Rating Update: MOODY’S AFFIRMS ILLINOIS WESLEYAN’S (IL) Baa1 RATING; OUTLOOK REMAINS STABLE

Global Credit Research - 16 Jun 2011

TOTAL RATED DEBT OUTSTANDING IS $80 MILLION

Illinois Finance Authority
Higher Education
IL

Opinion

NEW YORK, Jun 16, 2011 -- Moody's Investors Service has affirmed the Baa1 rating assigned to Illinois Wesleyan University's ("Illinois Wesleyan" or the "University") revenue bonds issued through the Illinois Educational Facilities Authority. The Series 2008 bonds carry an A2/VMIG 1 rating based on support by a letter of credit from PNC Bank, National Association (rated A2/P-1). For complete details of the letter of credit substitution, please see our report issued May 5, 2011. Please refer to the RATED DEBT section of this report for a complete listing of total rated debt outstanding. The rating outlook remains stable.

SUMMARY RATING RATIONALE

The Baa1 rating is based on Illinois Wesleyan's stable market position, improving operating performance and growing financial resources to support debt and operations. These strengths are offset by challenges associated with the University's highly competitive market environment, relatively small size, and significant dependence on student charges. The risks associated with the University's variable rate and demand debt exposure are mitigated by sufficient monthly liquidity.

STRENGTHS

* Established demand as a private undergraduate liberal arts university in Bloomington, Illinois, as evidenced by stable total full-time equivalent enrollment averaging 2,100 students over the last five years and modest growth in net tuition per student;

* Implementation of more stringent budgeting and fiscal management have led to improved operations, generating the first positive operating margin, as calculated by Moody's, of 1.3% in FY 2010 compared to prior years of deeply imbalanced operations and significantly improved operating cash flow margin (13.5% in FY 2010 versus an average of 4.2% in FYs 2006-2008) leading to good debt service coverage (1.8 times in FY 2010);

* Growth in expendable financial resources of 52% from FY 2008-2010 through investment returns and fundraising. We note that financial resources include $40 million of farmland in the unrestricted net asset category;

* Modest capital plans with limited additional debt plans within the next two years, but Moody's notes the University's rising age of plant which may necessitate future borrowing.

CHALLENGES

* Highly competitive market environment in Illinois with many high profile private and public institutions in the region and declining demographics of graduating high school students in Illinois expected over the next decade. Illinois Wesleyan experienced a deterioration in selectivity and matriculation of first-year students over the last five years (62% selectivity in fall 2010 compared with 52% in fall 2006 and 28% matriculation in fall 2010 versus 34% in fall 2006);

* Heavily reliant upon student charges (tuition and fees) at 76% heightens the importance for the University to meet its enrollment targets and continue to increase net tuition revenue;

* Significant leverage reflected in a high debt load relative to revenue at 1.1 times;

* Variable rate exposure adds risk to the credit profile with 35.4% of the University's debt in variable rate mode supported by a letter of credit (LOC) containing financial covenants and is subject to acceleration.

DETAILED CREDIT DISCUSSION

LEGAL SECURITY: All bonds are an unsecured general obligation of the University.

DEBT STRUCTURE AND DEBT RELATED DERIVATIVES: In August 2010 the University extended its floating-to-fixed rate swap agreement with JPMorgan Chase (rated Aa1) originally entered into in 2003. Under the Agreement, Illinois Wesleyan makes fixed payments to JPMorgan in exchange for variable payments based on 74% of LIBOR. The Agreement expires on September 1, 2016. A termination of the swap may occur if IWU's rating is lowered below Baa3. In addition, the University may need to post collateral if the value of the swap agreement falls below a certain level, depending on its credit rating at the time. At the University's current rating, IWU may be required to post collateral if the liability exceeds $3 million. If the University's rating falls below Baa1, the threshold would be reduced to $0. As of 5/31/11, the mark-to-market valuation on the swap was a liability of $822,897 for the University. Moody's believes the University's liquidity profile, with $82.9 million of monthly liquidity, is sufficient to manage potential collateral postings at the current rating level.

RECENT DEVELOPMENTS:

In FY 2009 and 2010, the University instituted several new budgeting practices and expense cuts that have begun to turn the University's
In FY 2010, the University's endowment pool had a modest 7.7% positive return after an investment loss of 10.7% in FY 2009. As of April 30, 2011, management reports a fiscal 2011 year-to-date positive 17.4% endowment return. The $186.7 million endowment is allocated as follows: 19.1% domestic equity, 16.9% international equity, 13.9% hedge funds, 10.7% fixed income, 9.4% cash and cash equivalents, 4.7% private equity, and 25.2% in real estate, which consists of farmland that the University manages as an investment. The farmland is valued at $47 million. The University uses Mercer Consulting as an investment consultant providing asset allocations, fund performance reviews and manager searches. Mercer presents to the University's Investment Committee quarterly. The University's spending policy is 5.25%, slightly above the industry average of 5%, of a four-year rolling average and is based on the December 31 market value.

