Revised Not-For-Profit Public and Private Colleges and Universities Criteria

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Agenda

Recap of Revised Criteria

Changes Post RFC

• Overrides
• Enterprise Profile
• Financial Profile

Implementation and Timing
Criteria Objectives

• Methodology and assumptions for assigning ratings is clear and transparent
• Continues to reflect an accurate and forward-looking view of sector risks, today and into the future
• Enable better comparison between higher education ratings and other sectors and asset classes
• Assessment structure is consistent with other S&P rating sectors
Analytical Framework

Determining The Indicative SACP

<table>
<thead>
<tr>
<th>Enterprise Profile</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
<th>6</th>
</tr>
</thead>
<tbody>
<tr>
<td>Extremely strong</td>
<td>aaa</td>
<td>aa+</td>
<td>aa-</td>
<td>a</td>
<td>bbb+/bbb</td>
<td>bb+/bb</td>
</tr>
<tr>
<td>Very strong</td>
<td>aa+</td>
<td>aa/aa-</td>
<td>a+</td>
<td>a-</td>
<td>bbb/bbb-</td>
<td>bb/bb-</td>
</tr>
<tr>
<td>Strong</td>
<td>aa-</td>
<td>a+</td>
<td>a</td>
<td>bbb+/bbb</td>
<td>bbb-/bb+</td>
<td>bb-</td>
</tr>
<tr>
<td>Adequate</td>
<td>a</td>
<td>a/a-</td>
<td>a-/bb+</td>
<td>bbb/bbb-</td>
<td>bb-</td>
<td>b+</td>
</tr>
<tr>
<td>Vulnerable</td>
<td>bbb+</td>
<td>bbb/bbb-</td>
<td>bbb-/bb+</td>
<td>bb-</td>
<td>b-</td>
<td>b-</td>
</tr>
<tr>
<td>Highly vulnerable</td>
<td>bbb-</td>
<td>bb</td>
<td>bb</td>
<td>b+</td>
<td>b</td>
<td>b-</td>
</tr>
</tbody>
</table>


Source: Methodology: Not-For-Profit Public And Private Colleges And Universities
Changes Post-RFC

We considered all comments, made changes where appropriation, but did not make all changes suggested

- 2 changes to the overrides
- 1 clarification on the enterprise profile
- 5 changes to the financial profile
Override Changes
## Overriding Factors and Caps

![Diagram of Enterprise Profile, Indicative SACP, and Financial Profile]

### Summary Of Overriding Factors/Caps

<table>
<thead>
<tr>
<th>Overriding Factor/Cap</th>
<th>Result</th>
</tr>
</thead>
<tbody>
<tr>
<td>Management demonstrates a lack of willingness to support the debt or we believe the organization may be considering a bankruptcy or receivership filing</td>
<td>The final SACP would be capped at 'b'.</td>
</tr>
<tr>
<td>A university that has emerged from bankruptcy or receivership or from a period of consultant or governmental oversight</td>
<td>Final SACP is capped at 'bb+' until the university achieves resolution of all covenant violations and has established a two- or three-year record of sustainable financial performance.</td>
</tr>
<tr>
<td>Business disruption/event risk</td>
<td>Depending on the disruption's expected magnitude and effect on the university's credit characteristics, the SACP could differ from the indicative SACP.</td>
</tr>
<tr>
<td>Supporting government rating cap</td>
<td>If a university has 30% or more of revenues derived from a supporting government, it can be rated up to three notches above the supporting government if it demonstrates governance independence and financial resiliency.</td>
</tr>
<tr>
<td>Management score equals a '5' or '6' or financial policy score is a '6'</td>
<td>The indicative SACP may be up to three notches lower than suggested by table 1.</td>
</tr>
<tr>
<td>Available resources are greater than three times the outstanding debt for public universities or four times outstanding debt for private universities</td>
<td>The indicative SACP may be one notch higher than suggested by table 1.</td>
</tr>
<tr>
<td>The financial performance assessment is a '6' (see table 9) and the financial resources assessment (see table 10 or 11) is also a '6'</td>
<td>The final SACP would be capped at 'bb+'.</td>
</tr>
<tr>
<td>Financial resources assessment and debt and contingent liabilities assessment are both a '6'</td>
<td>The final SACP would be capped at 'bb+'.</td>
</tr>
<tr>
<td>Specialty school--Law/pharmacy/medical school</td>
<td>The indicative SACP may be one notch lower than suggested by table 1.</td>
</tr>
</tbody>
</table>

*Source: Methodology: Not-For-Profit Public And Private Colleges And Universities*
Change: In addition to the business disruption, adding the concept of “unsustainable business practices.” (paragraph 27)

What is an unsustainable business practice?
• Trend of unsustainable, large endowment draws
• Dramatic changes to the market position and student demand (think Sweet Briar)

If there is an unsustainable business practice(s)
• Final SACP will be lowered depending on the magnitude.

If there are unsustainable business practices that lead to severe business disruption or closure of the institution.
• Final SACP will be capped at b+
Change: Allows the analyst to forgo the use this override in cases where this ratio is favorable is because the college or university has extraordinarily low debt levels. (paragraph 35)

How do we know when to use it?
Preserve this override for organizations which have both balanced debt levels and unusually strong cash and investments developed over time.
Enterprise Profile Changes
Enterprise Profile Changes

Change: Very minor — using full time equivalent enrollment throughout the criteria rather than headcount. (table 6)

<table>
<thead>
<tr>
<th>Assessing Market Position And Demand For Public Universities</th>
</tr>
</thead>
<tbody>
<tr>
<td>Measure</td>
</tr>
<tr>
<td>Selectivity rate*</td>
</tr>
<tr>
<td>Enrollment (headcount)</td>
</tr>
<tr>
<td>First-year retention rate*</td>
</tr>
<tr>
<td>Other demand factors (see paragraph 66)</td>
</tr>
</tbody>
</table>

Changing to FTE
Financial Profile Changes
Lack of Audit

Change: Incorporated the possibility of rating a university that does not have audited financial statements. (paragraph 88)

Only applies to universities located in jurisdictions where audited financials are not the norm.

