

Rating Update: American University, DC

MOODY'S ASSIGNS A2 UNDERLYING RATING TO AMERICAN UNIVERSITY'S SERIES 2008 REVENUE BONDS AND AFFIRMS A2 UNDERLYING RATING ON SERIES 2003 AND SERIES 2006A AND B REVENUE BONDS; RATING OUTLOOK IS STABLE

UNIVERSITY HAS \$198 MILLION OF RATED DEBT OUTSTANDING

District of Columbia
Higher Education
DC

Opinion

NEW YORK, Jun 16, 2009 -- Moody's Investors Service has assigned an A2 underlying rating to American University's (American or the University) Series 2008 revenue bonds and affirmed the A2 underlying rating on the University's Series 2003 and Series 2006A and B revenue bonds. All of the bond series were issued through the District of Columbia. This rating applies to \$198 million of outstanding debt. The rating outlook remains stable. The University has a total of \$255.9 million of direct debt outstanding, of which all is in a variable rate mode and \$218.9 million has a put feature. Moody's maintains ratings based on credit support for other series of bonds issued by American, as detailed below (see RATED DEBT).

LEGAL SECURITY: Unsecured general obligation of the University under loan agreements with the District of Columbia. Under the letters of credit with Bank of America, N.A. (rated Aa3/P-1) that support its outstanding Series 2003, Series 2006A and B bonds, and Series 2008 bonds, the University must maintain a Leverage Ratio (unrestricted and temporarily net assets less net investment in plant divided by long-term indebtedness) of at least 1.30 at the end of each fiscal year and the end of the second quarter of each fiscal year to avoid a notice event of default and to issue additional debt. The calculation at the end of the University's 2009 fiscal year on April 30, 2009 is not yet complete, but the University expects it will be at or slightly above the required level.

INTEREST RATE DERIVATIVES: American University is party to six floating-to-fixed interest rate swaps with two counterparties that total a notional amount of \$216.7 million. These swaps serve to hedge the interest rates on 85% of the University's outstanding direct debt. Five of the swaps are with Morgan Stanley Capital Services (rated A2/P-1) and total \$155.8 million. The remaining swap is with Bank of America for a notional amount of \$60.9 million, which was entered into in conjunction with the issuance of the Series 2008 bonds. Under the swaps, the University pays a fixed rate and receives a variable rate based on either SIFMA or a percentage of LIBOR. American can terminate the swaps at any time at market value. The counterparty could terminate the swap if American's rating declined below Baa3. The University could be required to post collateral depending on the current market value of the swaps and its rating level. At May 31, 2009, the market value of the swaps was negative \$38.2 million, and the University was not required to post collateral. American had posted collateral of up to \$29 million during the past six months. While Moody's believes the swaps add risk to the University's debt structure, its significant liquidity derived from both working capital and endowment investments help mitigate the risks of collateral posting or termination payments, and we are comfortable with these risks at the current rating level.

STRENGTHS

*Sustained improvement in operating performance results from sound financial management practices. The University's annual operating margin as calculated by Moody's has strengthened each year since 2003, with a three-year average annual margin of 11.0% as of Fiscal Year (FY) 2008. Based on preliminary figures, the University anticipates a further improved operating margin for FY 2009. Operating cash flow margin has also increased steadily, and was 19.5% in FY 2008. As a result, debt service coverage of American's obligations, which are mostly structured as bullet maturities, averaged 5.4 times from FY 2006 through 2008. Coverage of maximum annual debt service assuming amortizing principal results in a lower, but still healthy, three-year average of 3.4 times. Management budgets for two-year cycles and funds contingencies each year that equal over 6% of annual expenses, both of which bolster operating results. With the University dependent on student charges (81% of operating revenues as calculated by Moody's in FY 2008), University leadership prepared alternate actions in anticipation of potential softening of enrollment for fall 2009 due to economic conditions. While projections for fall enrollment appear strong, Moody's believes this exercise demonstrates the proactive financial management style employed by American.

*Strengthening market position. American's student market position has strengthened and stabilized in recent years, as full-time equivalent (FTE) enrollment in fall 2008 of 10,503 was more than 5% greater than in 2003 and represented a record figure. Freshman applications grew to over 15,000 for fall 2006 and have remained slightly above since that time. Selectivity improved to 53% for fall 2008 from 63% for fall 2002. For fall 2009, officials report that projected enrollments are at targeted levels and above budget assumptions. The University's net tuition per student is very healthy at \$26,157 for FY 2008, due in part to nearly 40% of enrollment represented by graduate programs.

*Growth in financial resources through FY 2008. The University expanded total financial resources nearly 135% between FY 2003 and 2008 to \$520 million. This increase was based on retained operating surpluses, solid investment returns through FY 2007 (average 17.7% return from FY 2004 through 2007; the return in FY 2008 was negative 3.9%), and sustained fundraising (three-year average gift revenues of \$16.2 million for FY 2008). Expendable financial resources at June 30, 2008 covered direct debt by 1.7 times and operations by 1.2 times. These levels match Moody's FY 2008 medians for A-rated private colleges and universities. American is currently in a capital campaign to raise \$200 million for priorities such as facilities, endowments, and the arts. As of May 31, 2008, the University had raised \$180 million toward the goal, including \$133 million received in cash. The University plans to use \$11.6 million of operating funds and internal reserves to finance the renovation of existing academic facilities to create new student housing capacity and a new revenue stream during the next two years.

