



## Debt Management Policy

“Worcester State College is dedicated to offering high quality, affordable undergraduate and graduate academic programs and to promoting the lifelong intellectual growth, global awareness, and career opportunities of its students.”

*Source: Worcester State University Mission Statement*

## FY 2011 Financial Statement Review

## **OBJECTIVE:**

To establish a policy and procedure for arranging and approving financing transactions that will cause the University to become indebted or contingently obligated to an outside third party. This policy, established by the Vice President of Finance and Administration and approved by the Board of Trustees ("Board") provides guidance for the prudent use of debt to finance capital projects that enable the University to fulfill its mission and achieve strategic objectives. This policy will be reviewed at least annually, as part of the presentation and discussion regarding the annual audited financial statements, to ensure financial and operational flexibility. Management will update the Board on a quarterly basis with an overview of the financial health of the University and its use of debt.

## **SCOPE:**

This policy applies to all University financings.

## **INTRODUCTION:**

Debt financing allows the University to pay for a capital asset over a period of time. This is a financially responsible practice for certain types of capital investments when within appropriate limitations and at appropriate interest rates. Debt financing may also be financially beneficial to the University if borrowing rates are below expected investment returns or if the University invests in capital assets which provide investment returns or cost savings which are greater than the cost of borrowing. Since debt capacity is limited and our demand for debt may from time-to-time exceed capacity, it is imperative that borrowings fund only those projects that support the vision, mission and values of the University.

Decisions regarding the use of appropriate financial leverage should be balanced to ensure the University's current financial health, while considering the financial effect of present decisions on future costs of capital.

## **DEBT FUNDING SOURCES:**

Worcester State University, under the aegis of the Board of Higher Education (BHE), receives funding for capital projects from three sources: Commonwealth General Obligation Bonds; bonds issued by the Massachusetts Health and Educational Facilities Authority (HEFA)*[HEFA is no longer a viable choice for debt as it was legislatively eliminated in FY 2011. It remains in the document for historical reference as WSU outstanding bonds were issued through HEFA]*; and bonds issued by the Massachusetts State College Building Authority (MSCBA).

### Commonwealth of Massachusetts General Obligation Bonds

General obligation bonds of the Commonwealth provide capital funding for all of state government. Portions of the funds available through this source are assigned to various agencies through debt caps determined by the Executive Office of Administration and Finance. The cost of this debt, and its availability, depend on the creditworthiness of the Commonwealth as a whole. The Commonwealth assumes the liability for this debt and records it as such on its financial statements. The funds flow to the University as a capital appropriation and do not affect the University's debt capacity.

### HEFA and MSCBA

HEFA and MSCBA debt is issued by quasi-public authorities for specific types of capital projects and are paid for via dedicated revenue streams. HEFA states its mandate as providing financing or refinancing for any capital project related to the "primary charitable purpose" of an institution. The MSCBA issues debt to finance student activity and residential buildings. The cost and availability of HEFA and MSCBA debt depends on the creditworthiness of the individual college for which a project is being financed. HEFA financing is available upon receipt of legislative authorization of a specific project and related financing cap. Debt issued through HEFA becomes debt of the university and is reported as such on its financial

statements. Debt issued by the MSCBA is debt of the MSCBA and is reported as such on their financial statements. MSCBA debt issued for a university project creates a long term commitment for the university that is evidenced by a lease document. This contingent liability is disclosed in a footnote in the university's financial statements. HEFA issued debt directly reduces the university's debt capacity. MSCBA issued debt obligates specific revenue streams thereby reducing available revenue streams to service future debt.

#### Capital leases

Capital lease financing is available through the Commonwealth of Massachusetts Equipment Lease-Purchase (TELP), Massachusetts Higher Education Consortium (MHEC) leases and other viable leasing mechanisms within the Commonwealth's rules and regulations.

#### Alternative Financing

The College will work closely with the Board of Higher Education, various state or federal agencies, and other state colleges to explore and/or develop other potential debt financing vehicles.

