



New Issue: MOODY'S ASSIGNS Aa2 RATING TO MIDDLEBURY COLLEGE'S \$96.9 MILLION FIXED-RATE SERIES 2010 REVENUE REFUNDING BONDS AND AFFIRMS Aa2 RATING ON OUTSTANDING DEBT; OUTLOOK IS STABLE

Global Credit Research - 17 Oct 2010

COLLEGE WILL HAVE \$278.8 MILLION OF RATED DEBT OUTSTANDING

Vermont Educational & Hlth. Bldgs. Fin. Agy.
Higher Education
VT

Moody's Rating

ISSUE	RATING
Series 2010 Revenue Refunding Bonds	Aa2
Sale Amount \$96,885,000	
Expected Sale Date 10/26/10	
Rating Description Private College Revenue Bonds	

Moody's Outlook Stable

Opinion

NEW YORK, Oct 17, 2010 – Moody's Investors Service has assigned a rating of Aa2 to Middlebury College's fixed-rate Series 2010 Revenue Refunding Bonds to be issued through the Vermont Educational and Health Buildings Financing Agency. The rating outlook is stable. At this time, Moody's is also affirming the ratings on Middlebury's outstanding debt (see RATED DEBT below). Following the current issuance, the College will have a total of \$278.8 million of rated debt outstanding and an all fixed-rate debt structure.

RATING RATIONALE:

USE OF PROCEEDS: Bond proceeds will be used to refund the outstanding variable-rate Series 1998A, 2002B, and 2008 bonds and to pay costs of issuance.

LEGAL SECURITY: Payments under the loan agreement are an unsecured general obligation of the College.

INTEREST RATE DERIVATIVES: The College is party to a floating-to-fixed interest rate swap with a current notional amount of \$51.2 million that now hedges the Series 2008 bonds. The counterparty is Goldman Sachs Bank USA (guaranteed by The Goldman Sachs Group, rated A1/P-1). When the College originally entered into the swap in 2004, it received an upfront payment of \$4.3 million. As of October 1, 2010, the market valuation of the swap was negative \$12.8 million to the College. In conjunction with the issuance of the Series 2010 bonds and the resulting all fixed-rate debt structure, the College anticipates terminating the swap and paying the termination payment with its own cash reserves.

STRENGTHS

*Excellent student market position as a nationally prominent liberal arts college located in west-central Vermont, with reputational strength in languages, international studies, and literature. Middlebury is highly selective, with a 17% freshmen selectivity ratio in fall 2010 and 42% matriculation ratio (accepted applicants who chose to enroll). Management is focused on program and revenue diversification, as highlighted by the recent full merger with the Monterey Institute of International Studies in California, summer programs, and the launch of Middlebury Interactive Languages LLC, a language learning company geared for pre-college students, featuring both an on-line language learning program and residential, language immersion summer academies located in various states.

*Management actions to reduce operating expenses in light of investment losses and forward budget planning likely to help mitigate impact of reduced availability of spending from endowment, including voluntary separation programs, salary freezes, and other budget reductions. By Moody's calculation, operating expenses (including capital campaign expenses) declined 3% in FY 2010 (based on draft FY 2010 financial statements). Management is now projecting breakeven operating performance in FY 2012-2015, compared to earlier projections of roughly \$5-10 million deficits.

*Although fundraising has experienced some pressure recently in light of the economic climate, strong gift revenue remains a key credit strength of the College, which is in the midst of a \$500 million comprehensive capital campaign. Gift revenue was \$30.7 million in FY 2009 and increased moderately to \$34.6 million based on draft FY 2010 financial data.

CHALLENGES

*Higher leverage than most similar-sized Aa rated private colleges due to the College's significant investment in its facilities and its decision historically to use debt rather than gifts or reserves to finance several large capital programs. Further, the College has made extensive use of debt (approximately \$279 million of pro-forma debt), some of which has been structured as bullet maturities with principal payments scheduled for later years. This concern is partly mitigated by the College's lack of near-term additional borrowing plans and healthy balance sheet. In FY 2009, expendable financial resources of \$515.8 million covered debt 1.8 times compared to the Aa-rated private university median of 2.3 times.

