Leveraging Debt for Campus Improvement

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Session CPE Requirements

- You need to attend 50 minutes to receive the full 1 CPE credit.
- There will be 4 polling questions throughout the presentation. You must respond to a minimum of 3 to receive the full 1 CPE credit.

Both requirements must be met to receive CPE credit

Speakers

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Learning Objectives

- Identify how to responsibly leverage debt to advance campus initiatives
- Identify debt structuring strategies to avoid common pitfalls
- Recognize financing trends in higher education

Polling Question

Is your institution currently considering obtaining new debt?

- Yes, in the next year
- Yes, in the next 1-5 years
- No, not at this time

Debt Utilization for Higher Education Borrowers

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Campus Involvement and Modernization

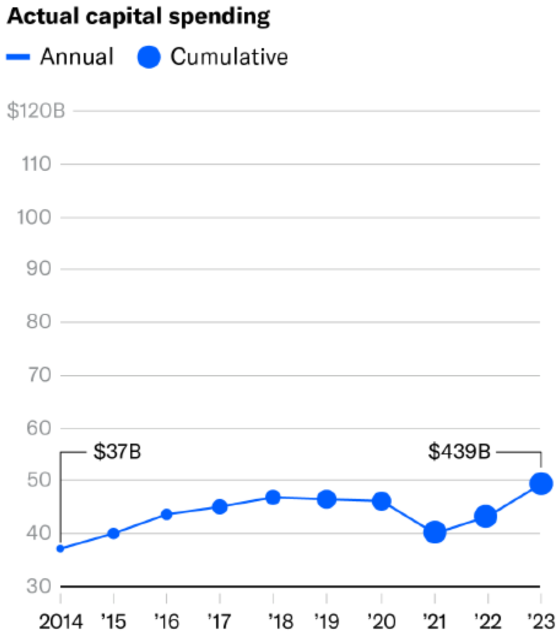
Modernization of campus is crucial to maintain long-term competitiveness

New projects in the right areas can spur revenue and enrollment growth

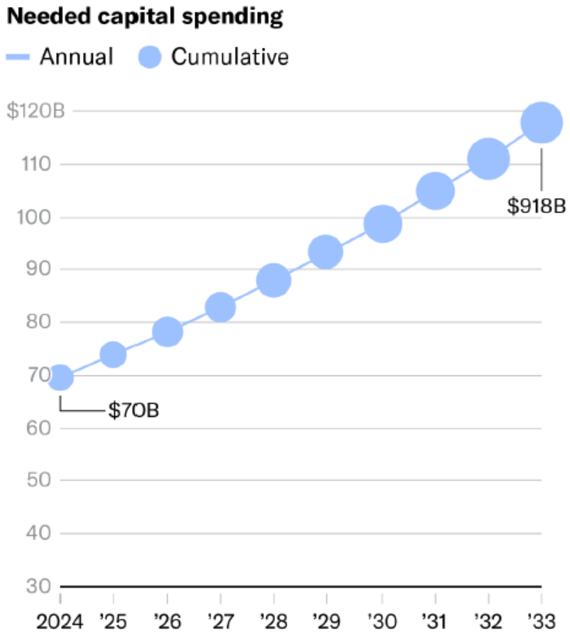
Photo Credit: Carleton College

Campus Involvement and Modernization

- Addressing growing deferred maintenance and aging of plant remains a necessity



Source: Moody's Ratings



Source: Moody's Ratings

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Primary Capital Funding Sources

- Debt
- Operations/investments
- Capital campaigns

Preserving Liquidity and Investment Returns

Maintaining a manageable level of debt can be a means of preserving liquidity in the face of operational headwinds

Tax-exemption allows borrowers to issue debt at attractive costs of capital relative to historical investment rates of return

Average One-, Three-, Five-, 10-, 15-, 20-, and 25-Year Net Annualized Returns

Numbers in percent (%)	TOTAL INSTITUTIONS
TOTAL INSTITUTIONS	**658**
1-year net annualized return	11.2
3-year net annualized return	3.4
5-year net annualized return	8.3
10-year net annualized return	6.8
15-year net annualized return	8.2
20-year net annualized return	6.9
25-year net annualized return	6.1

