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INVESTORS SERVICE

Rating Update: MOODY'S AFFIRMS AMERICAN UNIVERSITY'S (DC) A2 RATING; OUTLOOK REVISED TO POSITIVE FROM STABLE

Global Credit Research - 14 Nov 2011

UNIVERSITY HAS $197.9 MILLION OF RATED DEBT OUTSTANDING

AMERICAN UNIVERSITY, DC
Private Colleges & Universities
N/A

Opinion

NEW YORK, November 14, 2011 --Moody's Investors Service has affirmed the A2 underlying rating on American University's (American or University) outstanding revenue bonds, affecting $197.9 million of rated debt outstanding. All of the bonds were issued through the District of Columbia. The outlook has been revised to positive from stable. Please see RATED DEBT section for more detail.

SUMMARY RATING RATIONALE

The A2 rating reflects the University's strong market position with growing enrollment, conservative fiscal and budgeting practices, consistently healthy operating performance, material balance sheet growth that are projected to remain at least at similar levels, and risks associated with its relatively aggressive debt structure.

The positive outlook is driven by the University's strengthening student market position, management's demonstrated ability to plan and budget well enough to generate consistently favorable operating margins and our expectation that the University can absorb additional debt associated with the current $287 million capital plan. The University will begin issuing debt under a new $125 million commercial program backed by its own self-liquidity. Moodys has not been asked to rate the commercial paper program. An upgrade to A1 was prevented at this time by lingering risks associated with American's high exposure to variable rate debt, which carries renewal risks for four letters of credit set to expire in 2013, potential acceleration risk should covenants be breached, and swap collateral posting risks under certain circumstances. At this time, these risks are largely mitigated by American's liquidity.

STRENGTHS:

*Selective, well-known private university with a desirable Washington D.C. location and improving student market position, symbolized best by an improving yield on admitted students at a time when yields are generally declining in the industry. New student acceptance rates have also strengthened, reaching 42% in FY 2011 from 53% in FY 2007 while yields rose to 20% in FY 2011, compared to 15% in FY 2007. Enrollment has increased by 14% during the same period with the fall 2011 enrollment at 11,506 full-time equivalent (FTE) students.

*Strong financial management practices including an unusual two-year budgeting cycle that facilitates better predictability and consistency of strong operating results, including average operating margin for three-years ended April 30, 2011 at 12.9% and cash flow margin a strong 16.7% in FY 2011

*Continued growth of financial resources, with 29% increase since FY 2007 in total financial resources to $652.7 million in FY 2011, a new high, which is not projected to decline materially over the next several years. Expendable financial resources in FY 2011 covers pro forma debt by 1.25 times, including a $75 million 10-year (fixed rate) loan with JPMorgan Chase N.A. (rated Aa1/P-1) and the University's commercial paper program at the full authorized amount of $125 million.

CHALLENGES:

*Aggressive use of variable rate debt including 84% of its direct debt, including the CP program at full $125 million authorized amount, and numerous bullet maturities. The University is also party to five swaps with two counterparties related to approximately 40% of pro forma direct debt, introducing counterparty, collateral posting, and termination risks. External liquidity support for the University's variable rate demand debt in the form of three letters of credit and one standby bond purchase agreement would introduce risks as well, including renewal risk when all four expire in 2013.

*Significant reliance on tuition and fees for operations compared to similarly sized and rated institutions, 82% of operating revenues. However, program diversity, reflective in part of a low 63% of total FTEs representing undergraduates, mitigates this challenge.

*Sizeable capital plans and increasing age of plant despite trend of healthy capital spending may further increase leverage that may not be appropriate at current rating level without commensurate balance sheet growth

DETAILED CREDIT DISCUSSION

LEGAL SECURITY: Unsecured general obligation of the University under loan agreements with the District of Columbia.