*History of variable operating performance, although operating cash flow remains healthy. Although the College employs a 5% endowment spending policy, it also draws from the endowment to support debt service payments. Thus endowment draws are typically higher than the 5% draw that Moody's includes for all universities. In FY 2008 and 2009, the College's operating margins were negative 2.9% and negative 4.5% respectively. A focus on expense containment has contributed to operating improvement in FY 2010, with an estimated 0.5% surplus generated. Medians for the Aa-rated private universities are stronger, with a 4.3% median surplus in FY 2009.

MARKET POSITION/COMPETITIVE STRATEGY: EXCELLENT MARKET POSITION ENHANCED BY COMPLETED MERGER WITH THE MONTEREY INSTITUTE OF INTERNATIONAL STUDIES, SUMMER PROGRAMS AND RECENT LAUNCH OF ONLINE LANGUAGE LEARNING PROGRAM

Moody's expects that Middlebury will maintain its excellent student market position as a highly selective liberal arts college, recognized for its language, literature and environmental studies programs. The College continues to focus on avenues for strategically diversifying its program offerings and revenue base. In addition to the 2,515 FTE students enrolled in the core academic program in fall 2010, the College operates a summer language immersion program (1,520 students in summer 2010), undergraduate and graduate programs at the Middlebury College Schools located throughout the world, and the Bread Loaf School of English, which is a graduate program. Middlebury draws from a national geographic base (fewer than 30% of students are from the Northeast and approximately 10% are international) and competes for students with other prestigious liberal arts colleges as well as many Ivy League institutions. Student demand remains very strong, with 17% selectivity in fall 2010 and 42% of accepted students choosing to enroll.

As part of a strategic plan adopted in 2006, Middlebury has been increasing financial aid, as evidenced by an increase in the tuition discount rate to 38.7% in FY 2009 from 31.6% in FY 2004. However, management projects that the FY 2011 financial aid budget will decline modestly to \$48.1 million from \$48.99 million in FY 2010. Net tuition per student as calculated by Moody's remains high at \$25,831 in FY 2009, with approximately 46% of Middlebury students receiving some form of need-based financial aid. For fall 2010, the College increased its comprehensive fee by 3.4%.

As of June 2010, Middlebury has fully merged with the Monterey Institute of International Studies (MIS). MIS, which is located in California, has an enrollment of approximately 713 students and offers degrees in international business, international policy studies, and language-related programs that are complementary to programs offered at Middlebury. Moody's believes Middlebury has the opportunity to expand its expertise in international education, language teaching, and cultural studies. In FY 2009, MIS represented approximately 2% of consolidated total net assets and 14% of operating expenses.

In May 2010, the College launched a for-profit language learning company geared for pre-college students, Middlebury Interactive Languages, in conjunction with a for-profit company which specializes in online programs for this age group. This new company features both an on-line language learning program and residential, language immersion summer academies located in various states. We believe that this program has the potential to generate additional income for the College and build its reputation with younger students, aspects which are credit positives. To-date Middlebury has invested \$4 million of cash in the launch of the program, and the College initially has a 40% ownership stake in the joint venture. We will continue to monitor the profitability of the new program as well as the need for future capital investments.

OPERATING PERFORMANCE: STRONG FOCUS ON EXPENSE REDUCTIONS IN ORDER TO COMPENSATE FOR PRESSURE ON ENDOWMENT DRAWS

Over the past several years, Middlebury's operating margin as calculated by Moody's has been below the peer group average, fluctuating from a low of negative 9.1% in 2005 to a high of 3.4% in 2004. Following positive margins in FY 2006 and 2007 of 2.8% and 2.2%, respectively, the College produced deficits of negative 2.9% in FY 2008 and negative 4.5% in FY 2009. The three-year average operating margin as of FY 2009 is negative 1.7%. Operating cash flow was satisfactory at 11.2% for FY 2009, and debt service coverage averaged 1.4 times in 2007-2009. Moody's notes that much of the College's debt utilizes bullet principal maturities, which depresses the actual implied debt service and creates greater need to build liquidity to pay the bullet maturities or dependence on market access to refinance the debt when due.