Source: 2024 NACUBO-Commonfund Study of Endowments

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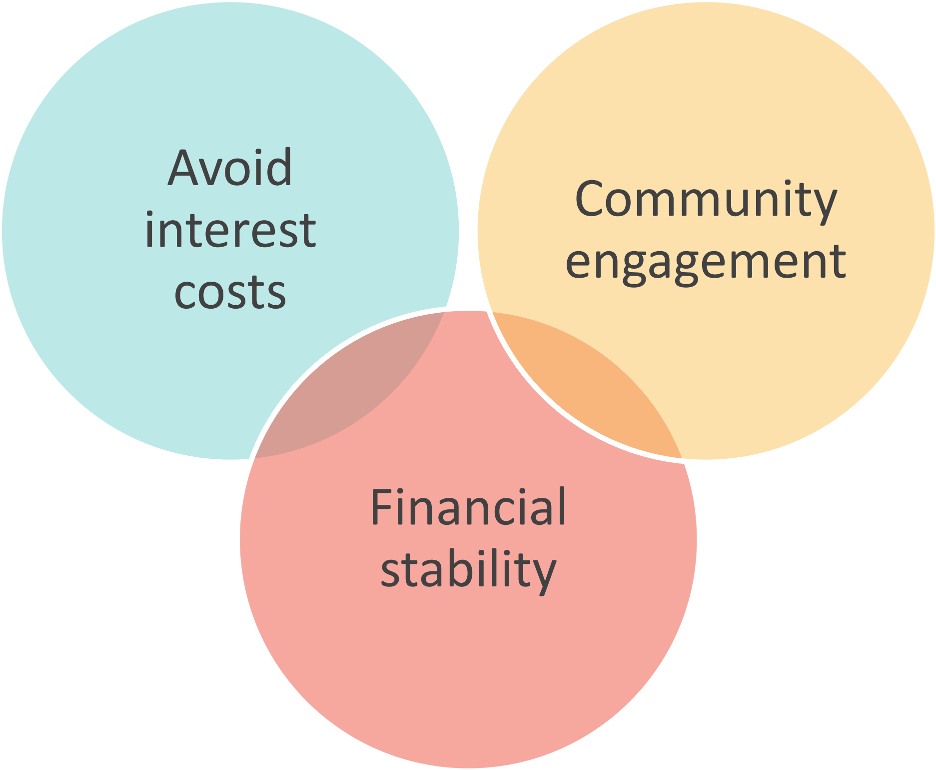
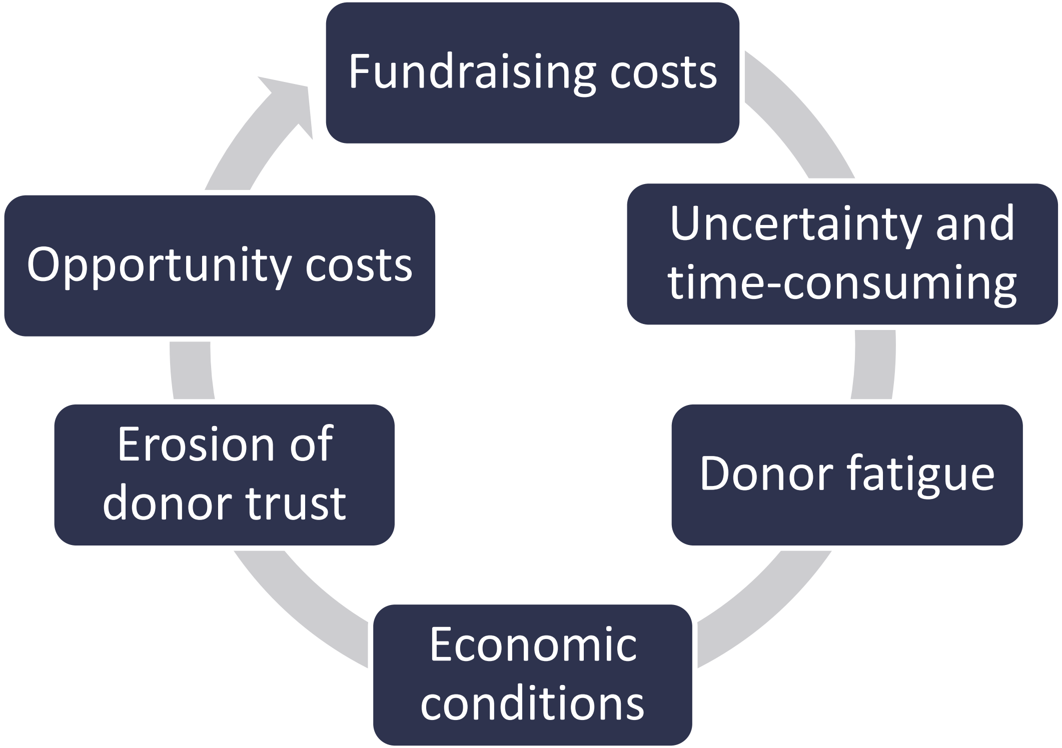
Capital Campaign – Opportunities