DEBT STRUCTURE: Total direct debt is currently $455.9 million, of which approximately $219 million, or 48%, is variable rate demand debt consisting of the Series 2003, Series 2006A and B, and Series 2008 bonds, all of which have bullet maturities. After the end of FY 2011 in June 2011, the University entered into a $75 million taxable fixed-rate 10-year term loan with JPMorgan Chase Bank, N.A. to partially finance its current capital plan,

The University also plans to begin a taxable commercial paper (CP) program to temporarily finance the capital plan at an authorized level of $125 million which will be supported by its own internal liquidity. We do not rate this program. The University expects to issue up to $25 million over the next 12 months and up to $80 million by FYE 2014, and the full $125 million by FY 2015. Preliminary plans are to permanently finance

any CP outstanding around FY 2015 with fixed rate bonds. Daily maturities of CP is limited to $20 million, although no more than $50 million of CP can mature in any week.

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. Three letters of credit are with Bank of America, N.A. (rated A2/P-1) that support $198 million of outstanding Series 2003, Series 2006A and B bonds, and Series 2008 bonds 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.

The LOCs with Bank of America and $75 million loan with JPMC are subject to Leverage Ratio and Debt Service Coverage Ratio covenants. 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 0.85 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 2011 fiscal year on April 30, 2011 was 2.07 times; as of September 31, 2011, it was 2.31 times including the $75 million loan with JPMC. Any CP outstanding will be included in the Leverage Ratio, rather than the full authorized amount. The debt service coverage ratio (change in unrestricted net assets from operations plus depreciation and interest expense) must be at least 1.60 times as calculated at the end of each fiscal year. At FYE 2011, the debt service coverage ratio was 7.78 times, providing ample headroom.

The University also has a standby bond purchase agreement (SBPA) with TD Bank, N.A. (rated Aa2/P-1) that supports the tender feature of its $21 million outstanding Series 1999 bonds. There are no financial covenants associated with the SBPA.

INTEREST RATE DERIVATIVES: American University is party to five floating-to-fixed interest rate swaps with two counterparties that total a notional amount of $194.7 million. A sixth swap had expired in September 2011. These swaps serve to hedge the interest rates on 59% of the University's outstanding direct debt. Four of the swaps are with Morgan Stanley Capital Services (rated A2/P-1) for a combined notional amount of $133.8 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. As of August 31, 2011, the market value of the existing five swaps was negative $61.1 million. The collateral posting threshold is $25 million for each counterparty and the University currently has $19 million posted with Morgan Stanley as of October 30, 2011 and none with Bank of America. During the past six months, American had posted collateral of up to $29 million. 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. As of September 30, 2011, the University estimated that $144 million of working capital and endowment assets can be liquidated on a daily basis.

MARKET POSITION/COMPETITIVE STRATEGY: SELECTIVE, URBAN UNIVERSITY WITH IMPROVING MARKET POSITION OFFERING DIVERSE ARRAY OF PROGRAMMING

Located in Washington D.C., American University is private university with diverse undergraduate and graduate programs, with 62% of total full-time equivalent students represented by undergraduate students. Full-time equivalent (FTE) enrollment in fall 2011 was 11,506, a 14% increase since fall 2007 driven primarily by undergraduate growth. Going forward, enrollment is projected to stabilize and the University has conservatively assumed annual FTE growth ranging between 0.2% to 0.7% through FY 2018. The University's market position has strengthened over the last 15 years, due in part to its desirable urban location, brand enhancement strategy, and increased selectivity at other private university located in D.C. Applications increased again for the fall 2011 class, growing by 10.5% and since 1997, selectivity has materially improved from a 79% acceptance rate in 1997 to a 42% acceptance rate for the fall 2011 class. Matriculation rates have also steadily improved, to 20% in fall 2011 from 15% in fall 2007. In addition to enhancing the University's brand, senior management also attributes a stronger market position to improved efforts to identify those students more likely to attend the University, more aggressive recruiting of students outside the DC/Maryland/Virginia regions, especially in California and the southeast region, and investments in faculty, staff and programs. Retention rates have also improved over the years from the 70% range in the 1990s to consistently over 90% since 2008.