Management and the board have focused on areas for ongoing expense reduction in anticipation of pressure on endowment draws due to past investment losses and initial projections for budget gaps between \$5 and \$10 million annually between FY 2012 and 2015. These cuts have included salary freezes, salary reductions for top management, freezing open staff positions, and the implementation of two early retirement programs and one voluntary separation program for staff and one faculty retirement incentive program (\$9.9 million in total separation costs, including \$2.9 million in post-employment benefits accounted for as non-operating expenses in FY 2009 and FY 2010). Based on draft FY 2010 financial statements, the College's operating expenses (including fundraising campaign expenses, but excluding early retirement program expenses) declined by 3% over FY 2009. As a result of expense containment and healthy growth of revenue streams, the College's operating performance is expected to have improved to 0.5% in FY 2010 after deficits in FY 2008 and 2009. Despite initial projected budget deficits, the College is now projecting breakeven operating performance in FY 2012 and 2015. Middlebury's operating revenues are diversified, with the largest portions consisting of student charges (58% in FY 2010), investment income (21%), and gifts (11%).

BALANCE SHEET POSITION: STRONG INVESTMENT PERFORMANCE AND GIFT REVENUE IN FY 2010 CONTRIBUTE TO BALANCE SHEET STRENGTHENING; LEVERAGE REMAINS RELATIVELY HIGH

Moody's expects that Middlebury will maintain a large financial resource base providing strong support for its expense base, although the College's balance sheet and operating leverage remain relatively high. Following investment losses of negative 1.0% in FY 2008 and negative 15.9% in FY 2009, the College reports a strong return of positive 17.7% in FY 2010. Based on draft FY 2010 financial statements, we estimate that total financial resources rebounded to approximately \$855 million in FY 2010, up from \$776 million in FY 2009. Expendable financial resources covered operations a healthy 2.3 times in FY 2009 and an estimated 2.7 times in FY 2010. Although the College's balance sheet strengthened in FY 2010, it is still rebounding from investment losses and weak operating performance in prior years. In FY 2007, the College had \$808 million of expendable financial resources which covered operations over 4 times and covered debt 2.7 times.

Middlebury has historically relied on debt to finance most of its larger capital projects, with fundraising primarily targeted toward endowment. As a result, Moody's believes that Middlebury is relatively highly leveraged compared to other similarly sized Aa-rated private colleges, both from balance sheet and operating perspectives. The College does not have additional borrowing plans at this time. Pro-forma debt to revenue is high at 128%, and debt service to operations is nearly 7%. Further, much of the College's debt has bullet maturities so a modest amount of principal is currently being amortized. The College may consider paying off some of its outstanding debt at future call dates in 2012 and 2016. Balance sheet leverage also remains high, with expendable financial resources to debt of 1.8 times in FY 2009 and estimated at 2.1 times in FY 2010. Although resource coverage of debt remains strong, it is relatively weaker than the 2.3 times expendable financial resources-to-debt median for

Aa-rated private colleges (we expect the median for this ratio may improve in FY 2010 as a result of positive investment returns).

Middlebury outsources its investment function to Investure, LLC, and approximately two-thirds of investments are held in Investure fund of funds. Under Investure, the College's asset allocation has been heavily weighted toward alternative equity and private partnerships. As of August 31, 2010, the endowment asset allocation includes 34% in private partnerships, 25% alternative equity, 32% global equity (including largely long-only equity funds), 6% fixed income (including hedge funds) and 3% cash. As of June 30, 2010, the College reports \$106 million of unfunded capital commitments to private investments, approximately half of which are estimated to be called within the next year.

