Rating Update: **MOODY'S AFFIRMS KALAMAZOO COLLEGE'S A1 DEBT RATING; OUTLOOK IS STABLE**

Global Credit Research - 11 Feb 2010

**COLLEGE HAS $23.7 MILLION OF RATED DEBT OUTSTANDING**

Michigan Higher Education Facilities Auth.
Higher Education
MI

**Opinion**


LEGAL SECURITY: Bond payments are an unsecured obligation of the College. The Loan Agreement contains financial covenants that require a minimum of 1.1 times coverage of maximum annual debt service, Adjusted Annual Operating Deficits of no more than 15% or Cumulative Operating Deficits of no more than 25%, and additional bonds tests. There are no debt service reserve funds.

DEBT RELATED INTEREST RATE DERIVATIVES: None

**STRENGTHS**

* Solid financial resource coverage of debt and operations, with expendable financial resources of $56.4 million providing 2.4 times coverage of debt and 1.3 times coverage of annual operating expenses in FY 2009. Moody's calculations of financial resources include approximately 90% of the market value of an externally held trust, the Heyl Fund. The Fund distributes funds to the College for scholarships for qualifying students on a discretionary basis, with distributions averaging over $1 million annually. The balance sheet cushion incorporates nearly a 19% decline in investments during FY 2009. Kalamazoo's financial resource cushion and limited amount of debt continue to be key factors underpinning the College's A1 rating.

* Improved operating performance generating healthy cash flow of 17.6%, by Moody's calculations, which provided solid 4.4 times annual debt service coverage in FY 2009. Management expects continued healthy operations due to permanent expense reductions and increased contingency budgeting implemented in fiscal 2010 combined with revenues that are at or above budget. Moody's views favorably management's introduction of multi-year budgeting and sensitivity analysis which support five-year forecasts.

* Moderate future borrowing plans to finance the construction of a new fitness center, offset by expectations of philanthropic support for the project. The College is contemplating issuing approximately $12 million of debt within the next two years. Kalamazoo is in the quiet phase of a major gifts campaign, with a portion of gift proceeds expected to be directed towards capital projects. Kalamazoo's most recent capital campaign ended in 2004 and raised $78 million, surpassing the $65 million goal.

**CHALLENGES**

* Relatively small operating revenue base largely dependant on student-derived charges (including net tuition, fee, and auxiliary revenue streams), which accounted for 61% of the College's operating revenue for FY 2009. The College's relatively low net tuition per student ($17,288 in FY 2009 compared to the median for small A-rated institutions of $19,059 for FY 2008) demonstrates the strong competition it faces from lower cost public universities and other small liberal arts colleges.

* With nearly 66% of total enrollment from within Michigan, the ability to continue to grow student charges could be pressured in the near term due to adverse economic conditions in the State which are expected to outlast the current national recession combined with weak demographic projections for the number of high school graduates. Management reports a decline in the number of applications from Michigan residents. The College attributes this decrease to the elimination of and reductions to the State's financial aid programs as well as high unemployment.
rates within Michigan. The College will continue its recently increased recruitment and marketing efforts which has resulted in a more geographically diverse applicant pool and should help mitigate some of these challenges (35% of applicants from outside of Michigan in fall 2009 compared to 29% in fall 2004).

*High age of plant (accumulated depreciation divided by annual depreciation expense) of 18.6 years in FY 2009, signaling the need for further investment in facilities. Moody's views Kalamazoo's investment in its facilities as a factor in its ability to attract students, and we will continue to monitor capital spending. The College has identified approximately $35 to $45 million of capital facilities improvements related to its sports and recreational facilities. Management intends to fund these projects through a combination of gifts and debt over the next three years.

*Highly concentrated donor base, with nearly half of all contributions received in fiscal 2009 coming from three donors and over 60% of contributions receivable from two donors, leaving the College vulnerable to changes in individual donor's circumstances. Nevertheless, this concentration reflects a modest increase in diversification than in the recent past. As the College embarks on a capital campaign, we would view further diversification of donors as a positive credit factor.

RECENT DEVELOPMENTS
At fiscal year end 2009, the College was not in compliance with the financial covenants of its Loan Agreement due to the unprecedented investment losses experienced in fiscal 2009, which were exacerbated by the College's rebalancing of its investment portfolio while market values were low. Kalamazoo's endowment declined 18.7% in FY 2009, but has increased by 14.4% for fiscal 2010 through December 31, 2009. With the improvement in the market value of its investments, the College had cured these covenant violations by September 30, 2009. Kalamazoo's investments are allocated 25% domestic equities, 21% international equities, 24% fixed income, 13% hedge funds, 6% private equity, 4% in commodities and other alternatives, 5% in cash, and 2% in other investments. As of June 30, 2009, monthly unrestricted liquidity of $49.8 million provided a strong 386 days of cash on hand.

Outlook
Moody's stable outlook reflects our expectation that Kalamazoo's balance sheet will continue to provide good support for debt and operations and that improved operating performance will continue to produce solid coverage of annual debt service.

What could change the rating-UP
Substantial increase in financial resources through improved philanthropic support and increased retained operating surpluses, significant strengthening of student demand reflected in improved selectivity and higher yield and continued rising net tuition per student

What could change the rating-DOWN
Deterioration of the College's balance sheet profile, currently its primary credit strength, either due to investment declines, operating losses or issuance of additional debt

KEY INDICATORS (FY 2009 financial data, fall 2009 enrollment)
Full-Time Equivalent Enrollment: 1,378 students
Expendable Financial Resources: $56.5 million
Total Direct Debt: $23.7 million
Expendable Financial Resources to Direct Debt: 2.4 times
Expendable Financial Resources to Operations: 1.3 times
Three-Year Average Operating Margin: 7.2%
Three-Year Average Debt Service Coverage: 3.5 times
Reliance on Tuition and Auxiliary Revenue (% of Operating Revenue): 61.1%
RATED DEBT
CONTACTS

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METHODOLOGY

The principal methodology used in rating Kalamazoo College was Moody's "Rating Approach for Private Colleges and Universities," published in September 2002 and available on 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 was on September 4, 2007 when Kalamazoo College's A1 long-term rating and stable outlook were affirmed.

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