Net tuition per student is very healthy at $28,064 for FY 2010, due in part to nearly 40% of enrollment represented by graduate programs and a relatively low 21.7% discount rate, as calculated by Moody's. The University assumes a 29% discount through FY 2018 applied to all full-time and graduate programs. After several years of 5-6% tuition rate increases, the University increased tuition by 3.8% in FY 2012 and FY 2013, the lowest increase in recent years, and is forecasting 4% increases from FY 2014 to FY 2018 in its five-year budget model.

OPERATING PERFORMANCE: HEALTHY OPERATING PERFORMANCE SUPPORTED BY CONSERVATIVE FISCAL PRACTICES

Conservative budgeting and fiscal practices are expected to continue to contribute to the University's healthy operating performance. The University's three-year average annual margin was a healthy 12.9% in FY 2011, as calculated by Moody's and operating cash flow margin, while declined from FY 2010, was a still-solid 16.7% in FY 2011. Management budgets for two-year cycles and funds contingencies each year that equal 6-7% of annual expenses ($36.2 million in FY 2012), both of which bolster operating results annually. Examples include a capital renewal deferred maintenance fund that is typically budgeted to support annual deferred maintenance expenses of $8-10 million (compared to $11.4 million budgeted in FY 2012); funding of next year's salary increase in the prior year, and transfers to the quasi-endowment fund.

Debt service coverage of American's obligations have been strong and was 7.4 times in FY 2011 because nearly all of the University's debt is structured as bullet maturities. Using maximum annual debt service as a better proxy for actual debt service, which we calculate using 8% of total principal outstanding, average MADS coverage was 3.97 times in FY 2011 and a still-healthy 2.9 times on a pro forma basis including the $75 million loan with JPMC and a maximum of $25 million of CP issued in the next 12 months under the new CP program. As another example of prudent fiscal practice, the University internally budgets for annual level debt service of each debt series with bullet maturities, with an assumption of a 5% interest rate (compared to actual rates of about 4.3%), to ensure adequate coverage of its variable rate debt.

The University continues to be highly dependent on student charges for operations (82.3% of FY 2011 operations). However, we believe potential concerns with this concentration is softened with the University's programmatic diversity, including its approximately 60/40 split between undergraduate and graduate students. To further diversify its programs and extend its reach, the University is considering several options, such as a partnership with an online distance education provider, although the University will maintain full control over the curriculum.

BALANCE SHEET POSITION: STEADY GROWTH OF FINANCIAL RESOURCES EXPECTED TO CONTINUE WITH HEALTHY LIQUIDITY; SIGNIFICANT FUTURE CAPITAL PLANS

We believe the University will continue to grow total financial resources driven by positive operating performance, healthy investment returns (average 10.6% return from FY 2009-2011, including 20% loss in FY 2009), conservative practice of budgeting annual transfers to quasi-endowment, and sustained fundraising (three-year average gift revenues of $20.2 million for FY 2011). Since FY 2007, total financial resources have increased by 28.7% to $652.6 million in FY 2011 (ended April 30, 2011), a new high. Expendable financial resources of $567.9 million covered operations by 1.3 times and direct debt by 2.2 times in FY 2011. After including the new $75 million bank loan with JPMC and assuming a maximum $25 million of commercial paper that the University expects to issue over the next 12 months, expendable financial resources covers debt by 1.6 times. The University maintains a healthy level of liquidity, with monthly liquidity of $545.0 million in FY 2011 which would cover 489 days of operations.

On December 31, 2010, the University closed its AnewAU campaign, exceeding the $200 million target by raising $214.1 million. While the University is not currently in a comprehensive campaign, it has several targeted campaigns underway that coincide with its long-term strategic plan and includes projects related to the law and communications schools and the alumni center. Average gift revenue has held steady over the last several years, despite the recent economic downturn, but remains below rated-peer institutions at $20.2 million for the three-years ended April 30, 2011. Ongoing initiatives to improve fundraising and increase annual giving levels are expected to result in increases to gifts and fundraising over the next several years.

