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# MHEFA 2021 – Higher Education Update

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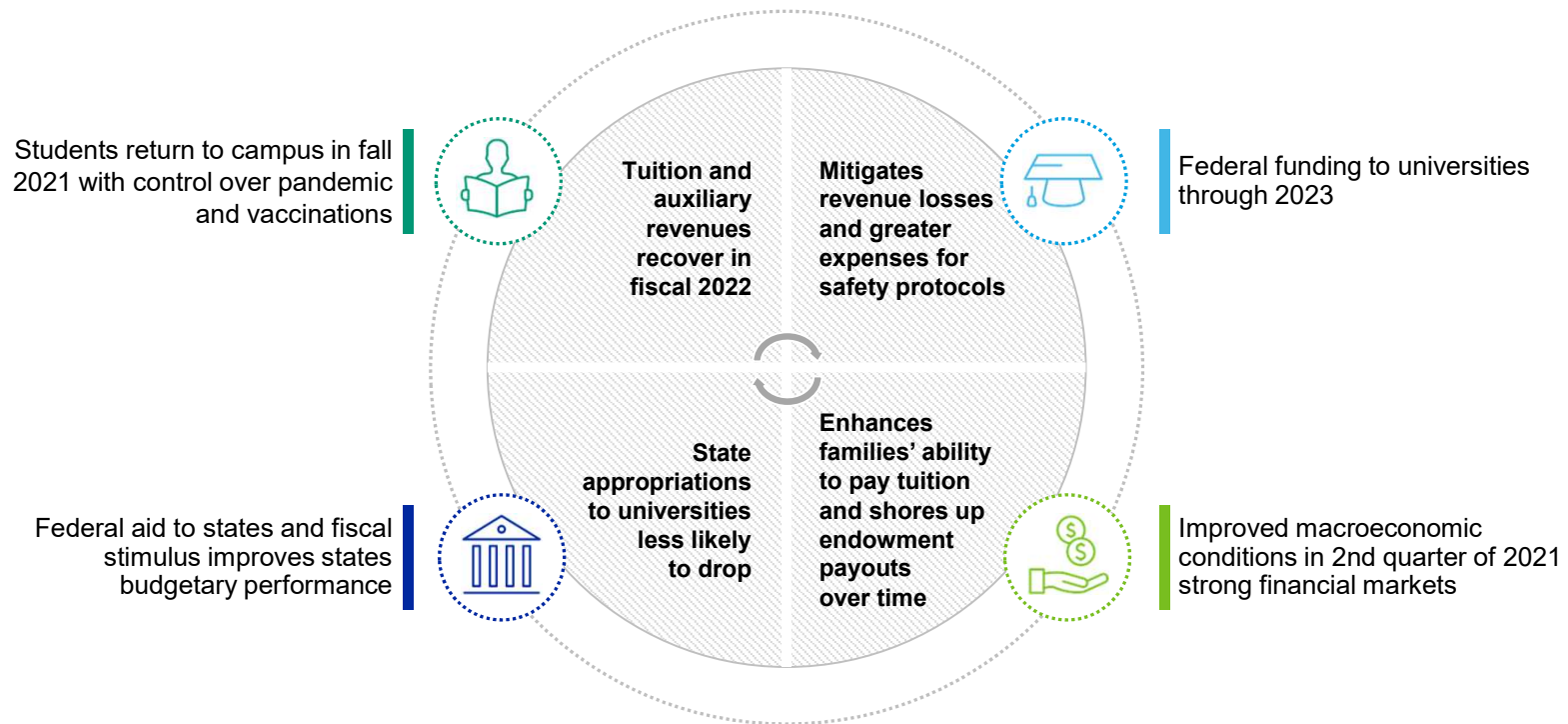
# Agenda