### **POLICY:**

The following debt policy and procedures establish the guidelines for the University activities related to the issuance and servicing of debt. Adherence to these policies and procedures will help ensure that the University's exposures are effectively managed. It is the responsibility of the Office of Vice President of Finance and Administration to analyze, evaluate, and propose to the University Board of Trustees any long or short-term debt (short-term debt includes, but is not limited to, revolving line of credit, overdraft facility, commercial paper, bankers' acceptance, letter of credit and accounts receivable discount facilities) required for University operations. The analysis would ensure that any proposed financing has the lowest possible cost commensurate with the most favorable financial terms, conditions and risks and is consistent with the University's capital structure requirements. The University's Board of Trustees, in consultation with the Vice President of Finance and Administration and General Counsel, will have final approval for any instrument, document or agreement (prior to execution) which will cause the University to become indebted or contingently obligated to a third party.

### **DEBT OPERATING GUIDELINES:**

In developing a debt management strategy there are three primary guidelines to consider.

**Affordability** - Includes an analysis of the cost of capital, cash flow forecasts and rationale to instill budget discipline and help ensure that intergenerational equity is achieved. (Intergenerational equity refers to the concept of matching the beneficiaries and users of the capital projects financed using debt proceeds and the actual payment of the principal and interest on the debt used to finance the facilities)

**Risk Management** - Includes an appropriate weighting or mix between fixed and variable (when available) rate debt, a plan to manage liquidity risks and exposures and rationale for matching assets to liabilities.

**Financial Structure / Balance Sheet Management**- Includes a goal of establishing and maintaining the highest credit/bond rating possible, a rationale for the appropriate level of debt versus equity and proactive monitoring of the capital markets to manage unplanned inefficiencies or disequilibriums in both debt and investment markets.

#### **Affordability**

- When issuing debt, the University will seek the lowest-cost source of funding available.
- All annual debt interest and principal amortization payments will be provided for in the annual budget plan with a target not to exceed 5% of annual operating expenditures. FY 2011 Financial Statements provide for annual debt service of \$3,640,090. FY 2011 actual debt service was \$930,370. Long term commitments exist with MSCBA to cover residence hall and parking garage debt. Contractual payments to

cover these costs are budgeted for \$5,114,876 and \$755,314, respectively in FY 2012. Residence Hall commitments are funded by student rents set by the MSCBA. Parking Garage commitments are funded by the Capital Improvement Trust Fund.

- Additional indebtedness is limited by existing covenants stating additional debt service will be equal to or less than the excess of revenues over expenses [excluding extraordinary items, depreciation, interest on long term debt and amortization of bond costs] as it appears on the most recent audited financial statements. The maximum calculated from the FY 2011 financial statements is \$8,840,143.
- External borrowings will be coordinated to the extent practical so that multiple project needs can be accomplished in a single borrowing, thereby reducing issuance costs.
- The University will consider credit enhancement when it is cost beneficial and/or results in more favorable covenants.
- A project that has a related revenue stream or can create budgetary savings will receive priority consideration. For these projects, the use of debt must be supported by an achievable financial plan that includes servicing the debt and meeting any new or increased operating costs. However, this priority consideration is not meant to exclude other projects that are key to the University's mission and strategic initiatives.
- The cost of debt-financed capital acquisitions will be charged to the future users of the capital asset over the period the debt is outstanding and the assets usefulness.