Capital Campaign – Challenges



Polling Question

How does your institution generally fund campus projects?

- Debt financing only
- Combination of capital campaign and debt
- Combination of cash reserves and debt
- Combination of all three, capital campaign, cash reserves and debt

Keys to Purposeful Debt Management

Debt affordability is among the most important considerations when evaluating new debt plans

Borrowers evaluating new projects must consider what level of additional leverage they can sustain operationally

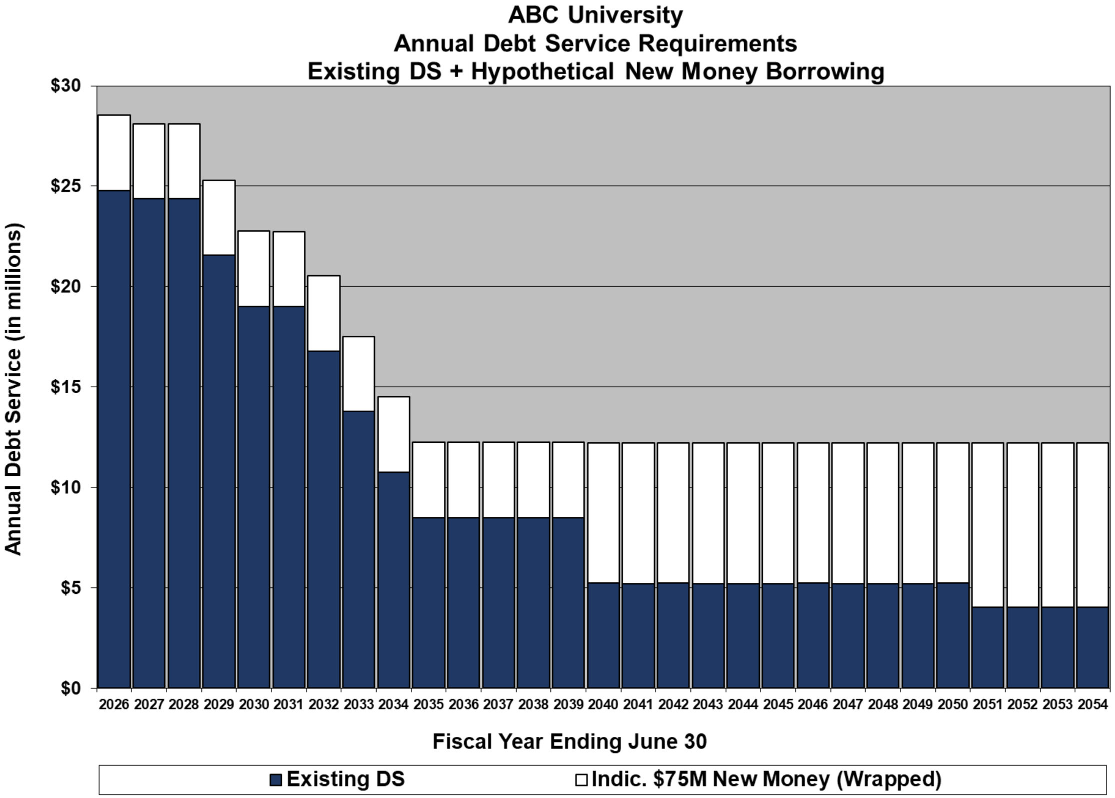
Cashflow and Debt Affordability

Revenue-generating/expense-reducing projects provide additional borrowing capacity