1. Outlook
2. Methodology Update
3. ESG: Minnesota
4. Questions

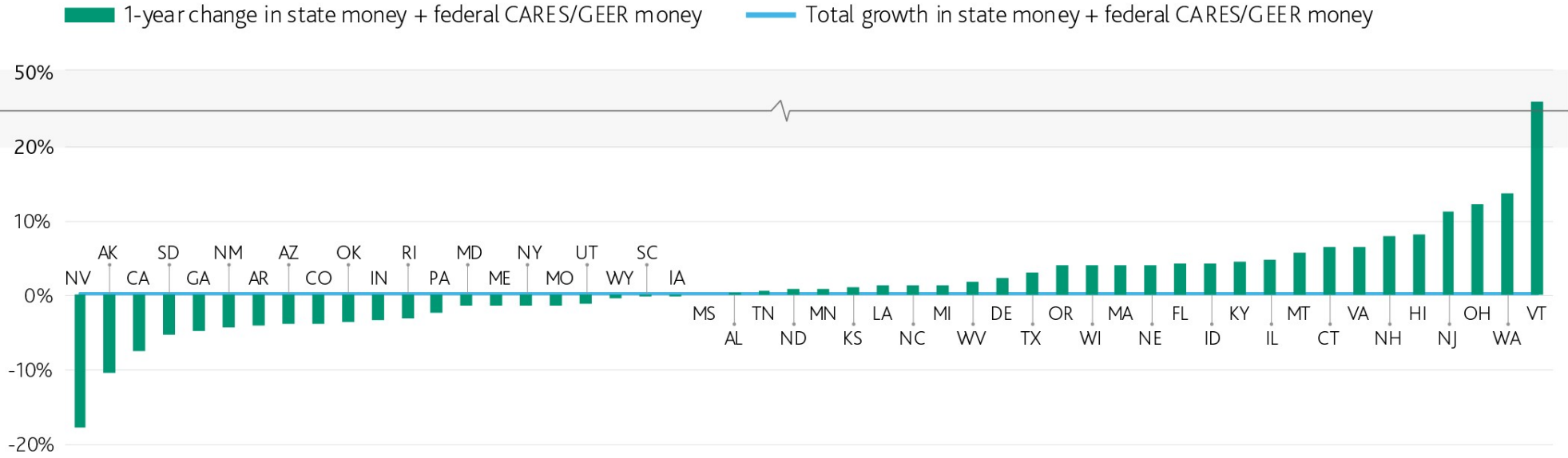
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Outlook