Since 1998, the University began a practice of budgeting annual transfers as quasi-endowment, which was an important contribution to overall endowment growth. The University currently targets transfers of 2% of the budget to quasi-endowment, and has averaged 1.5%, which contributed to overall growth of the endowment. In FY 2011, board-designated endowment was a sizeable $309.5 million compared to monthly liquidity of $545 million.

As of August 31, 2011, the University's pooled endowment was valued at $396.3 million and does not include $1.7 million of non-pooled endowment and $13.5 million held as interest in perpetual trust. Investment returns on the pooled endowment was 15.8% in FY 2011 and FYTD 2012 investment results as of August 31, 2011 reflected a loss of 8.3%. American's endowment is managed by a nine-member Investment Committee in conjunction with two external investment consultants, including one specific for alternative investments. The University's investments are diversified, with assets allocated among equities (53.7%), hedge funds (18.3%), fixed income (12.2%), real assets (5.5%), real estate (5.4%), cash (3.6%), and private equity (1.3%).

American University has a $287 million capital plan that aligns with its long-term strategic plan, of which $202.5 million is expected to be financed with debt, $44.5 million with University reserves, and $40 million with gifts. Projects include renovations and additions to Nebraska and North residential halls ($48 million, expected completion August 2013); the East Campus mixed-use development, including residential, parking, and academic/administrative buildings ($99 million, expected completion August 2015); and the relocation of the Washington College of Law on the Tenley Campus (140 million, expected completion August 2015). Debt used to finance this capital plan is comprised of a $75 million 10-year fixed rate loan with JPMC with the balance expected to be temporarily financed with a new $125 million commercial paper program before being permanently financed with fixed rate long-term bonds in FY 2015.

We note that age of plant continues to increase, and was 15 years in FY 2011, despite capital spending ratios that consistently exceed 1.0 (1.3 times in FY 2011), although upcoming capital investments is expected to lower age of plant noticeable over the next several years.

Outlook

The positive outlook is driven by the University's strengthening student market position, management's demonstrated ability to plan and budget well enough to generate consistently favorable operating margins and our expectation that the University can absorb additional debt associated with the current $287 million capital plan.

WHAT COULD CHANGE THE RATING UP

Reduction of risk in the University's debt structure; material change in University's balance sheet; improve and sustained fundraising levels; continued strengthening in market position, including matriculation

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 2011 financial data and fall 2011 enrollment data)

Total Full-Time Equivalent Students (FTE): 11,506 students

Freshman Acceptance Rate: 41.6%

Freshman Matriculation Rate: 20.0%

Net tuition per student: $28,867

Expendable financial resources: $567.9 million

Total financial resources: $652.6 million

Monthly liquidity: $545.0 million

Monthly liquidity to demand debt: 213.0% (194%, including $75 million loan with JPMorgan Chase Bank entered into after FYE 2011)

Total Direct Debt: $255.9 million; $330.9 million (including $75 million JPMC Bank)

Expendable Financial Resources to Direct Debt: 2.22 times; 1.60 times, including $75 million loan with JPMC

Expendable Resources to Operations: 1.32 times

Monthly days cash on hand: 489 days

Three-year Average Operating Margin: 12.9%

Operating Cash Flow Margin: 16.7%

Reliance on Student Charges: 82.3%

RATED DEBT

Series 2003, Series 2006A, Series 2006B: A2 underlying; Aa3/VMIG 1 (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/VMIG 1 (based on letter of credit provided by Bank of America, N.A., with stated expiration date of 11/1/2013)

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PRINCIPAL METHODOLOGY USED

The principal methodology used in this rating was U.S. Not-for-Profit Private and Public Higher Education published in August 2011. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

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