Creative bond structuring can spread out cashflow impact of new debt, but this often comes with additional costs

Debt Structuring Considerations

- Many institutions utilize a debt profile which "steps down" over time, maintaining capacity for future borrowing
- New money issues can be structured for level debt service, or "wrapped" around an existing portfolio
- Others may opt to structure debt with large "balloon" maturities in lieu of an amortizing structure
- Institutions with greater credit strength have correspondingly greater flexibility in how they opt to structure their debt profiles




Impact of debt covenants
Elevated exposure and risk
Restrictions on financial flexibility
Increased monitoring
Potential for default and penalties
Limitations on strategic decisions
Interest rate uncertainty

Impact on Credit Quality/Ratings

For rated institutions, evaluating the potential impact of new debt on their credit rating(s) is a key step in the planning process

Borrowers without a credit rating must also consider the credit capacity of their direct lending institution(s)

Phased borrowing in multiple tranches can allow for more planful issuance with a less dramatic immediate credit impact

Credit Rating Considerations – Moody's Scorecard

ABC University
Historical Moody's Scorecard Analysis

	Factor Weight	Fiscal Year 2022		Fiscal Year 2023		Fiscal Year 2024	
		Factor	Score	Factor	Score	Factor	Score
Factor 1: Scale (15%)							
Operating Revenue ($, in Millions)	15%	145	7.2	128	7.3	150	7.1
Factor 2: Market Profile (20%)							
Brand and Strategic Positioning	10%	Qualitative	9.0	Qualitative	9.0	Qualitative	9.0
Operating Environment	10%	Qualitative	6.0	Qualitative	6.0	Qualitative	6.0
Factor 3: Operating Performance (10%)							
Operating Cash Flow Margin (%)	10%	20.5%	2.3	16.0%	4.1	18.0%	3.3
Factor 4: Financial Resources and Liquidity (25%)							
Total Cash & Investments ($, in Millions)	10%	238	4.3	225	4.3	250	4.3
Total C&I to Operating Expenses (x)	15%	1.79x	1.1	1.70x	1.1	1.80x	1.1
Factor 5: Leverage (20%)							
Total C&I to Total Adjusted Debt (x)	10%	3.22x	1.4	3.29x	1.4	3.90x	1.1
Annual Debt Service Coverage (x)	10%	2.85x	3.2	2.30x	4.1	2.50x	3.8
Factor 6: Financial Policy and Strategy (10%)							
Financial Policy and Strategy	10%	Qualitative	6.0	Qualitative	6.0	Qualitative	6.0
Weighted Total Score:			**4.46**		**4.75**		**4.57**
Estimated Scorecard Rating Outcome:			**Aa3**		**A1**		**A1**
Current Moody's Rating:			**A1**		**A1**		**A1**

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Credit Rating Considerations – S&P Scorecard

Standard & Poor's Scorecard
Indicative Stand-Alone Credit Profile (SACP) Summary

Enterprise Profile	Implied Score
Industry Risk (10%)	2
Economic Fundamentals (10%)	2
Market Position (60%)	2
Management and Governance (20%)	3
Rounded Score:	**2**

Financial Profile	Implied Score
Financial Performance (20%)	3
Financial Resources (35%)	2
Debt & Contingent Liabilities (35%)	2
Rounded Score:	**2**

Indicative SACP Rating: AA / AA-

		Financial Profile					
	Rounded Score	**1**	**2**	**3**	**4**	**5**	**6**
Enterprise Profile	**1**	AAA	AA+	AA-	A	BBB+ / BBB	BB+ / BB
	2	AA+	**AA / AA-**	A+	A-	BBB / BBB-	BB / BB-
	3	AA-	A+	A	BBB+ / BBB	BBB- / BB+	BB-
	4	A	A / A-	A- / BBB+	BBB / BBB-	BB	B+
	5	BBB+	BBB / BBB-	BBB- / BB+	BB	BB-	B
	6	BBB-	BB	BB-	B+	B	B-

