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Rating Update: MOODY'S AFFIRMS WESTERN CAROLINA UNIVERSITY'S Aa3 ISSUER RATING; OUTLOOK HAS BEEN REVISED TO NEGATIVE FROM STABLE

Global Credit Research - 28 Jul 2011

WESTERN CAROLINA UNIVERSITY HAS A TOTAL OF $89 MILLION DEBT OUTSTANDING

Higher Education
NC

Opinion

NEW YORK, Jul 28, 2011 -- Moody's Investors Service has affirmed the issuer rating of Western Carolina University (WCU or the University) at Aa3. The rating outlook has been revised to negative from stable. The University is a member of the University of North Carolina System and is located in Cullowhee, North Carolina. This issuer rating is the sole published underlying rating that Moody's maintains on WCU.

SUMMARY RATING RATIONALE

The revision to a negative outlook is a result of significant recent reductions in state support, a key revenue source for the University. Future state support is uncertain, and further reductions would pressure Western Carolina's operating performance. Additional factors include recent and projected near-term increases in debt coupled with recent declines in financial resources leading to a more leveraged balance sheet. The Aa3 rating reflects Western Carolina University's steadily growing market position, the University's ability to systematically prioritize expenses in response to reductions in state support and its ability to grow net tuition revenue through a pressured economic climate. Challenges include increasingly leveraged balance sheet and operations, and recent and anticipated reductions state support that continue to put pressure on operating performance.

CHALLENGES

*Substantial recent declines in state funding, WCU's primary revenue source (represents 49.6% of total operating revenues in FY 2010), putting pressure on the University's operating performance. The State of North Carolina (general obligation bonds rated Aaa) announced a 16.4% cut to the University's base appropriation for FY11;

*Significant tuition hikes are not sustainable as an annual, long-term response to state funding reductions;

*Financial resources have not recovered from their peak in FY2008 as comprehensive debt (including capital and operating leases) has grown by 38% in that same time period, creating a more leveraged balance sheet with expendable financial resources covering comprehensive debt only 0.51 times and operations by 0.43 times;

*Ambitious capital plans to increase and improve housing and other facilities will require additional borrowing in the near future.

STRENGTHS

*Demographically vibrant state with growing high school population provides foundation for growing market position. Total full-time equivalent enrollment has grew by 7% from fall 2006 to fall 2010;

*Although the State of North Carolina has cut its base appropriations to the University, it continues to offer both enrollment growth support and capital appropriations that bolster financial position and growth;

* Strong financial management has enabled the University to respond quickly and effectively to appropriation cuts with corresponding expense cuts, allowing the University to maintain break-even or near break-even operating margins (2% three-year average operating margin as calculated by Moody's for FY 2008-2010). The University also produced decent operating cash flow margins (10.7% in FY2010) that provided 2.5 times debt service coverage for FY2010.

DETAILED CREDIT DISCUSSION

LEGAL SECURITY: The A1 rating is an issuer rating, not assigned to any particular bond series.

INTEREST RATE DERIVATIVES: None.

RECENT DEVELOPMENTS:

As one of the 16 members of the University of North Carolina System, Western Carolina University benefits from growth in the state's pool of potential students. Through 2018, the number of high-school graduates in the state is expected to increase by 18%. As a regional comprehensive university and designated focused growth institution within the UNC System, WCU delivers a variety of offerings tailored to meet state and regional economic needs, including teacher training and allied health education. From fall 2006 to fall 2010, the University's total enrollment grew by 7% on an FTE basis to 8,312. The University has plans to increase enrollment to 10,000 over the next several years. The University received a record number of 14,979 applications for fall 2010 - more than three times the 4,830 it received in fall 2007 - and University management reports that it's applications are tracking similar to last year for the class entering fall 2011. Based on freshmen deposits as of June 9, 2011, Management expects to exceed its budgeted freshmen enrollment of 1,500 for fall 2011. Overall enrollment will show only a slight increase over fall 2010. The ability to maintain stable student demand and grow student revenue is a positive credit factor for the University.

Relatively low levels of tuition and fees also underpin demand, but are threatened as the state continues to reduce operating support. For the 2010-2011 academic year, undergraduate tuition and fees increased by 33.7% for in-state residents to $5,999, as North Carolina passed

special legislation to allow WCU to increase tuition to make up for shortfalls in state revenue and the subsequent cuts in state appropriation. For fall 2011, the University received special authorization to increase tuition by 6.5%. WCU's net tuition per student of $3,919 in FY2010 was still among the lowest of the 16 North Carolina public universities, pointing to some pricing power and continued ability to attract students with a relatively low cost of attendance.