### **Risk Management**

- The University will actively consider refinancing outstanding debt only when net savings for the refinancing, measured on a net present value basis, are positive.
- Call options on outstanding debt will be exercised when; (1) they offer net present value savings when compared to alternative investment opportunities for these funds, (2) more favorable covenants can be obtained, and/or (3) the University desires to reshape the amortization pattern of its debt.
- The Office of Vice President of Finance and Administration will be responsible for monitoring the debt markets and recommending the appropriate tactical strategy depending on the interest rate environment, the University's liquidity position, tax regulations and market dynamics.
- In all borrowings, the University will strictly adhere to the principle of matching the term of the debt to the expected useful life of the project or to the purpose of the program being funded with that debt.
- Where financially feasible, debt will be retired as soon as possible to recapture debt capacity for future use. The maturity on a tax-exempt bond issue should be as short as economically feasible for the project, and will not exceed the useful life of the financed asset (this is more restrictive than the federal limit of 125% of the useful life).
- It is the general intent of the University to employ debt as a "financing vehicle" rather than a funding source. To the extent possible, internal funds, external gifts, grants, etc. will be used to "fund" capital projects, with the use of debt as a temporary financing source and/or "lowest cost of capital" alternative.
- External borrowing will be for the minimum required portion of project cost. Projects with alternative restricted or unrestricted funding sources may only use debt financing for the unfunded portion and to bridge the timing of cash payments on gifts and pledges.
- Debt service payments will be made in an accurate and timely manner.

- Compliance with debt covenants will be monitored by the Office of Vice President of Finance and Administration and external auditors and reported regularly to the Board.
- The Office of Vice President of Finance and Administration will strive to structure borrowings such that the University meets the required "spend down tests" thereby enabling it to retain project fund earnings in excess of the "arbitrage yield".
- The Office of Vice President of Finance and Administration will monitor the University's rebatable arbitrage earnings for tax purposes on an annual basis and evaluate compliance with IRS private use rules at issuance and periodically thereafter.
- The University's "debt capacity" will be determined from time to time, based on the evaluation of bond rating agency guidelines with the goal of maintaining the current minimum investment grade rating of A - and preferably, a rating of A or better. [attached are most recent rating review results from Moody's and Standard and Poor]

Based on the three main objectives previously identified, the following guidelines will be used, although they are not intended to be all-inclusive.

### **Financial Ratios**

This policy establishes guidelines to measure the total amount of debt outstanding and to assess overall financial health. The following ratios are consistent with ratios utilized in the higher education industry and should be reviewed at least annually and on a pro forma basis when considering debt financed projects.

#### Viability Ratio FY 2011 = 2.41

This ratio measures the availability of expendable net assets to pay off long term debt. A ratio of 1.0 or higher indicates an institution has sufficient net assets to satisfy debt requirements.

Ratio = Expendable Net Assets/Long-Term Debt

#### Debt Burden Ratio FY 2011 = 1.3%

This ratio expresses annual debt service payments as a percent of total expenses. It measures an institution's ability to repay debt service on all outstanding debt and its impact on the institution's overall budget.

Ratio = Annual Debt Service/Total Expenses

As a general guideline, it is believed that if more than 5% of an institution's budget were devoted to debt service, that institution's flexibility to devote its resources to other needs would be compromised. It is understood that rising expenses could make this ratio seem more attractive, though misleading, and is evaluated in conjunction with an institution's income statement.

#### Primary Reserve Ratio FY 2011 = 1.4116

This ratio provides a snapshot of an institution's financial strength and flexibility. The ratio indicates how long the University could operate using expendable reserves without relying on additional new assets generated by operations. Trend analysis indicates whether an institution has increased its net worth in proportion to its rate of growth. A negative or decreasing trend indicates a weakening financial condition.

Ratio = Unrestricted & Expendable Net Assets / Total Operating Expenses

Return on Net Assets Ratio FY 2011 = 5.6%

This ratio reports whether an institution's resources are growing and if it is financially better off than in previous years. It is important to assess this ratio as a linear trend – an increasing trend indicates an increase in net assets and an increased likelihood that the institution is able to set aside financial resources to strengthen future flexibility. Single year events, like a substantial gift or extreme investment performance, can cause significant year-to-year volatility.

Ratio = Increase (Decrease) in Net Assets / Beginning of Year Net Assets

Net Operating Revenues Ratio FY 2011 = 5.87%

This ratio indicates whether operating activities resulted in a surplus or deficit. A positive ratio indicates the College experienced an operating surplus; a continuing decline or pattern of deficits indicates financial problems.

