Major Events in Stocks Too



SOURCE: Moody's and S&P

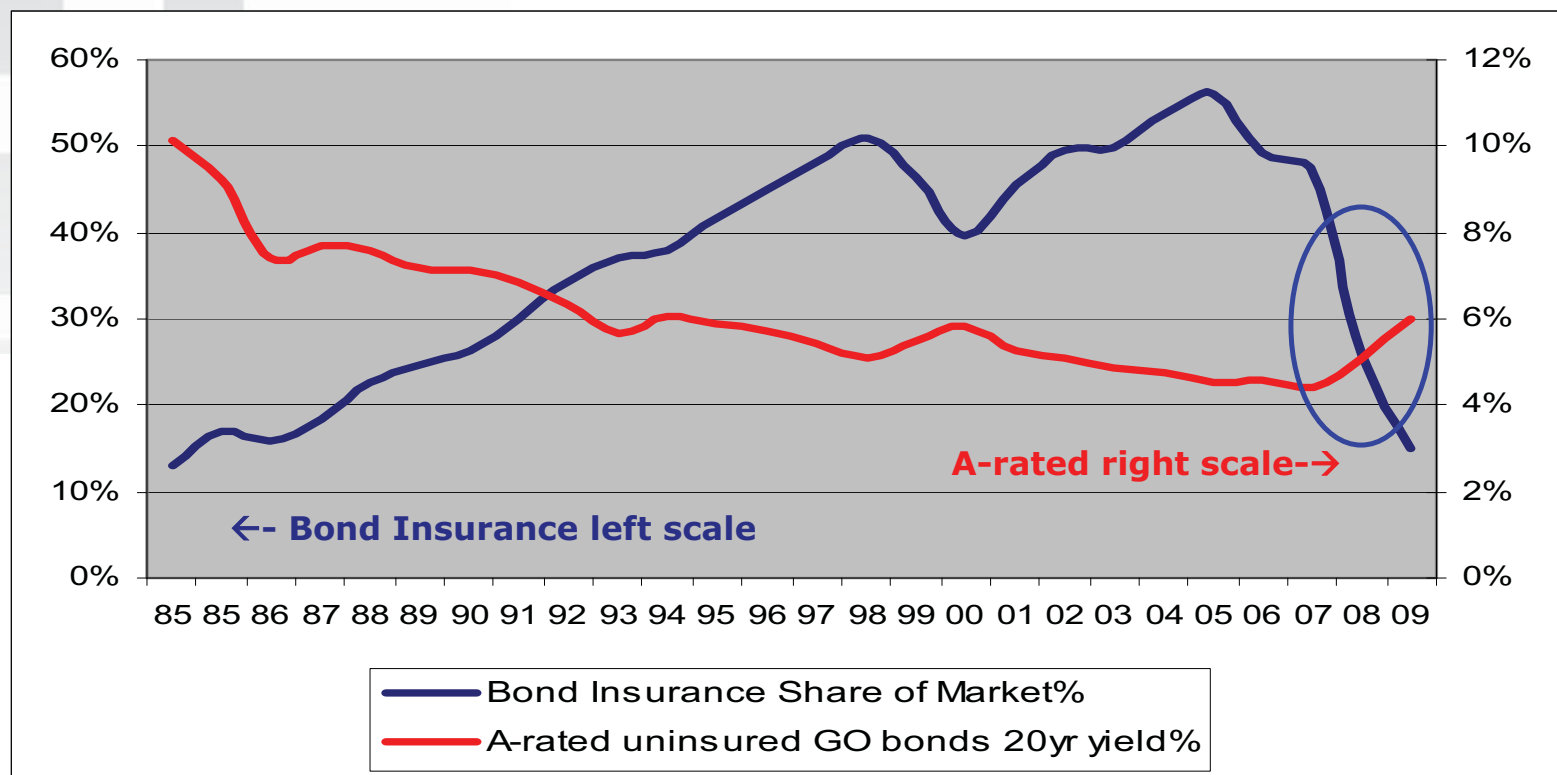
Another Look at Past Benign Municipal Market

- ◆ Last 2 decades, lessening investor concerns re: credit
- ◆ Falling rates, rising bond insurance, soft recessions
- ◆ Few defaults-Orange County and AHERF