# Return to stable reflects improved revenue prospects over next 18 months

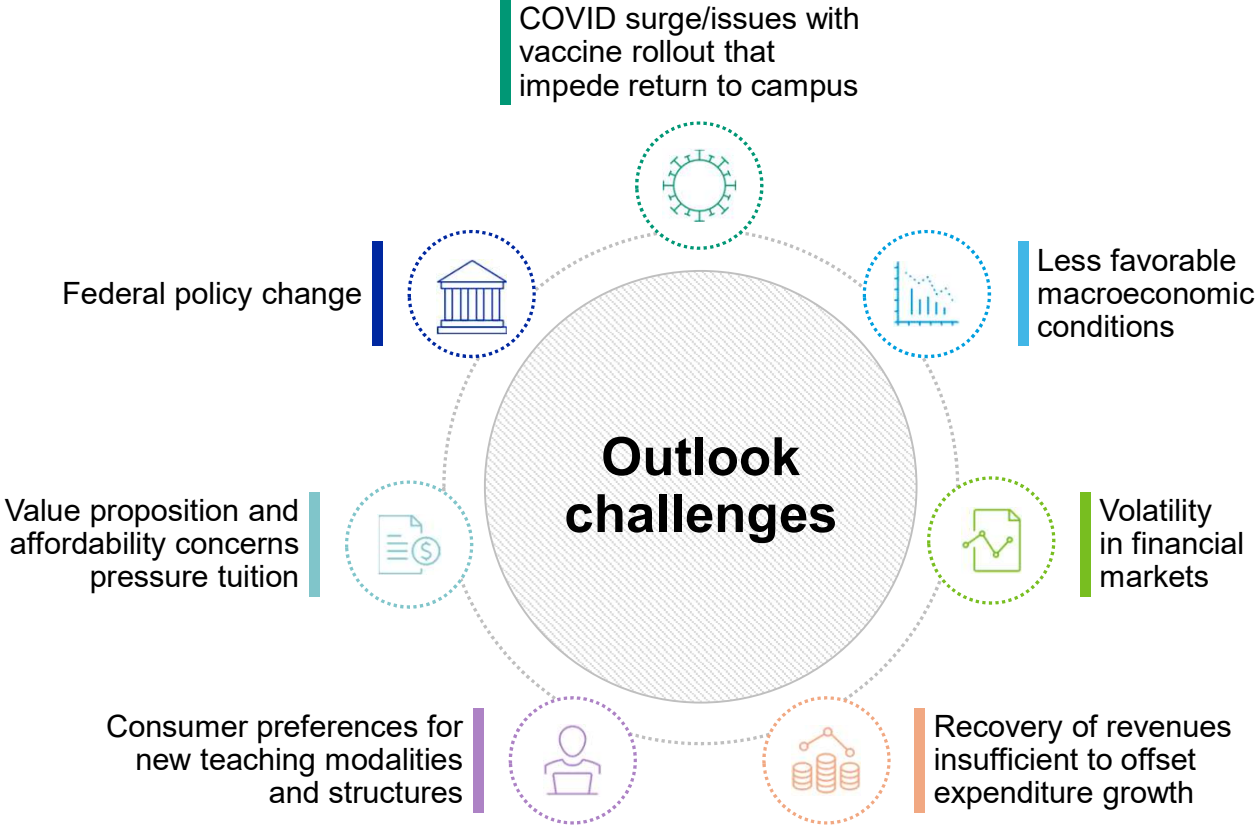


# State appropriations overall flat growth in fiscal 2021



Vermont is an outlier reflecting one-time funding and a small base; GEERF is Governors Emergency Education Relief Fund  
 Source: Grapevine Higher Education Funding fiscal 2021

# Key challenges to outlook



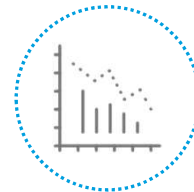
# Uneven outlook for different institutions



## Weaker outlook

Small or mid-sized privates with less brand recognition

Regional public universities

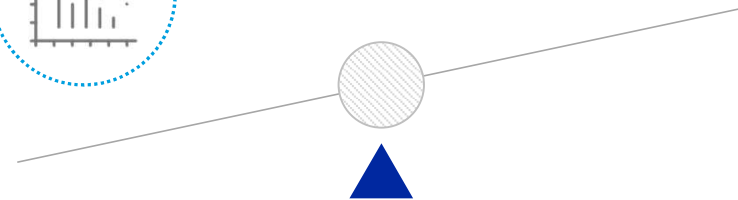
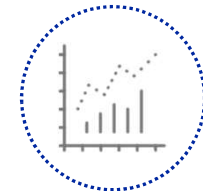