On May 5, 2011, the University substituted its LOC with The Northern Trust Company (rated Aa3/P-1) on its Series 2008 variable rate bonds with a direct pay LOC with PNC Bank, National Association for $27.4 million. The new letter of credit expires on September 9, 2014, which mitigates near term renewal risk. Under the terms of the new agreement, the bank may demand immediate repayment of the bonds in the case of an event of default, which includes compliance with a semi-annual adjusted liquidity ratio of unrestricted cash and investments to indebtedness of 1.0 time in July and 1.05 times in January of each year. Management reports 1.4 times coverage as of April 30, 2011. In the event of a default, the University could face an accelerated repayment schedule of 20 business days. Moody's believes that IWU's approximately $82.9 million of monthly liquidity, providing 456 monthly days cash on hand of July 31, 2010, as compared to variable rate debt of $27.4 million helps mitigate some of the risk associated with the debt structure.

The University's Series 2006 and 2006A loan agreements were amended on June 1, 2010 to include the same semi-annual adjusted liquidity covenant of unrestricted cash and investments to indebtedness of 1.0 time in July and 1.05 times in January of each year (calculated coverage was 1.4 times as of April 30, 2011).

The University has a few capital projects lined up for the next year which it intends to fund through fundraising with a potential for borrowing bridge financing. A new $15 million academic building is planned for which the University has received a $10 million lead gift. The University has not yet determined whether to proceed this summer or wait to raise the remaining $2M. In FY 2011, the University received a gift to install an artificial turf football field. A related endowment of $500,000 has been raised to fund the replacement in 10 years. The field should be complete by July 2011. The University has received a gift to enhance the entrance of its art building. Work on that project began in May 2011. Longer-term debt plans include a potential $6 million dollar apartment style housing complex to begin in FY 2013.

Outlook
The stable outlook reflects Moody's expectation that the University's sound financial management will maintain at least breakeven operating margin and produce sufficient cash flow to cover debt service, while maintaining a stable student market position. The stable outlook also incorporates limited additional borrowing and compliance with the letter of credit and debt covenants.

WHAT COULD CHANGE THE RATING-UP
Continued positive operating performance coupled with financial resource growth and maintenance of student market position

WHAT COULD CHANGE THE RATING-DOWN
Deterioration in student market position, including enrollment declines or significant increases in financial aid; weakening of operating performance; weakened balance sheet cushion for debt and operations, particularly a decline in liquid resources to provide a cushion for debt with a tender feature and potential swap collateral postings; significant additional borrowing absent commensurate growth of financial resources

KEY INDICATORS (Fall 2010 enrollment data and FY2010 financial data):
Total Full-Time Equivalent (FTE) Students: 2,090 students
Freshmen Selectivity: 62%
Freshmen Matriculation: 28%
Net Tuition per Student: $20,289
Total Financial Resources: $154 million
Expendable Financial Resources: $88 million
Total Direct Debt: $80 million
Total Comprehensive Debt: $80 million
Monthly Liquidity: $82.9 million
Monthly Days Cash on Hand (unrestricted funds available within 1 month divided by operating expenses excluding depreciation, divided by 365 days): 318.1 days
Expendable Financial Resources-to-Direct Debt: 1.1 times
Expendable Financial Resources-to-Operations: 1.2 times
Average Three-Year Operating Margin: -3.1%
Reliance on Student Charges: 75.9%

RATED DEBT
Series 2001, 2006 and 2006B: Baa1
Series 2008: A2/VMIG 1 (based on letter of credit with PNC Bank, National Association (rated A2/P-1); letter of credit expires September 9, 2014)

CONTACTS:
University: Illinois Wesleyan University: Mr. Daniel P. Klotzbach, Vice President for Business and Finance, 309-556-3021

PRINCIPAL METHODOLOGY USED
The principal methodology used in this rating was Moody's Rating Approach for Private Colleges and Universities published in September 2002.

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Analysts
Eva Bogaty
Analyst
Public Finance Group
Moody's Investors Service

Erin V. Ortiz
Backup Analyst
Public Finance Group
Moody's Investors Service

Contacts
Journalists: (212) 553-0376
Research Clients: (212) 553-1653

Moody's Investors Service
250 Greenwich Street
New York, NY 10007
USA

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