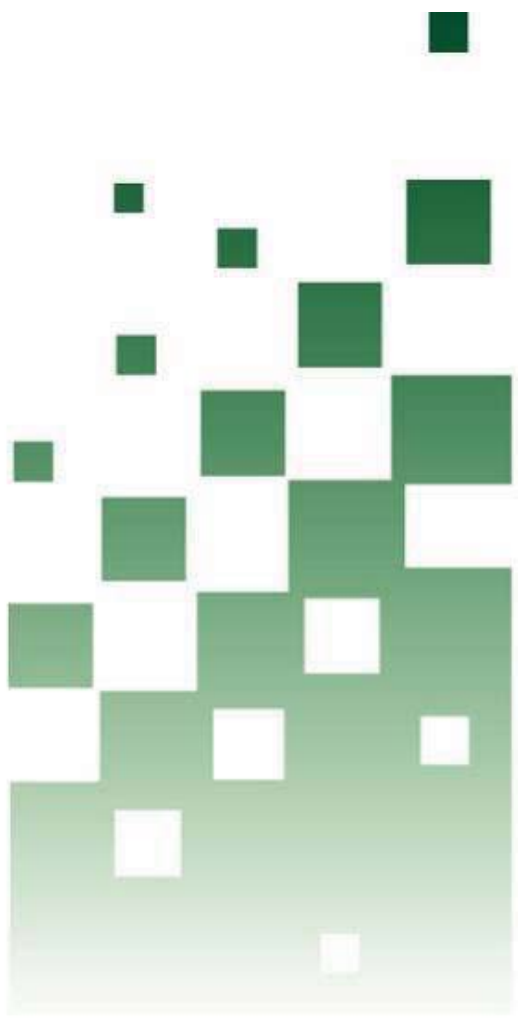


2008 & 2009: Fundamental Reassessment of Risk Investors & Lenders Now Much More Cautious

- ◆ Last 2 years , rising investor concerns about credit
- ◆ Rising rates, falling bond insurance, deep recession
- ◆ More municipal defaults? Jefferson County & debt structure risk, pensions



Outlook for Higher Education Ratings in Credit-Sensitive Market



U.S. Higher Education & Not-For-Profits: Moody's Rates Approx 800; \$135 Billion Rated Debt

- ◆ Private N.F.P. Higher Education: 330 issuers & \$50 bill. debt
 - Median rating of A3
 - Ratings cover 70% of enrollment
 - Ratings cover 20% of institutions
 - Many additional credit-enhanced LOC ratings

- ◆ Public Higher Education: 250 issuers & \$80 bill. Debt
 - Median rating of A1
 - Ratings cover 95% of enrollment
 - Ratings cover 90% of 4-year colleges, universities & systems

- ◆ Not-for-Profit Culturals, Foundations, Charities: 200 issuers & \$5 bill. Debt; much of it LOC-backed
 - Median rating of A3, many LOC-backed and lower rated
 - Highly diverse group from local museums to AARP to Salvation Army