- Example: China and France
- In the U.S., an audit is standard, so this will not apply to US credits.
- In order to be accepted, it must pass our standard for information quality.

Note: If audits are unavailable, the rating can not be computed by the model. This change will likely occur in fiscal 2016.
## Financial Performance Assessment– Negative Qualifiers

### Changes

<table>
<thead>
<tr>
<th>Issue: Revenue Concentration</th>
<th>Issue: State Appropriations as student derived revenue</th>
<th>Issue: Bifurcation of percentages for publics and privates</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Concentrated if one source of non student revenue was &gt; 30% for publics and 40% for privates, but also positive adjustment if no single source was &gt;30%.</td>
<td>• We no longer consider state appropriations as “student derived” as they generally do not offset tuition costs.</td>
<td>• Used a single threshold of 80% student derived revenues to denote “concentrated”. Now, no longer consider state appropriations as “student derived” so we bifurcated the percentages for publics and privates.</td>
</tr>
<tr>
<td>• Resolution: Concentration threshold was moved up to 40% for all universities.</td>
<td>• Resolution: See bifurcation</td>
<td>• Resolution: 80% for privates and 70% for publics to be considered concentrated</td>
</tr>
</tbody>
</table>
Bullet Maturities Changes

RFC: debt service was “smoothed” by dividing the debt principal by the life of the bonds.

Change: We have revised this to divide the principal by no more than 30 years, which we consider to be the average length of long-term borrowing and include the smoothed annual amount in the calculation of total debt service to determine the maximum annual debt service. (paragraph 110)
Treatment of GASB 68

Summary Of S&P Adjustments Due To GASB 68 Implementation

**Income statement adjustments**
Public higher education: Add back to total adjusted operating expenses the accrued pension expense (equal to the total pension expense, minus the pension contributions made by the public college or university in the fiscal year).
Charter schools: Add back to operating expenses the accrued pension expense and record the same amount as cumulative changes in accounting principles for total change in net assets.

**Balance sheet adjustments**
Public higher education: Add back to total adjusted unrestricted net assets: a) net pension liability, and b) net change in pension deferred inflows and pension deferred outflows, if deemed material.
Charter schools: Add back to unrestricted net assets: a) net pension liability, and b) net change in pension deferred inflows and pension deferred outflows, if deemed material.

Source: Assessing The Impact Of GASB 68 On U.S. Public Universities And Charter Schools

- GASB 68 should not have a significant credit impact on higher education institutions and charter schools unless the ultimate responsibility for those pension obligations shifts to the schools.

- In assessing the pension burden of a public institution, Standard & Poor's could also consider the health of the related government, the funding levels of the respective pension programs, and the likelihood that the related government will continue to retain the responsibility for these obligations.
Implementation and Timing
Impact on Ratings

~ 85% of ratings will have no impact

~ 10% of ratings could be raised

~ 5% of ratings could be lowered

- Raising/lowering of ratings will generally be one notch.

- Assumes unchanged credit fundamentals for a particular university between now and implementation.

- Combination of revised criteria and changes to credit fundamentals—Could be true for approximately 17% of colleges and universities which currently have nonstable outlooks.
January 6th – Effective date of revised criteria

All Credits must be reviewed by Jan. 6, 2017.

• No ratings will be placed on CreditWatch or under criteria observation as a result of the revised methodology.
  • Exception Non-U.S. credits: will be placed “Under Criteria Watch”
• We cannot disclose the timing for any reviews for particular credits beyond the guidance provided in this notice.
• We cannot accept any requests for expedited reviews of ratings during the implementation period except for new sale-driven transactions.
• Through January 2017, we also plan to publish a monthly update detailing all our rating actions for the prior month including upgrades, downgrades, and affirmations.
## Timing

<table>
<thead>
<tr>
<th>Jan. 2016 - June 2016</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Credits we believe may move up or down a notch or more</td>
</tr>
<tr>
<td>• Credits due for review based on our targeted 12-month cycle.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>July-2016 - Jan. 2017</th>
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<tbody>
<tr>
<td>• All other credits</td>
</tr>
</tbody>
</table>
Revised Rationale

• Rationale will remain largely unchanged.

• Research updates will include our evaluation of the following rating components with assessments provided for the Enterprise Profile and Financial Profile.

• Will include a discussion on each of the topics under each profile
  • Industry Risk
  • Economic Fundamentals
  • Market position and Demand
  • Management and Governance
  • Financial Policies
  • Financial Performance
  • Financial Resources
  • Debt and Contingent Liabilities
Questions
Additional Resources


- Additional relevant criteria pieces:
  - Group Rating Methodology
  - Management & Governance
  - Industry Risk
- Podcast
- CreditMatters TV
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Additional Resources/Related Articles

Criteria Scoring Model:
- Higher Education: Credit Scoring Model For Not-For-Profit Public And Private Universities

RFC Process Summary:
- Methodology: Not-For-Profit Public And Private Colleges And Universities

Credit FAQs:
- An Overview Of Standard & Poor’s Updated Methodology For Rating Not-For-Profit Private and Public Colleges and Universities

Implementation Plan:
- How Standard & Poor’s Intends To Finalize Its Criteria For Not-For-Profit Public and Private Colleges And Universities And Apply Them To Ratings