Management reports that as of June 30, 2010 the College had \$122.9 million of unrestricted cash and investments which could have been liquidated within a one month period. This level of liquidity would cover 229 days of cash expenses and cover demand debt outstanding in FY 2010 1.2 times. In addition to this liquidity, the College currently has two operating lines of credit with a combined \$75 million authorized draw amount. Although the College's liquidity relative to its debt structure has been a concern, we view the conversion to an all fixed-rate debt structure with no swaps as a clear credit positive, with the College better able to budget for annual debt service and avoid sudden liquidity issues due to debt structure. Prior to this refunding, the College has \$51 million of variable-rate demand bonds supported by a standby bond purchase agreement and over \$50 million of long-maturity put bonds supported by the College's own liquidity.

Middlebury has a strong fundraising track record, with average annual gift revenue of \$49.8 million in FY 2007-2009 and an estimated \$34.6 million of gift revenue in FY 2010. The College is in the midst of a \$500 million capital campaign which began collecting commitments in 2005. As of August 31, 2010, the College had raised \$33.5 million of gifts and pledges. "The Middlebury Initiative" is focused on raising endowment for financial aid and faculty support. Alumni support is particularly strong, with 55% participation rate for undergraduate alumni in annual giving in FY 2010 (down from 62% in FY 2009). The College is evaluating extending the campaign completion beyond the currently scheduled 2012 end date.

Outlook

The stable outlook is based on Moody's expectation that Middlebury will maintain its excellent student market position, strong philanthropic support, improved level of operating performance, and adequate liquidity to support ongoing operating expenses and other potential calls on liquidity. We believe the College's credit profile could improve longer term as a result of further balance sheet growth to support high debt levels and sustained strengthening of operations.

What could change the rating—UP

Significant growth of financial resources and minimal increase in debt coupled with ongoing improvement in operating performance

What could change the rating—DOWN

Significant additional borrowing without compensating growth of financial resources; sustained deterioration of student market position and fundraising; trend of large operating deficits; significant decline in financial resources

KEY INDICATORS (FY 2009 financial data and fall 2009 Middlebury College undergraduate enrollment data; figures in parentheses represent fall 2010 enrollment data and FY 2010 financial estimates based on draft financial statements)

Total Full-Time Equivalent (FTE) Enrollment: 2,465 students (2,515 FTE)

Freshman Selectivity: 20.5% (17.2%)

Primary Matriculation: 42.7% (42.1%)

Total Financial Resources: \$776 million (\$855 million)

Pro-Forma Direct Debt: \$278.8 million

Expendable Financial Resources-to-Pro-Forma Direct Debt: 1.8 times (2.1 times)

Expendable Financial Resources-to-Operations: 2.3 times (2.7 times)

Three-Year Average Operating Margin: -1.7% (-2.3%)

Operating Cash Flow Margin: 11.2% (15%)

Reliance on Student Charges: 56.1% (57.7%)

Reliance on Investment Income: 22.3% (21.2%)

Monthly Liquidity: \$162 million (\$122.9 million)

Monthly Days Cash on Hand: 295 days (229 days)

RATED DEBT

2002A, 2006A, 2009, 2010: Aa2

Series 2002B: Aa2/NR (Moody's has not expressed an opinion on the short-term, variable rate demand feature of the College's Series 2002B variable rate demand bonds, bonds expected to be refunded by Series 2010)

Series 2008: Aa2/MMIG1 (expected to be refunded by Series 2010)

Monterey Institute for International Studies, Series 2001 (issued through California Statewide Communities Development Agency; guaranteed by Middlebury College): Aa2

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METHODOLOGY

The principal methodology used in rating Middlebury College was "Moody's Rating Approach for Private Colleges and Universities," published in September 2002. Other methodologies and factors that may have been considered in the process of rating this issuer can also be found on Moody's website.

LAST RATING ACTION

The last rating action with respect to Middlebury College was on November 17, 2009 when a municipal finance scale rating of Aa2 with a stable outlook was assigned. That rating was subsequently recalibrated to Aa2 with a stable outlook on May 7, 2010.

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Information sources used to prepare the credit rating are the following: parties involved in the ratings, public information.

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