2009: First Time Negative Outlook for Higher Education Sector

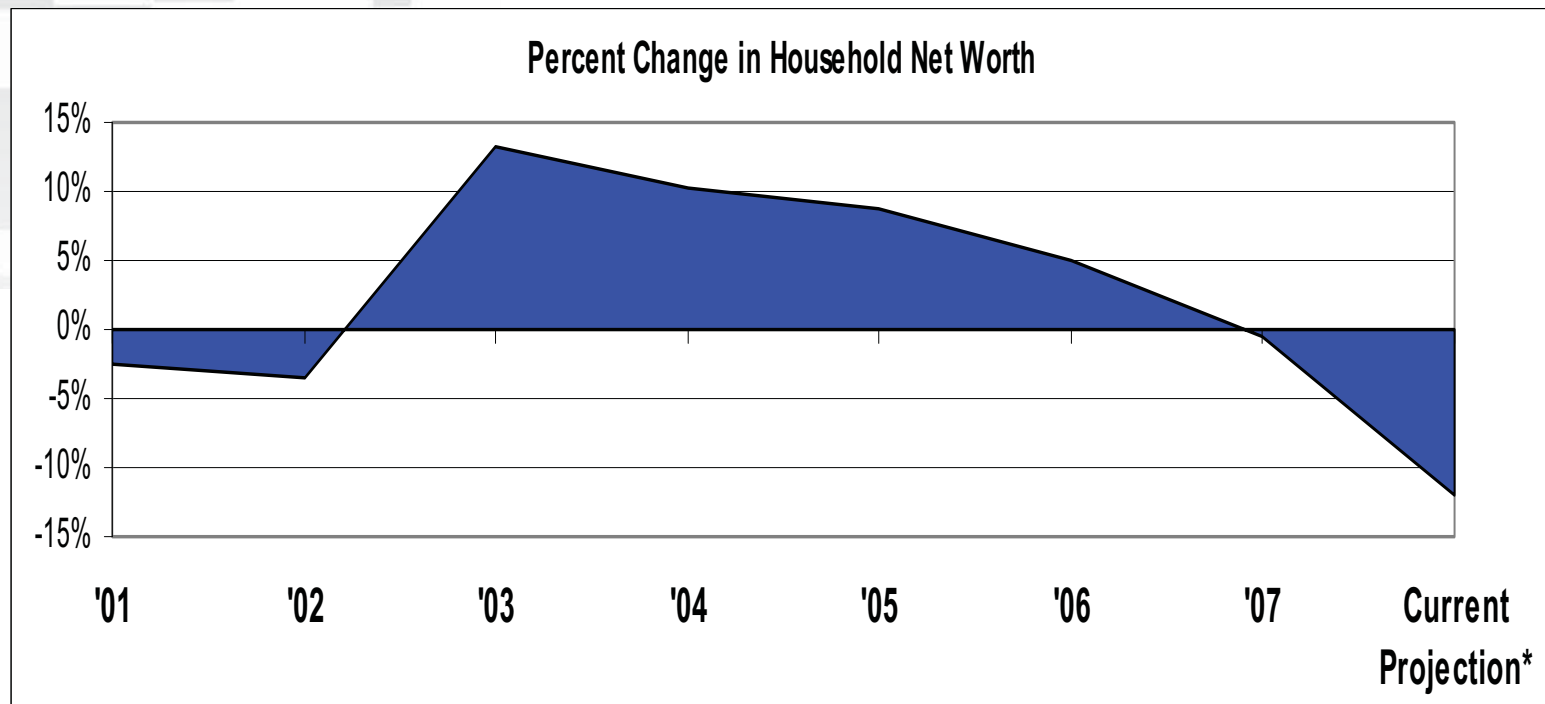
- ◆ Intensified pressure on household income and net worth causes new pressure on tuition and financial aid
- ◆ Broad impact of investment losses on operations & philanthropy
- ◆ Illiquidity of balance sheets, amplified by alternative investments, drop in philanthropy
- ◆ Reversion to correlation in crisis—largest endowments not outperforming
- ◆ Volatile debt markets, higher spreads, reduced market access, higher cost of bank liquidity
- ◆ Variable rate debt structures & swap collateral posting are now problematic for many