## Stronger outlook

Public flagships

Name brand and comprehensive privates

Smaller privates with strong niche markets

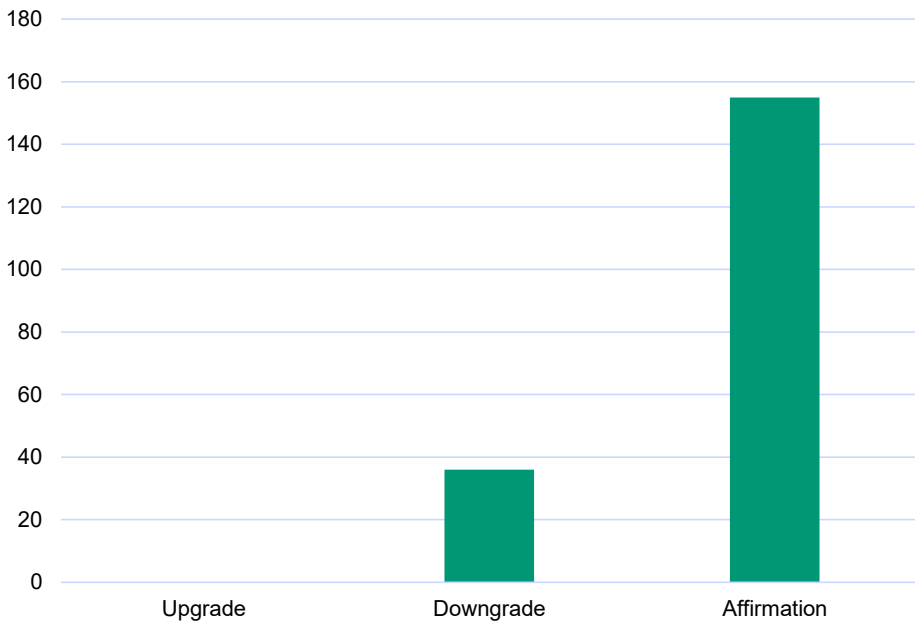




# Rating actions reflect prior conditions & COVID

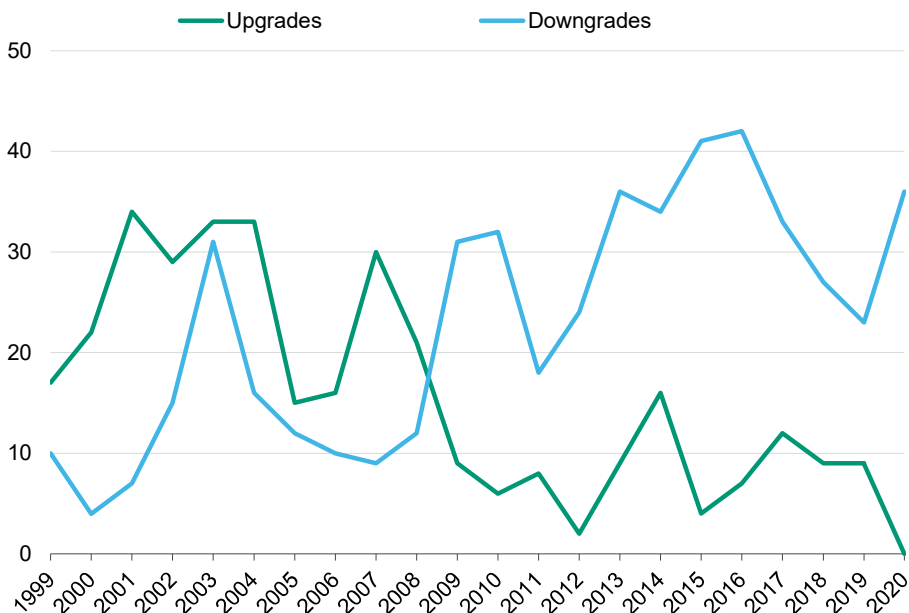
40 downgrades in 2020 versus 23 in 2019; 17% of universities have negative outlooks

No upgrades in 2020 as downgrades continue to trend higher



Source: Moody's Investors Service, as of December 31, 2020

Downgrades have outpaced upgrades since 2008



Source: Moody's Investors Service; 2020 YTD is as of December 31, 2020

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Methodology Update

# Proposed updates: Key analytical priorities

- » Combine the higher education and revenue-backed community college methodologies and scorecards
- » Expand qualitative factors from one to three and increase overall scorecard weight of qualitative factors to 30%
- » Assign issuer level ratings to all US credits rated under this methodology, and provide guidance around notching conventions
- » Increase the dependence on third party verified data within scorecard metrics
- » Update and replace certain metrics and financial ranges for each rating category

# Proposed updates: High level scorecard updates

Increase the number of qualitative factors	Replace leverage metric with total adjusted debt	Replace coverage metric with debt service coverage	Replace quantitative metrics that depend on issuer-reported data
<p>Improves ability to differentiate and capture credit characteristics that may not be explicitly reflected in financial metrics and ratios</p>	<p>Allows for a more complete view of an entity's financial obligations</p>	<p>Debt service coverage is globally recognized metric and a strong indicator of an entity's ability to meet current principal and interest payments</p>	<p>Use of third party verified data provides for greater transparency and accuracy</p>
<p><u>Relevant sub-factors:</u></p> <ul style="list-style-type: none"> <li>▪ Brand and strategic positioning</li> <li>▪ Financial policy and strategy</li> <li>▪ Operating environment</li> </ul>	<p><u>Relevant sub-factor:</u></p> <ul style="list-style-type: none"> <li>▪ Total cash and investments to total adjusted debt</li> </ul>	<p><u>Relevant sub-factor:</u></p> <ul style="list-style-type: none"> <li>▪ Annual debt service coverage</li> </ul>	<p><u>Eliminated sub-factors:</u></p> <ul style="list-style-type: none"> <li>▪ Spendable cash and investments to total debt</li> <li>▪ Spendable cash and investments to expenses</li> <li>▪ Monthly days cash on hand</li> </ul>

# Comparison of existing and proposed scorecard metrics

	Factor	Sub-factor	Existing weighting	Proposed weighting
Higher weight for market profile factor with two qualitative sub-factors	Market profile	Adjusted operating revenue	15%	15%
		Annual change in operating revenue	5%	0%
		Brand and strategic positioning	10%	10%
New qualitative sub-factors	Operating performance	Operating environment	0%	10%
		EBIDA margin	10%	10%
		Maximum single contribution	15%	0%
Replace spendable cash and investments with total cash and investments – broader view of resources	Wealth and liquidity	Financial policy and strategy	0%	10%
		Total cash and investments	10%	10%
		Total cash and investments to operating expenses	0%	15%
		Spendable cash and investments to operating expenses	10%	0%
		Monthly days cash on hand	5%	0%
Replace total direct debt with total adjusted debt – broader view of liabilities including pensions	Leverage and coverage	Total cash and investments to total adjusted debt	0%	10%
		Annual debt service coverage	0%	10%
		Spendable cash and investments to total direct debt	10%	0%
		Debt to cash flow	10%	0%

