Rating Update: University of Vermont & State Agr. Coll., VT

MOODY’S AFFIRMS UNIVERSITY OF VERMONT’S A1 LONG-TERM RATING AND P-1 RATING ON COMMERCIAL PAPER PROGRAM; OUTLOOK REVISED TO NEGATIVE FROM STABLE

UNIVERSITY HAS $505 MILLION OF RATED DEBT OUTSTANDING, INCLUDING COMMERCIAL PAPER AT FULL AUTHORIZED PROGRAM SIZE

Higher Education
VT

Opinion

NEW YORK, Nov 21, 2008 -- Moody's Investors Service has affirmed the A1 underlying rating on the University of Vermont's (UVM) bonds and its P-1 rating on the University's $100 million authorized commercial paper program. The A1 rating applies to $405 million of outstanding debt (see RATED DEBT below). The affirmation of the P-1 rating is based on self-liquidity, including access to a $50 million revolving credit agreement provided by Landesbank Hessen-Thuringen Girozentrale (rated Aa2/P-1). At this time, we have revised our long-term rating outlook to negative from stable. This change in outlook is based on the University's decline in unrestricted financial resources and liquidity, exacerbated by the lock up of funds in the Commonfund Short Term Fund, as well as continued operating deficits and market vulnerability in the current economic environment.

LEGAL SECURITY: Repayment of the bonds and the University's commercial paper is a general obligation of the University and is not secured by a pledge of revenues or property of the University.

INTEREST RATE DERIVATIVES: None

STRENGTHS

*Flagship and land grant university for Vermont (rated Aaa), coupled with its ability to attract out-of-state students, has driven application, enrollment and net tuition growth. Total full-time equivalent enrollment reached 11,594 students in fall 2008, surpassing goals in the University’s 10-year strategic plan two years early. Freshman application volume grew 101% between the classes entering in the fall of 2003 and the fall of 2008, allowing UVM to improve its selectivity to 65% from 80% during this period. Net tuition per student increased 27% from Fiscal Year (FY) 2003 to FY 2008, from $12,656 to $16,087, although Moody's notes a slight decrease in FY 2008 from the FY 2007 figure of $16,173. By contrast, the median net tuition per student for Moody's A1-rated public colleges and universities in 2007 was $6,430. This relatively high level of net tuition per student reflects the high share of students from outside Vermont. In the fall of 2008, 60% of all students and 75% of entering freshmen hailed from other states. Non-resident undergraduates pay 2.5 times the tuition paid by Vermont residents ($11,048 for in-state undergraduates versus $27,886 for non-residents for the 2008-09 academic year). UVM's market position is also bolstered by a medical school and research activity that garnered nearly $142 million of grant and contract revenue in FY 2008.

*Investment in facilities has boosted the attractiveness of the campus to prospective students. Between FY 2003 and FY 2008, the age of plant (accumulated depreciation divided by depreciation expense) decreased to 9.8 years from 15.6 years. Key facilities improvements in recent years include construction of new student residences and a new student center. Much of the capital spending was financed with debt, which grew to $432 million currently from $182 million in FY 2003.

*The University's financial position is enhanced by a diverse revenue base. As calculated by Moody's, net tuition and fees comprised 37% of operating revenues in FY 2008. Grants and contracts accounted for 28% of operating revenues, auxiliary revenues represented 16%, state appropriations were 9%, investment income was 4%, and gifts made up 3%. Among Moody's A1-rated public colleges and universities, the median contribution of state appropriations to operating revenues in 2007 was 33%. Grant and contract revenue grew by 16% between FY 2003 and FY 2008, signifying a greater emphasis on the University's research enterprise. The annual increase has been slower in recent years, however, reflecting the reduced pace of growth for federal research funding generally.

CHALLENGES

Operating deficits incurred in FY 2007 and 2008 reflect an imbalance projected to grow in the current fiscal year that significantly lowers debt service coverage. After achieving near break-even results between FY 2003 and 2006, UVM posted an operating margin of negative 4.7% in FY 2007 and negative 8.4% in FY 2008. For FY 2008, the three-year average operating margin was negative 4.5%. Debt service coverage dropped from 2.3 times in FY 2006 to 0.6 times in FY 2007 and declined again to negative 0.1 times in FY 2008. The operating deficits in FY 2007 and 2008 were primarily caused by the expense of unbudgeted small capital projects, costs of implementing new financial system software, and consulting fees associated with revising UVM’s processes and systems for administering sponsored research activity. In FY 2007, $5.2 million in expenses were recorded to update the vacation leave accrual, based on improved information available through the new PeopleSoft human capital management system. In FY 2008, costs associated with other post-employment employment benefits (OPEB) implemented under GASB 45 also contributed to the deficit, with the University incurring $37 million in expense for benefits accrued in both the current and previous years. UVM plans to fund its OPEB liability on a pay-as-you-go basis over a 30-year period. Excluding the OPEB costs, the operating margin in FY 2008 would have been negative 1.2%, the average operating margin would have been negative 1.9%, and debt service coverage would have been 1.8 times.