Biggest Risk—Tuition Revenue

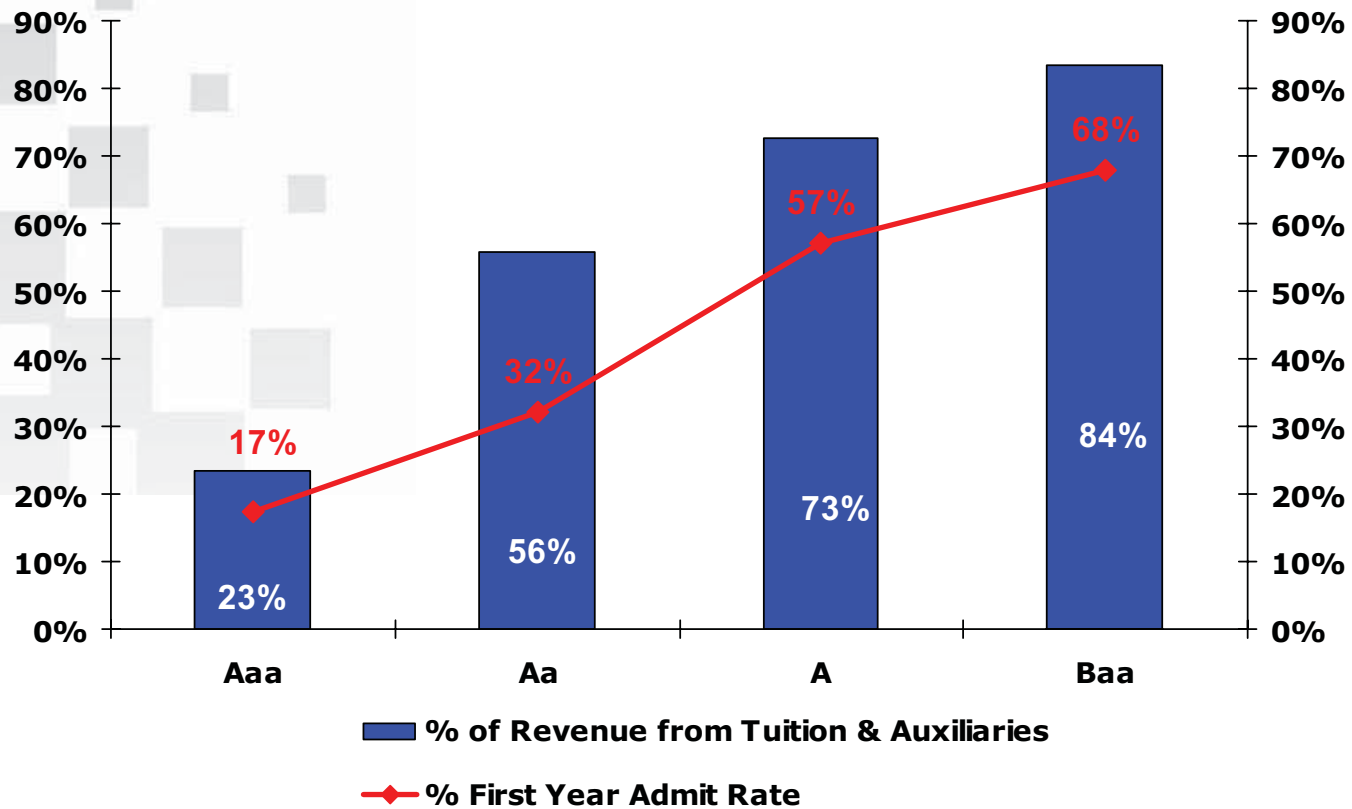
Will Universities Hit Stiff Pricing Resistance?

Remained Strong in Prior Recessions; Is This Cycle Different?

- **Net worth losses already much larger than 2000-2002**
- **Financial wealth decline at same time as home equity loss**
- **Borrowing capacity reduced; Student Lenders & Home Equity**