Legend

Eliminated New

# What informs our qualitative factors?

Brand and strategic positioning	Financial policy and strategy	Operating environment
<ul style="list-style-type: none"> <li>▪ Consistency of revenue generation to fund operations</li> </ul>	<ul style="list-style-type: none"> <li>▪ Quality of financial management, oversight, and planning</li> </ul>	<ul style="list-style-type: none"> <li>▪ Strength and predictability of government financial support</li> </ul>
<ul style="list-style-type: none"> <li>▪ Revenue diversity and academic program alignment</li> </ul>	<ul style="list-style-type: none"> <li>▪ Sufficiency of financial resources for strategic reinvestment</li> </ul>	<ul style="list-style-type: none"> <li>▪ Support provided by regulatory and policy framework</li> </ul>
<ul style="list-style-type: none"> <li>▪ Complexity of organizational structure</li> </ul>	<ul style="list-style-type: none"> <li>▪ Risk appetite and efforts to manage risks</li> </ul>	<ul style="list-style-type: none"> <li>▪ Flexibility of expense structure</li> </ul>

## Certain other considerations remain important drivers of credit quality though they may not be included in the scorecard

- » Environmental, social, and governance (ESG) considerations
- » Marketable real estate
- » Regulatory considerations
- » Financial controls
- » Liquidity
- » Event risk
- » Health care operations

# Assignment of Issuer Ratings & Pledge-Specific Ratings

- » All US credits under this methodology will have issuer-level ratings assigned based on its fundamental credit quality
- » Assigning the security specific rating will begin with the issuer rating, then apply appropriate notching based on the characteristics of the debt instrument





# Methodology development process



\*Comments accepted *only* on the RFC page.

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ESG:  
Minnesota

# ESG Classification system incorporates credit relevant considerations

Our assessment of ESG risks is framed by the classification



## Environmental

Physical climate risks
Carbon transition
Water management
Waste and pollution
Natural capital



## Social

Private sector	Public sector
Customer relations	Access to basic services
Demographic and societal trends	Demographics
Human capital	Education
Health and safety	Health and safety
Responsible production	Housing
	Labor and income