For FY 2009, UVM is projecting a deficit of $15 million on a cash basis (compared to a $5.1 million deficit in FY 2008) that results from unbudgeted expenditures and continued expense from one-time commitments as well as lower short-term investment income and a $1 million rescission in the state appropriation for the year. While state appropriations account for just 9% of operating revenues as calculated by Moody’s and UVM reports that it can absorb the cut due to offsetting expense savings, any further reductions in the current year would require more substantial drawdowns on internal reserves and more significant expense cuts.

Moody’s rates the general obligation debt of the State of Vermont Aaa with a stable outlook. While Vermont was largely unaffected by the effects of the housing market decline, the State is not immune from the current economic downturn. The State is facing a mid-year FY 2009 budgetary shortfall of $30 million, which represents roughly 2% of general fund revenues and a projected shortfall of $95 million in FY 2010 (7% of FY 2010 general fund revenues). Year to date general fund revenues have performed close to the July 2008 revenue forecast assumptions, however the State is expecting revenue deterioration to increase during the remainder of FY 2009. The State has a proven track record of taking proactive measures to offset sudden revenue declines, primarily through spending reductions. It is expected that the State will take needed actions to address the current FY 2009 shortfall as well as the projected FY 2010 budgetary shortfall.

Decrease in unrestricted financial resources reduces the University’s liquidity and financial flexibility. Lower unrestricted financial resources result from the operating deficits as well as implementation of GASB 45 and a lower investment return in FY 2008. From a high of $126 million at the close of FY 2006, unrestricted financial resources steadily declined to $85 million for FY 2008, which includes initial recording of an OPEB liability of $26 million against the actuarial accrued liability of $320 million at July 1, 2007. Excluding the OPEB liability, unrestricted financial resources in FY 2008 would have been $111 million, the lowest level since FY 2005. Expendable financial resources at June 30, 2008 covered current direct debt by 0.9 times and operations by 0.7 times. After a high 21% investment return in FY 2007, UVM achieved a return of 0.3% in 2008. Investments are allocated across U.S. equity (27%), global equity (19%), marketable alternatives (21%), fixed income (16%), inflation-hedging assets including TIPS and real estate (14%), and venture capital/private equity (4%). Through September 30, 2008, UVM reported a negative 12% return.

Further pressure on liquidity due to lock up of working capital in the Commonfund Short-Term Fund. UVM held most of its operating cash in this fund, including $84 million at the time the fund was closed at the end of September. To date, the University has received nearly 60% of the amount initially locked up. Moody’s has reviewed UVM’s cash flow forecasts, which indicate tight balances through the end of the calendar year. In order to provide cash, UVM liquidated $14 million of long-term investments earlier this month. The University has also secured a $50 million line of credit with TD Bank (rated Aa2/P-1) that extends through November 1, 2010 to support its cash flow needs. We believe terms of the agreement could trigger an event of default requiring UVM to repay any amounts borrowed on an accelerated basis. Specifically, the agreement requires the University to maintain a Leverage Ratio of at least 0.60 to 1.0 as of each June 30. At June 30, 2008, UVM reported the ratio was 0.68. The ratio and the reported calculation include the impact of the OPEB liability. This level provides a narrow margin if investment losses or operating deficits lower the level of unrestricted and expendable restricted net assets.

Maintaining enrollment of higher-paying non-resident students may prove increasingly difficult in a challenging economic environment and projected declines in the number of high school graduates in the northeast over the next decade. While the significant share of non-resident enrollment has boosted tuition receipts in past years, Moody’s is concerned that this revenue source may weaken if families of current and prospective students from other states face financial stress and view public institutions in their home states more favorably.