Ratio = Adjusted Net Operating Revenues / Adjusted Total Income

**PROCEDURES:**

Whenever short or long-term debt is required to fund University operations, or whenever there are transactions that would contingently obligate the University, the Office of Vice President of Finance and Administration must be contacted to arrange and/or approve all terms, conditions and financial covenants.

General Counsel must approve the legal form on all instruments, documents or agreements relating to financing, indebtedness and contingent obligations.

The Board of Trustees must approve all tax-exempt borrowings and any "indebtedness," or "contingent obligations."

Whenever Board of Trustee approval is required, the Office of Vice President of Finance and Administration will prepare the appropriate Board authorization resolution.

**CONCLUSION:**

The debt strategy outlined in this policy is designed to provide discipline to capital financing and operating budget decisions, and provide guidelines to manage interest rate and liquidity risk and ensure appropriate balance is achieved between debt, equity and cost of capital. To succeed there must be proactive management by the Office of the Vice President of Finance and Administration, active oversight by the Board and a commitment by all to adhere to the principles and objectives set forth in this policy.

## GLOSSARY OF TERMS

<i>Adjusted Change in Net Assets</i>	Change in Unrestricted Net Assets per the statement of activities, plus depreciation and interest expense.
<i>Credit</i>	Credit is the ability to repay a financial obligation. A measure of the quality and safety of a bond, based on the University's financial condition. More specifically, an evaluation from a rating agency indicating the relative likelihood that the College will be able to meet scheduled interest and principal repayments to investors. Credit Rating
<i>Debt</i>	All short and long term obligations, guarantees, and instruments that have the effect of committing the University to future payments and therefore impacting its credit.
<i>Debt Capacity</i>	The amount of debt the University can take on under specified criteria. Internal criteria include financial ratios. External criteria include credit ratings from rating agencies.
<i>Financial Ratios</i>	One value divided by another which are used to study and interpret relationships between financial variables.
<i>Leverage</i>	The degree to which the University is utilizing borrowed money versus internal funds to finance projects.
<i>Net Investment in Plant</i>	Total plant, property and equipment assets less long-term debt and accumulated depreciation.
<i>Rating Agencies</i>	Companies that publish borrowers' credit ratings, such as Moody's and Standard and Poor



Moody's Investors Service

**Rating Update: MOODY'S AFFIRMS THE A3 LONG-TERM RATING ON WORCESTER STATE COLLEGE'S SERIES 2002 BONDS; OUTLOOK REMAINS STABLE**

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Global Credit Research - 29 Oct 2009

**COLLEGE HAS \$12.8 MILLION OF RATED DEBT OUTSTANDING**

Massachusetts Health & Educ. Fac. Auth  
Higher Education  
MA

**Opinion**

NEW YORK, Oct 29, 2009 -- Moody's Investors Service has affirmed Worcester State College's A3 long-term rating. The rating applies to \$12.8 million of Series 2002 bonds issued through the Massachusetts Health and Educational Facilities Authority. The outlook for the rating is stable.

**LEGAL SECURITY:** General revenues of the College, including state appropriations and tuition.

**INTEREST RATE DERIVATIVES:** None.

**STRENGTHS**

\* Healthy market position as a regional public college serving central Massachusetts. The College enrolls 4,121 full time equivalent (FTE) students as of fall 2009 and has enjoyed a historically strong selectivity ratio at 51% with continued demand evidenced by a healthy 8% increase in freshman undergraduate applications for fall 2009. In an effort to manage enrollment for the semester, given strong application growth, the College instituted a waitlist which allowed it to control enrollment volume resulting in a healthy stable yield of 33.6%.

\* Strong management of operations and budget flexibility demonstrated by a consistently positive operating performance. Despite 13% or \$3.9 million in cuts in fiscal year (FY) 2009 commonwealth appropriations, the College ended the year with a strong 7.1% operating margin as a result of material expenditure reduction of approximately \$4.7 million or 7% of expenditures. Healthy tuition growth, modest increases in enrollment, additional expenditure consolidation and reduction and a moderate use of \$1 million of reserves is expected to offset an anticipated reduction in state support of approximately \$3 million for FY 2010, resulting in balanced operations. While FY 2010 and 2011 appropriation cuts will likely be backfilled by federal stimulus, the College plans to utilize any stimulus dollars for one time expenditures or out-year operations.