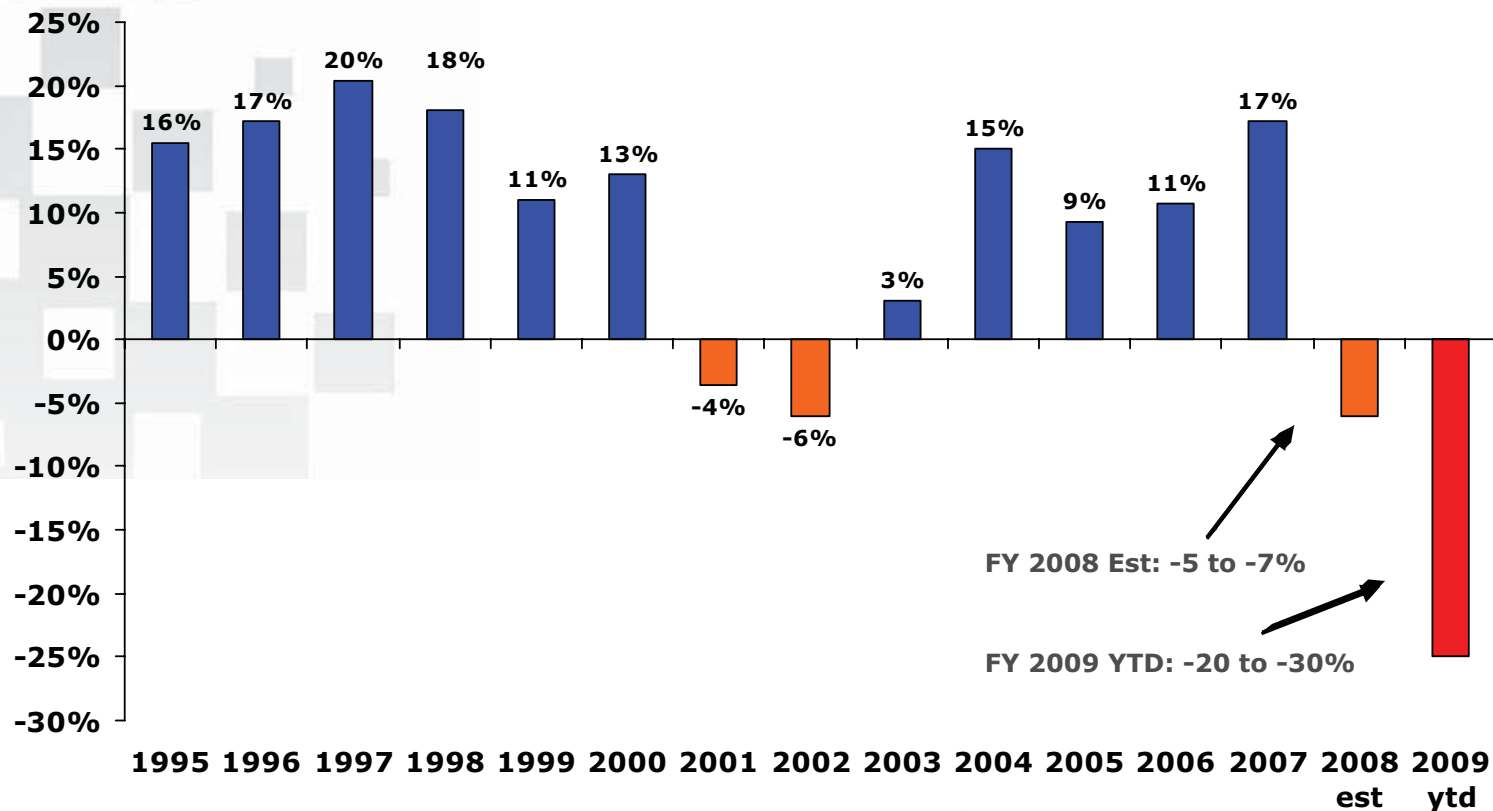
Most at Risk: “A” & “Baa” Rated Private Colleges Thin Market Cushion & High Tuition Dependence