The State of North Carolina (Aaa -rated general obligation bonds) has traditionally offered strong operating and capital support to its public universities which bolstered WCU's operating performance, but that support has been cut during recently challenging economic times and future levels of state support are uncertain. State appropriations for operations were reduced by 7.6% from a high of $87 million in FY 2008 to $82 million in FY 2010. This source represented 49.6% of total revenues as calculated by Moody's in 2010, but that number is likely to decrease for fiscal years 2011 and 2012. In FY 2011, Western Carolina had to make a $2.85M required reversion out of its FY 2011 budget and its June state funds were frozen and then reverted, resulting in an estimated $3-4M operating gap. The fall 2012 state appropriation was just approved with a 16.4% cut to WCU's operating support. The University made substantial cuts in expenses in FY 2011 in preparation for the FY 2012 cuts by reducing up to 10% of its employee force and letting positions lapse as they became vacant. The University will have to make additional cuts to staff to adjust to the more severe cuts in FY 2012. Additionally, the State has cut its annual restoration and renovation monies to fund depreciation over the last several years, from $1.2 million in FY 2010 to zero in FY 2011. The legislature approved a budgeted amount of $2,066,400 for fiscal 2012. The University reports that is maintaining its auxiliary facilities through auxiliary reserves. Moody's expects that the University will be able to manage through the budget cuts with additional tuition revenue and expense cuts in order to maintain a break-even or near break-even operating margin.

The University's financial resources have thinned over the last few years with substantial investment losses and capital plans, while debt has grown resulting in a more leveraged balance sheet. WCU's expendable financial resources fell by 14% from 2008 to 2010 and comprehensive debt grew by 38% over that time. The ratio of expendable financial resources to comprehensive debt has steadily decreased to 0.72 times in recent years. As of March 31, 2011, market value of WCU's total endowment was $45, 474,919, representing a 17.6% YTD change in market value. The University has an endowment spending policy of 5% of a three year rolling average. Half of the Endowment is managed by the UNC Management Company, Inc., a separate non-profit company affiliated with UNC Chapel Hill; and the remaining 50% is invested with Yon-Drake & Associates, an investment consulting firm located out of Columbia, South Carolina. Total allocation as of March 31, 2011, was 3.01% cash and equivalents, 3.29% limited partnerships, 93.7% mutual funds (traditional as well as well as emerging markets). This information is based on unaudited data.

The University completed its first capital campaign in 2009 and raised $51 million, far exceeding the goal of $40 million. University officials report that they are close to meeting that goal and have collected approximately 25% of the total in cash to date.

For the last several years, WCU has been making a concerted effort to improve the amount and quality of its residential housing and other amenities to attract students and generate auxiliary revenues. Since 2009, the University has opened two new residence halls (built by the Western Carolina University Research and Development Foundation, LLC and leased back to WCU through a capital lease in a privatized student housing model), a dining facility (funded through UNC System Series 2008A Pooled Bonds), a campus recreation center (funded through UNC System Series 2003A and 2008A Pooled Bonds) and Health Sciences Building that houses the nursing program (funded through state capital appropriations). The Health Sciences Building is the only facility located on the Millennial Campus, a 350-acre campus that the University intends to develop as a research and technology community. The original plan was that the Health Sciences Building would anchor one neighborhood within the new campus which could also include a retirement community developed by a third party under a ground lease from the University. The plans for the Millennial Campus are under review. Currently the University has modest debt plans with authorization to issue $13 million of new debt to renovate a current residence hall that will go offline in August 2011. The new debt will be issued through a UNC System Pooled Bond issuance sometime in the next year.

Outlook

The negative outlook is based on Moody's expectation that the University will face operating pressure as it adjusts to current and future potential state funding cuts; state appropriation are the University's primary revenue source. Over the last few years, WCU has also experienced increases in debt coupled with recent declines in financial resources leading to a more leveraged balance sheet. Additionally, the University's market has stabilized after a long period of extreme growth, so net tuition revenue may not grow enough to counteract state cuts.

What could make the rating go UP

Significant increase in financial resources combined with enrollment growth.

What could make the rating go DOWN

Inability to capture the growth in the state's high-school graduate population resulting in a weakened market position; weakened operating performance and comprehensive debt service coverage; substantial further reductions in state support.

KEY INDICATORS (Based on fiscal year 2010 financial data and fall 2010 enrollment data)

Total Enrollment: 8,312 full-time equivalent students

Total Direct Debt: $88.9 million

Total Comprehensive Debt: $94.3 million

Total Financial Resources: $95.5 million

Expendable Financial Resources: $67.9million

Expendable Financial Resources to Comprehensive Debt: 0.72 times

Expendable Financial Resources to Operations: 0.43 times

Monthly Liquidity: $50.7 million

Monthly Days Cash on Hand (unrestricted funds available within 1 month divided by operating expenses excluding depreciation, divided by 365

days): 121.6 days

Three-Year Average Operating Margin: 2.0%

Operating Cash Flow Margin: 10.7%

Share of Revenues from State Appropriations: 49.6%

State of North Carolina Issuer Rating: Aaa, stable outlook

RATED DEBT

The University of North Carolina System Pool Revenue Bonds, Series 2006A and Series 2008A: Aa3

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METHODOLOGY

The principal methodology used in this rating was Public College and Universities published in November 2006. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

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