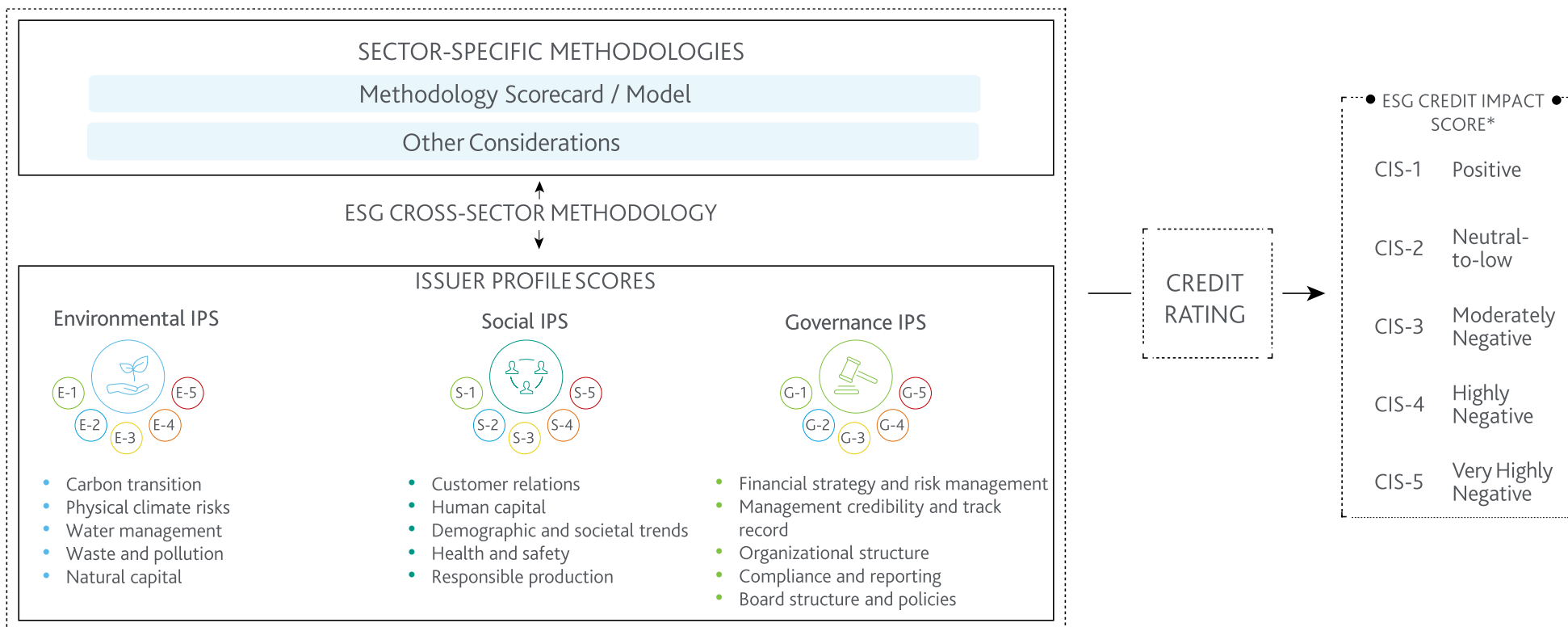
## Governance

Private sector	Public sector
Financial strategy & risk management	Institutional structure
Management credibility & track record	Policy credibility and effectiveness
Organizational structure	Budget management
Board structure, policies & procedures	Transparency and disclosure
Compliance & reporting	

Environmental classification updated 14 December 2020  
 Source: Moody's Investors Service

# ESG Integration Into Credit Analysis

Our rating analysis considers all material credit considerations, including ESG



The ESG credit impact score (CIS) is an output of the rating process that more transparently communicates the impact of ESG considerations on the rating of an issuer or transaction.

# How the framework will be applied

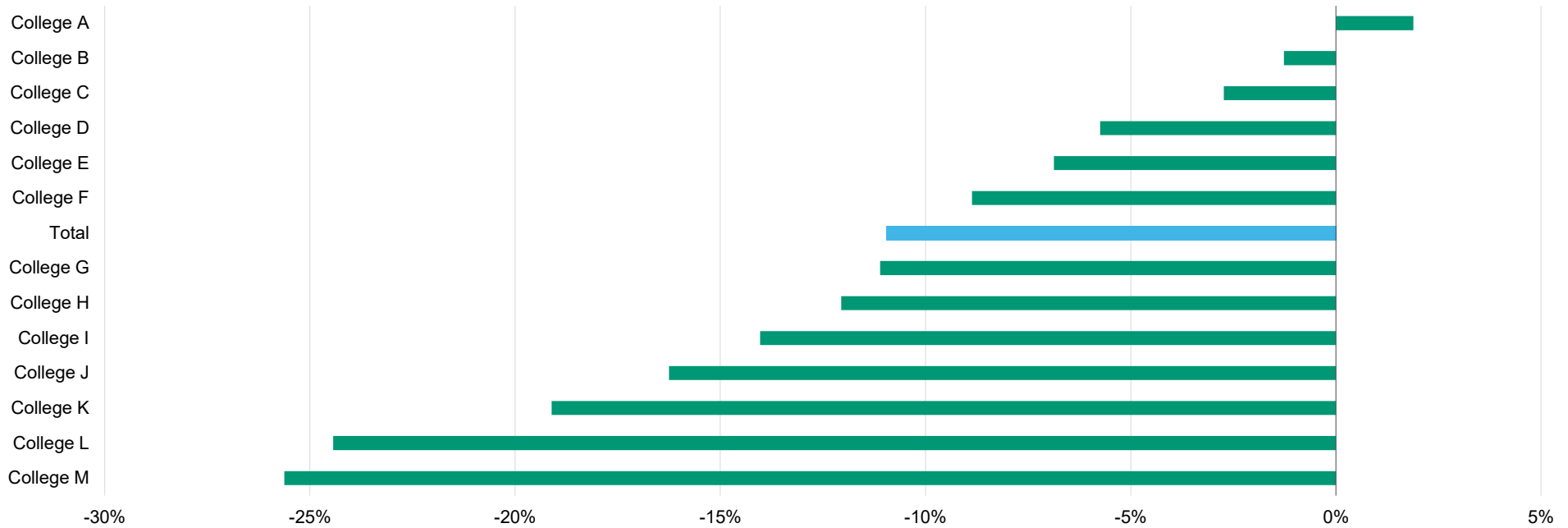
ESG scoring will provide transparency and deepen issuer interactions

- Scores provide two key benefits to the investors: bring more transparency to an issuer's ESG exposure as well as how these exposures impact the rating.
- Scoring will be largely qualitative, informed by available data.
- Ratings will not be impacted from the introduction of the scores. Scores are merely a deconstruction of the ESG factors already embedded into our credit analysis and ratings.
- The framework and scores support deeper interaction on ESG with issuers. Issuers are encouraged to share relevant information that we can incorporate into our analysis of ESG exposures as well as mitigating measures undertaken.