CHALLENGES

*The University employs a relatively aggressive debt structure in which all of its direct debt is in the variable rate mode with bullet maturities. While 85% of the direct debt is swapped to fixed rates under multiple interest rate swap agreements that help to hedge its interest rate exposure, these swaps introduce counterparty risk and the possibility of collateral posting and having to make a termination payment. Most of the swaps include rating triggers under which the counterparty could decide to terminate the swap if American's credit rating falls below Baa3. In addition, the University relies on external liquidity support in the form of letters of credit (LOCs) and a standby bond purchase to support the tender feature of \$219 million of its debt. Of this total, \$198 million of LOCs are with Bank of America, N.A. (Aa3/P-1). All of the LOCs expire in 2013, with two totaling \$137 million expiring on June 1, 2013 and one for \$60.9 million expiring on November 1, 2013. While immediate termination events are limited, should the letter of credit bank terminate an agreement or choose to not renew an agreement upon expiration, American could have to draw on its own liquidity. In the case of a failed remarketing, the University would have until the termination date to repay the bank for the tendered bonds. As of mid-May, the University estimated that \$369 million of working capital and endowment assets can be liquidated on a daily basis.

*Highlighting the strong competition American faces for higher quality undergraduate students with more selective and wealthy institutions, the University's matriculation rate remains low despite the rising popularity of Washington, D.C. as a desirable college destination. While matriculation rebounded for fall 2008 to 19.3%, the highest level since 20.3% for fall 2003, the level remains below the FY 2008 Moody's median for private colleges and universities of 27.1%. In Moody's opinion, the ability to boost the matriculation rate and sustain it at a higher level would be a positive credit factor for the University.

*Similar to peer institutions, American experienced significant investment losses in FY 2009 that weakened financial resources and increased leverage. For the fiscal year ended April 30, 2009, the University reports an investment return of negative 28.5%. Assuming a pro-forma 30% loss in total financial resources that fully impacts expendable financial resources, coverage of pro-forma direct debt would decline to a still healthy 1.1 times and coverage of operations would decline to 0.8 times. American's endowment investments are well diversified, with assets allocated among equities (47%), fixed income (24%), hedge funds (12%), real assets (9%), cash (5%), and real estate (3%). Moody's notes a concentration of management, with all fixed income investments held in a single fund. Three other managers each hold 7% of the portfolio. Over \$39 million of University working capital funds remain illiquid.

RECENT DEVELOPMENTS:

*In response to investment losses and the accounting impact expected from implementation of the Uniform Prudent Management of Institution Funds Act (UPMIFA) and adoption of FAS 117-1, the University renegotiated the Leverage Ratio in its letters of credit with Bank of America (the newly effective ratio is described above under LEGAL SECURITY). The Leverage Ratio now includes temporarily restricted net assets in the numerator of the ratio, and the required ratio was increased. The University expects to be in compliance when the ratio is calculated for fiscal year end April 30, 2009, but with limited headroom above the covenant.

*The University is replacing the standby bond purchase agreement (SBPA) with SunTrust Bank (A2/P-1) that supports the tender feature of its \$21 million outstanding Series 1999 bonds with an SBPA with TDBank, N.A. (Aa2/P-1). This substitution is scheduled to occur at the end of June 2009. As of June 15, 2009, \$2.7 million of the bonds were bank bonds. If the substitution does not occur and the bank bonds are still outstanding at August 7, 2009, they would convert to a term loan that the University would be scheduled to pay over a three-year period.

Outlook

The stable outlook reflects Moody's expectation that the University will maintain solid operating results while continuing to bolster financial resources over time and strengthen its market position.

What could change the rating-UP

Reduction of risk in the University's debt structure; further strengthening in market position, including a sustained upward trend in matriculation; continuing to generate strong operating surpluses contributing to growth of the University's balance sheet

What could change the rating-DOWN

Sustained deterioration of operating performance; decline in student demand indicators; substantially weakened balance sheet strength resulting from additional borrowing in excess of growth in financial resources, significant spend down of reserves for capital projects, or rapid repayment of debt due to accelerated schedules under the LOC reimbursement agreements.

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

*Ratios in parentheses represent a proforma 30% decline in total financial resources that fully impacts expendable financial resources to reflect expected investment losses and endowment spending

Total Full-Time Equivalent Students (FTE): 10,503 students

Freshman Acceptance Rate: 52.9%

Freshman Matriculation Rate: 19.3%

Total Direct Debt: \$255.9 million

Expendable Financial Resources to Direct Debt: 1.72 times (1.11 times)

Expendable Resources to Operations: 1.23 times (0.80 times)

Three-year Average Operating Margin: 11.0%

Operating Cash Flow Margin: 19.5%

Reliance on Student Charges: 81.4%

RATED DEBT

Series 2003, 2006A and 2006B: A2 underlying; Aa3/VMIG1 (based on letters of credit provided by Bank of America, N.A., with stated expiration dates of 6/1/2013)

Series 2008: A2 underlying; Aa3/VMIG1 (based on letter of credit provided by Bank of America, N.A., with stated expiration date of 11/1/2013)

CONTACTS

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METHODOLOGY

The principal methodology used in rating American University was Private Colleges and Universities, which can be found at www.moodys.com in the Credit Policy & Methodologies directory, in the Ratings Methodologies subdirectory. Other methodologies and factors that may have been considered in the process of rating this issuer can also be found in the Credit Policy & Methodologies directory.

The last rating action was on October 17, 2008 when the long-term rating assigned to American University was affirmed.

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