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Effects of Refinancing on Composite Score

- Dear Colleague Letter Gen-24-11
  - Refinanced debt with additional proceeds received will reclass any previous pre-implementation PP&E and related debt to a post-implementation category for the composite score.
  - Can refinance pre-implementation debt up to the outstanding balance at the date of the refinance and maintain the pre-implementation classification so long as there are no proceeds in excess of the outstanding balance.
  - If your institution has a large amount of pre-implementation PP&E and related debt, review the composite score if this debt would become post-implementation.

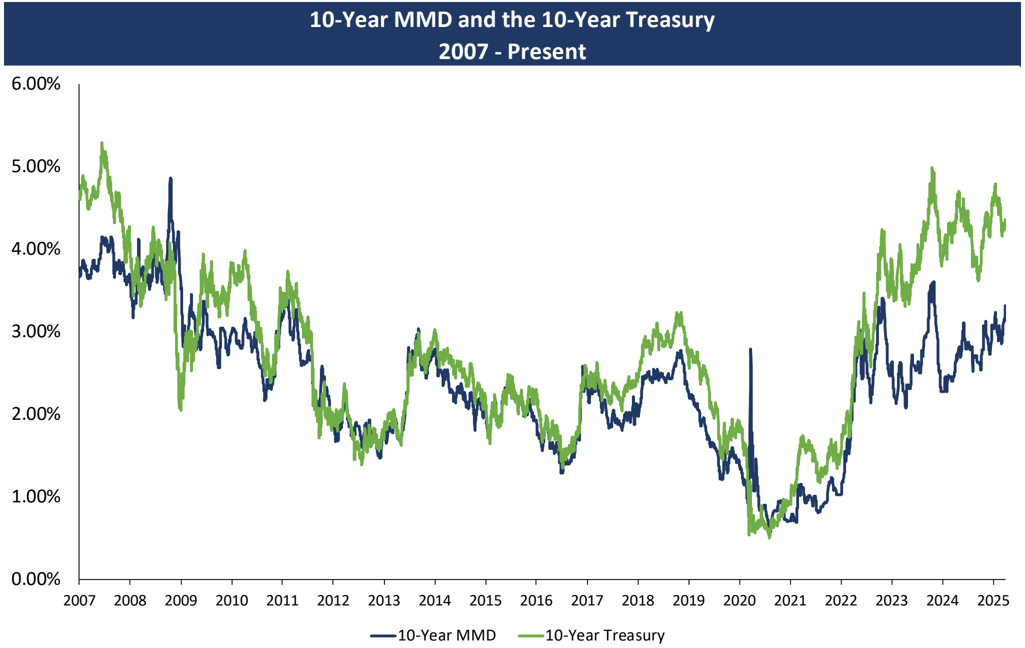
Polling Question

I would like CLA to call me to discuss the following services:

- Consulting on leveraging debt
- Consulting on debt affordability
- Consulting on debt structuring to support campus modernization and growth initiatives
- Nothing at this time

Current Financing Trends in Higher Ed

Recent Market Conditions – Interest Rates



Sources: Bloomberg Finance L.P., Thomson Reuters

- While inflation has elevated interest rates relative to historic lows achieved during the COVID pandemic, tax-exempt borrowing rates remain attractive for borrowers
- Since 2022, the gap between tax-exempt and taxable market performance has widened significantly

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Significant Topics to Monitor in 2025 and Beyond

- The threat of federal policy changes impacting availability of tax-exempt debt is causing some borrowers to accelerate their financing plans
- Inflation has impacted construction costs and interest rate expectations
- Elevated reinvestment rates for bond proceeds have reduced or eliminated negative arbitrage for borrowers
- Potential closures/mergers remain a consideration facing many higher education institutions
- Economic and demographic uncertainty continue to impact enrollment and the sector as a whole

Conclusion/Questions

Thank you!

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