# Enrollment declines by 11% over the last 8 years

Minnesotan private colleges and universities rated by Moody's

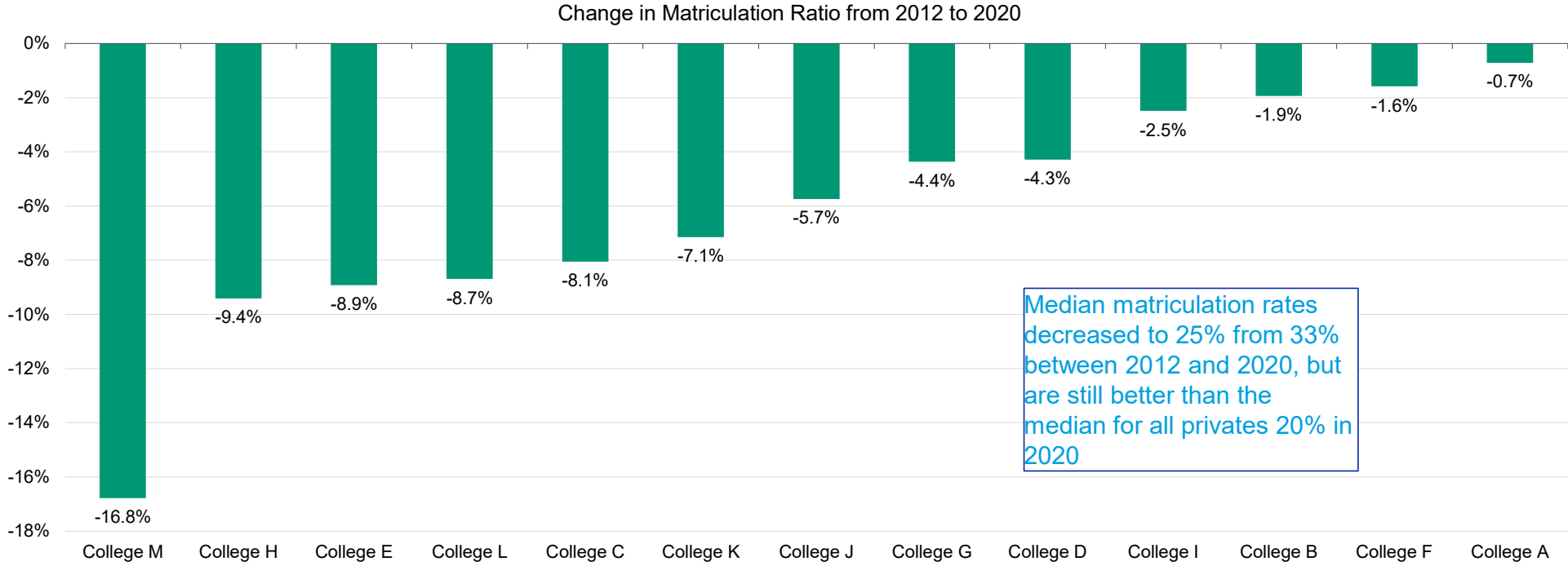
Change in FTE Enrollment from 2012-2020



Source: Moody's Investors Service

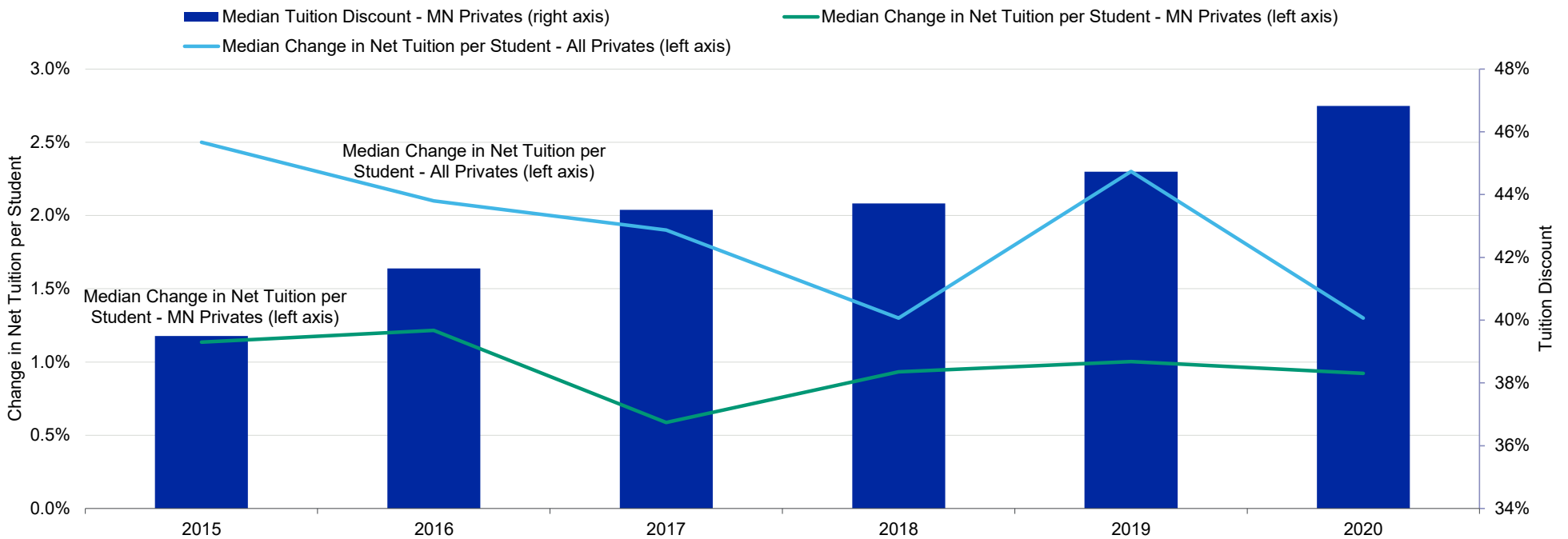
# Decline in yield rates for all Minnesotan privates