Source: Moodys MFRA Median Data

Investment Risk Affects: All Colleges & Universities

New Worries About Liquidity, Spend Rates & Gifts

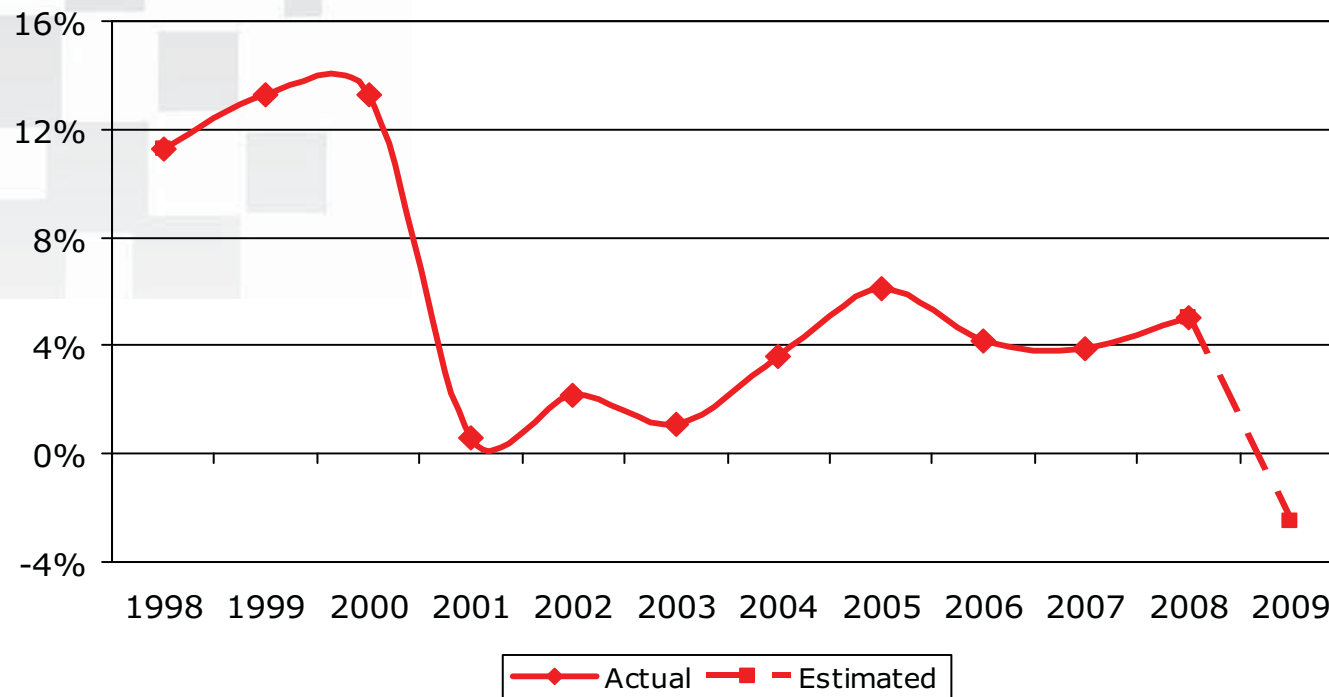


Average Annual Investment Return for Fiscal Year
 Source: NACUBO Endowment Study
 *2008-2009 Estimates by Moodys

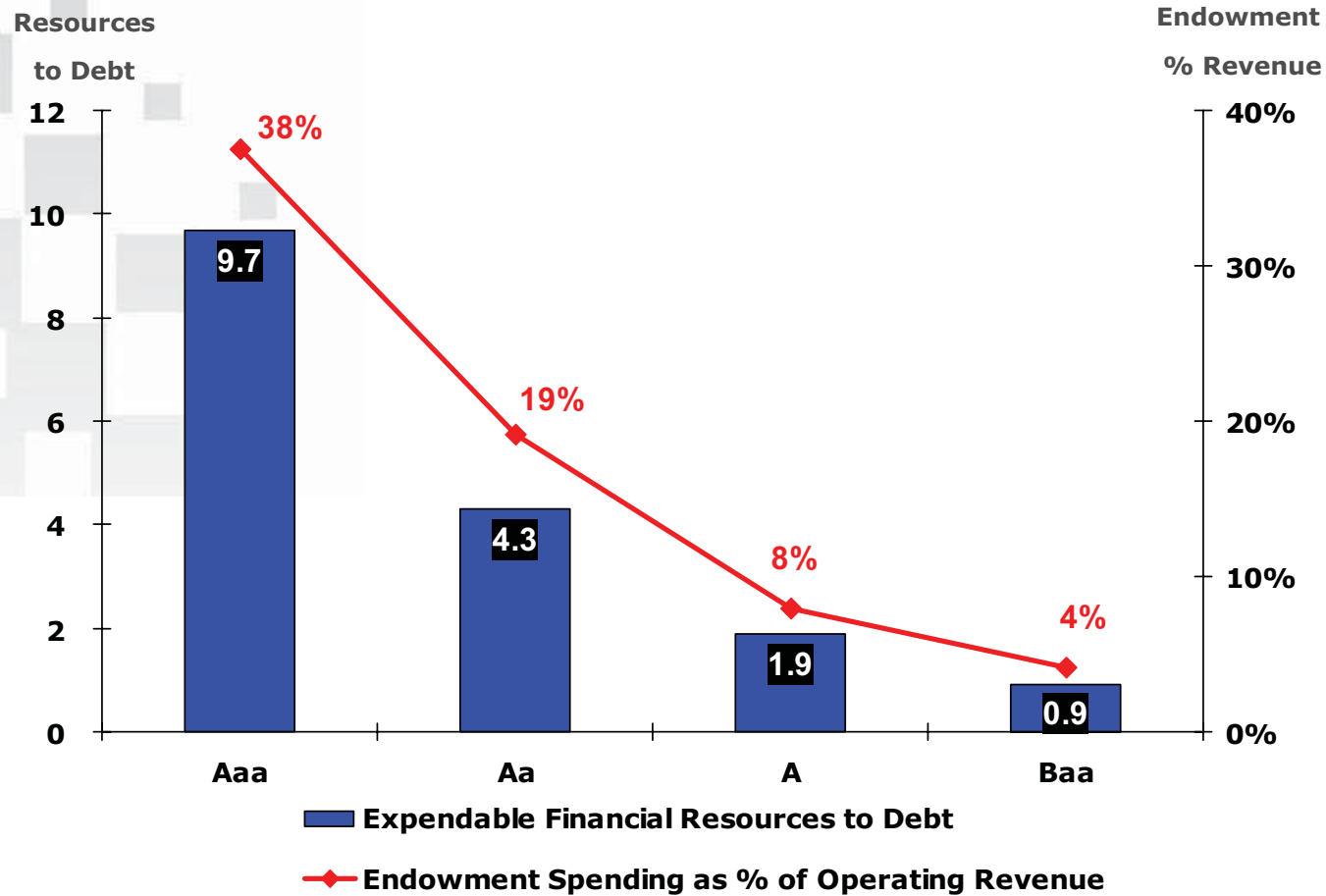
Philanthropy Under Pressure: Annual Fund Hit First; Major Gift Impact Likely to Lag