SHORT-TERM RATING RATIONALE: UVM RELIES ON SELF-LIQUIDITY, INCLUDING USE OF A LINE OF CREDIT, TO SUPPORT TENDER FEATURE OF MATURING COMMERCIAL PAPER

The University maintains a commercial paper authorized at $100 million, under which $25 million is currently outstanding. The obligation to pay commercial paper (CP) at maturity is a general obligation of UVM, and the University manages its own self-liquidity program. The self-liquidity program relies on the University’s own cash and investments as well as the presence of a bank liquidity support agreement for same-day liquidity.
The University maintains a $10 million limit on the amount of CP that can mature on a given day, which allows for $50 million to mature in any week. Moody's applies the Standard Approach to UVM's self-liquidity program. We believe the self-liquidity program provides adequate coverage of maturities for the $25 million currently outstanding, but would be insufficient should the University issue additional CP above that amount.

The University currently has approximately $41 million of investments (measured on a discounted basis) with same-day liquidity that provide 1.6 times coverage of the currently outstanding CP balance and 0.8 times coverage of the $50 million amount of CP that could mature in a given week. Thus, UVM's self-liquidity program also relies on the presence of a bank line of credit for same-day liquidity. The University maintains a $50 million credit agreement with Landesbank Hessen-Thuringen Girozentrale (rated Aa2/P-1) that expires July 23, 2011. This dedicated line of credit can only be used to pay maturing commercial paper, not also interest payments, and is not a general operating line. With the line of credit, coverage of the currently outstanding CP balance is 3.6 times and coverage of the $50 million of weekly CP maturities is 1.8 times. The University is responsible for making the request for funding, and would instruct the bank where to direct the funds. UVM must repay any advances made under the line in quarterly installments over a five-year period.

The University has the right to cancel the bank agreement with notice and/or replace the financial institution at its discretion. In addition, under certain circumstances the bank can declare all outstanding advances immediately due and payable and terminate its commitment. There is no mandatory redemption of outstanding CP upon the expiration or termination of the liquidity agreement. Events which would cause the agreement to immediately terminate without notice include: 1) UVM's failure to pay principal or interest on other debt that is not subordinate to payments under the agreement; 2) UVM's failure to pay any amount due to the bank under the agreement when due; 3) withdrawal of the University's long-term rating for credit-related reasons or downgrade of the long-term rating to below Baa3 by the two rating agencies rating the debt; 4) an Event of Insolvency with respect to the University; 5) failure to pay a final, non-appealable judgment in excess of $5 million within 30 days; or 6) a provision of the Agreement ceasing to be valid and binding or the University contests any provision of the Agreement or denies further liability under the Agreement. In addition to these immediate termination events of the bank agreement, other less severe events of default could enable the Bank to terminate the facility as soon as 45 days later.

Because there is no mandatory redemption of outstanding CP when the liquidity agreement expires or terminates, Moody's regularly monitors the University's levels of available funds that could be shifted from longer-term investment strategies to investments with same-day liquidity should the bank line of credit be terminated with notice. In addition to its same-day liquidity, the University currently has close to $30 million of investments which it could liquidate within one week.

**Outlook**

The negative outlook reflects Moody’s concern that weak operating performance and reduced liquidity as measured by the decline in unrestricted financial resources and tight cash flow may intensify in the face of another projected operating deficit for FY 2009 and an economic environment that could lower demand by higher-paying out of state students.

**What could change the rating-UP**

Significant increase in financial resources and liquidity as well as sustained improvement in operating performance; ability to absorb any decline in out-of-state enrollment without detriment to financial position.

**What could change the rating-DOWN**

Inability to navigate through pressures of reduced liquidity; reduced out-of-state enrollments that produce sustained operating deficits. Additional borrowing without compensating growth of resources.

**KEY INDICATORS (FY 2008 financial data and fall 2008 enrollment data)**

Total Full-Time Equivalent (FTE) Enrollment: 11,594

Freshmen Selectivity: 64.8%

Freshmen Matriculation: 18.1%

Net Tuition per Student: $16,087

Total Financial Resources: $453.4 million

Expendable Financial Resources to Total Direct Debt: 0.90 times
Expendable Financial Resources to Operations: 0.68 times

Three-Year Average Operating Margin: -4.5% (-1.9% excluding OPEB expenses in FY 2008)

Three-Year Average Debt Service Coverage: 0.70 times (1.5 times excluding OPEB expenses in FY 2008)

State Appropriation as Percent of Operating Revenue: 8.8%

RATED DEBT

Series 1998, 2005: A1 underlying, MBIA insured (MBIA's current financial strength rating is Baa1 with a developing outlook)

Series 2002, 2007: A1 underlying, Ambac insured (Ambac's current financial strength rating is Baa1 with a developing outlook)

Series 1990: A1

Commercial Paper Program: P-1 based on self-liquidity

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