Change in rates varies across entities



Source: Moody's Investors Service

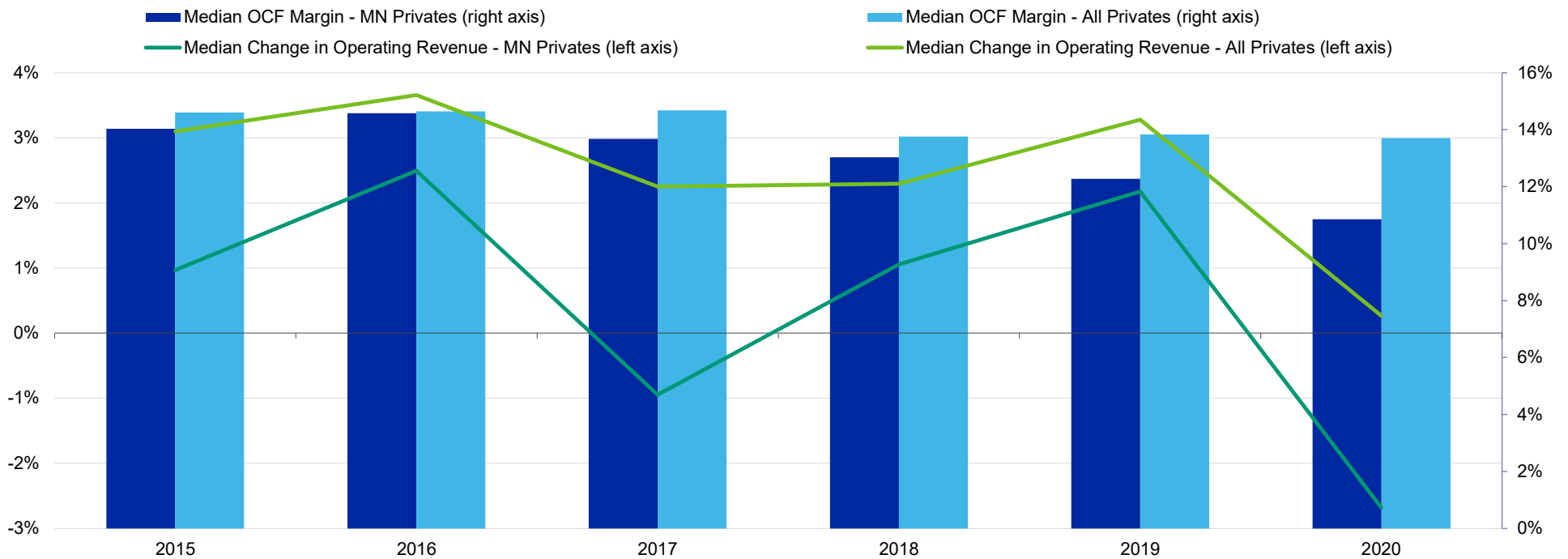
# Growth in net tuition per student is lower for Minnesotan privates; discount rate rises



2020 medians are estimated based on unpublished 2020 medians  
 Source: Moody's Investors Service



# Operating performance remains strong but slips steadily with softer revenue



2016-2020 medians are estimated based on unpublished 2020 medians  
 Source: Moody's Investors Service

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Questions



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