\* Growth of unrestricted financial resources. Unrestricted financial resources have increased a healthy 93% to \$17.1 million since FY 2005; largely due to positive operations.

\* No near-term borrowing plans coupled with a conservative 100% fixed rate debt structure.

**CHALLENGES**

\* Considerable fiscal challenges at the Commonwealth (rated Aa2 with a stable outlook) have challenged this revenue source for the College (40% of Moody's adjusted operating revenue in FY 2009). In FY 2009, Commonwealth appropriations fell below FY 2006 levels, despite 1% growth in enrollment. While FY 2010 and 2011 cuts will likely be backfilled by federal stimulus dollars to maintain relatively stable support going forward, Moody's notes concern regarding the potential for more significant reduction in support following the end of the stimulus program in September of 2011.

\* Thin level of resources to cushion outstanding debt and operations. The College has an expendable financial resource base of \$22.6 million which provides a modest cushion to support debt and operations of 0.23 times and 0.38 times respectively. The College is notably leveraged with Debt to revenues at 1.5 times.

**RECENT DEVELOPMENTS:**

Moody's includes in Worcester State's debt ratios \$84 million of bonds issued by the Massachusetts State College Building Authority (MSCBA, rated A1) in order to finance residence halls and other auxiliary facilities on the Worcester State campus. The bonds are supported by revenues from the residence hall and related facilities which are not included in the College's financial statements. The College has no near-term plans for additional issuance.

#### **Outlook**

Moody's stable outlook represents Moody's expectations that the college will continue to demonstrate flexibility in budgeting to produce at least balanced operating results during current and future state appropriation reductions as well as maintain the currently healthy market position.

#### **What could change the rating-UP**

Significant growth of financial resources to cushion debt and operations; increased student demand reflected in stronger growth of net tuition revenue and continued healthy operating results

#### **What could change the rating-DOWN**

Deterioration of operating margins or financial resources cushioning debt and operations; material increase in debt

#### **KEY INDICATORS (FY 2009 financial data and fall 2009 enrollment data)**

Total Full-Time Equivalent Students (FTE): 4,121 students

Freshman Acceptance Rate: 51.2%

Freshman Matriculation Rate: 33.6%

Total Direct Debt: \$97.1 million

Expendable Resources to Direct Debt: 0.23 times

Expendable Resources to Operations: 0.38 times

Three-year Average Operating Margin: 3.6%

Reliance on Student Charges: 51.4%

Reliance on State Appropriations: 39.9%

Commonwealth of Massachusetts G.O. rating: Aa2/stable

#### **RATED DEBT**

Series 2002: A3 (Insurance provided by Ambac; rated Caa2 with developing outlook)

#### **CONTACTS**

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The principal methodology used in rating Worcester State College was Moody's Rating Approach for Public Colleges and Universities, published in November 2006 and available on [www.moodys.com](http://www.moodys.com) in the Rating Methodologies sub-directory under the Research & Ratings tab. Other methodologies and factors that may have been considered in the process of rating this issuer can also be found in the Rating Methodologies sub-directory on Moody's website.

The last rating action with respect to Worcester State College was on August 31, 2005 when the A3 rating and stable outlook were affirmed.

#### **Analysts**

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*Moody's Investors Service*

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## Massachusetts Higher Education Facilities Authority (Worcester State College)

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**Credit Profile**

**Massachusetts Health & Higher Education Facilities Authority, Massachusetts**

Worcester State College, Massachusetts

Massachusetts Health & Educational Facilities Authority (Worcester State College) Ser 2002

**Unenhanced Rating** A-(SPUR)/Stable **Affirmed**

Many issues are enhanced by bond insurance.

**Rationale**

Standard & Poor's Ratings Services affirmed its 'A-' rating on Massachusetts Higher Education Facilities Authority's bonds, issued for Worcester State College.