Finance industry hit particularly hard in this cycle compared to prior downturns; drop in fundraising virtual certainty; regional differences

**Growth in Giving to Education Flattened in 2001-03;
Will Likely Fall in 2009-10**



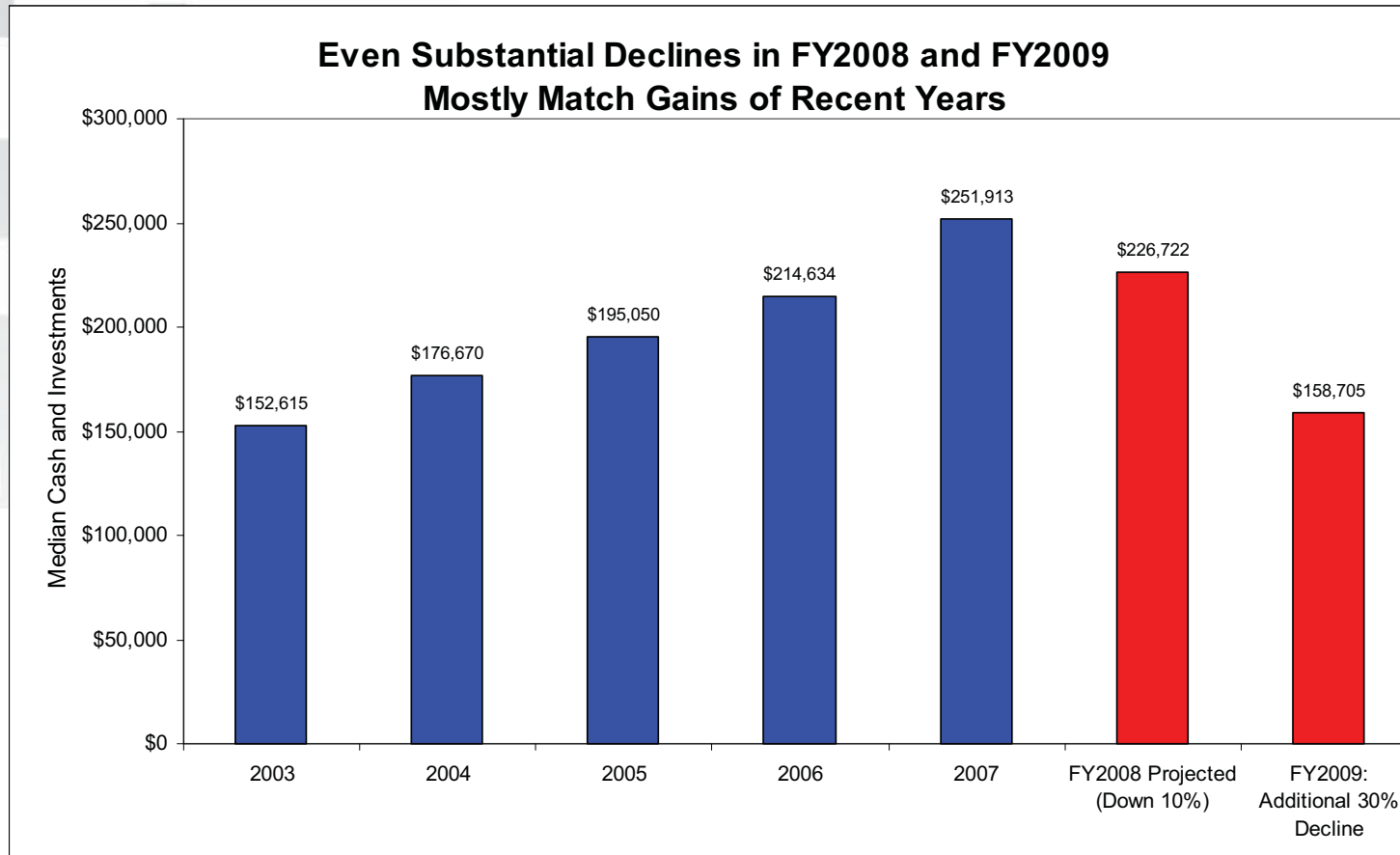
New Spend Rate Pressure: “Aaa” & “Aa” Privates Liquidity Is Biggest Concern; External & Internal