The 'A-' rating reflects:

- Good student demand, as evidenced by an acceptance rate of 54%;
- Improved liquidity, with adjusted unrestricted net assets equal to 20% of operating expenses and 87% of outstanding debt;
- A history of positive operating performance;
- State appropriations from the Commonwealth of Massachusetts (AA/Stable); and
- A low debt level, with annual debt service a low 1.6% of operating expenses and no additional debt plans.

**RatingsDirect**

**Publication Date**

June 22, 2007

Offsetting factors include a significant amount of off-balance sheet debt, issued for Worcester State through the Massachusetts State College Building Authority, and strong competition for students for other state schools, including community colleges.

### *Outlook*

The stable outlook reflects consistent financial performance, improved liquidity, and solid demand. Beyond the outlook period, continued improvement in demand and/or liquidity with limited additional debt plans could have positive rating implications.

### *History/Description*

Worcester State College is a public, state-supported college located in Worcester, Mass. The college is governed by a local board of trustees. In addition, an appointed board of governors provides oversight for the entire state college system. As one of nine, four-year, state-supported colleges in Massachusetts, the college awards baccalaureate and master's degrees in education, liberal arts and sciences, and a variety of professional programs for business administration, management, and nursing. The college also offers continuing education.

### *Demand*

Total headcount has remained relatively stable at 5,440 for fall 2006. The mix of students has changed to include more full-time students. As a result, the number of part-time undergraduate students decreased by about 2%. Freshman applications increased a strong 14% for fall 2007 and the selectivity has remained strong at 54% for fall 2007. The matriculation rate was 37%. As a result of increased tuition, graduate school headcount decreased by 6.8% to 814 students. However, management is working on tuition rates and improving the number of graduate students. The Board of Education sets undergraduate tuition at \$970 for an in-state student. Room and board fees increased 4.3% to \$7,738 for fall 2006. Total cost for in-state students remains low in comparison to the college's competitors. The first-year retention rate has improved to 75.6% from a low 70.0% in previous years. The college is close to capacity for freshman students and plans to grow enrollment at the junior and senior grade level.

### *Financial Performance*

Worcester State has consistently generated operating surpluses for the past five years. After accounting for state operating support, the college demonstrated a \$1.3 million surplus in fiscal 2006. The college's revenue diversity has also improved, with tuition and fees accounting for 46% of revenues, and state operating appropriations at 43% of revenues. State operating support is based on a funding formula and has increased in the past three years. For fiscal 2006, the state appropriated \$25.4 million in operating support and a slight increase is expected for fiscal 2007. The state provides additional capital support through the Massachusetts state bond funding.

Due to an increase in tuition and fee revenue and consistent increases in state appropriations, total net assets have increased in the past five years. In fiscal 2006, total net assets increased \$2.5 million to \$55.2 million. Unrestricted net assets also increased \$1.4 million to \$10.3 million.

### ***Liquidity/Debt***

Liquidity has also improved. Total adjusted unrestricted net assets, which include \$1.6 million of unrestricted net assets of the Worcester State College Foundation, equaled 20% of adjusted operating expenses and a strong 87% of outstanding debt. The annual debt service burden is a low 1.6% of operating expenses. Worcester State has additional off-balance sheet debt issued through the Massachusetts State College Building Authority (MSCBA). On-campus revenues generated through room and board and parking fees are used to pay debt service. Total outstanding debt through the MSCBA is \$49.6 million. Worcester State College has no additional debt plans and expects the state to issue bonds for campus improvements such as renovations to the administration building and a new wellness center.

### ***Development***

Worcester State College is in the quiet phase of a \$10 million capital campaign, for which \$3.5 million has been pledged to date. The campaign will support scholarships, academic development, and the endowment. The college's last campaign, which ended in 2001, raised \$5.2 million, exceeding the \$5.0 million goal.

The college's endowment is valued at \$11.2 million. The spending draw is 5% of the previous 12-quarter value.

### ***Contacts***

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