New Concerns About Liquidity- Even Aaa & Aa Face Liquidity Squeeze

- ◆ September meltdown still reverberates
- ◆ “Alternatives” managers set up gates, halting withdrawals
- ◆ Continuing “capital calls” coupled with slowed distributions from private investments
- ◆ Swap collateral posting has surged recently
- ◆ New bank external liquidity costs 100-125 bps more when available
- ◆ Cash flow problem from student loan disruptions, requests for late tuition payments, reduced annual gifts
- ◆ Reluctance to sell long term assets to raise cash; more taxable borrowing likely to occur to supplement liquidity
- ◆ Past decisions to reduce liquid cash balances & invest working capital in long term pool may have been overdone

Keeping Losses In Perspective—Back to 2003?



Source: Moody's.com

Reasons to be Optimistic About Higher Education, Especially Research Universities

- ◆ **Government, Business & Donors Need Universities:**
 - Educate the nation's youth
 - Provide affordable opportunity to lower-income
 - Discover cures for human diseases
 - Advance the frontiers of science
 - Solve socio-economic & environmental problems
 - Aid the nation's defense
 - Train skilled labor force
 - Provide technical assistance to business
 - Stimulate economic development in depressed areas
 - Incubate new industries
 - Advance US image abroad

- ◆ **Top Research Universities– The Nation's Most Stable and Important Institutions?**

Reasons to be Optimistic from Past Lessons: Survival Tactics of Small Private Colleges

- ◆ **FOCUS ON RETENTION:** Cheaper than recruiting
- ◆ **DONORS:** Even Baa-rated colleges get 6% of revenue from unrestricted gifts; alumni rally, bequests, deferred gifts
- ◆ **COMMUNITY SUPPORT:** Many college towns value their colleges highly and board members can rally support
- ◆ **ENDOWMENT BORROWING:** Might require court approval but is an option in many cases
- ◆ **PARTNERSHIPS/MARKET OUTREACH:** Locating new programs in more favorable locations, sharing costs with other colleges; internet-based learning used by some
- ◆ **OLDER STUDENTS:** More students over 21 stayed in college to get a masters or returned to college to complete degree
- ◆ **SUSPENSION OF TENURE:** Requires declaration of financial exigency; faculty often rallies to prevent

Concluding Thoughts on Higher Education Ratings

- ◆ Downgrades will Increase, but Most Will Retain Ratings
 - “Rate Through Cycle”– Cyclical vs Structural Effects

- ◆ Differential Impacts on Ratings
 - Public universities moderately stressed
 - Research universities have diversified businesses and more capacity to improve through management decisions
 - Highly selective privates have large market cushion
 - Tuition dependent, small privates most stressed

- ◆ Management Governance Practices/Decisions
 - Capital program retrenchment likely for most
 - New market/program development needed/international?
 - Improved treasury operations/liquidity management
 - Simpler debt structures
 - Much better disclosure needed

Questions & Answers

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