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Rating Update: MOODY'S HAS UPGRADED THE UNIVERSITY OF CENTRAL ARKANSAS' RATING TO A2 FROM A3; OUTLOOK IS STABLE AT THE HIGHER RATING LEVEL

Global Credit Research - 03 Jun 2011

THE UNIVERSITY HAS $107.2 MILLION OF RATED DEBT OUTSTANDING

University of Central Arkansas, AR
Higher Education
AR

Opinion

NEW YORK, Jun 3, 2011 -- Moody's Investors Service has upgraded the University of Central Arkansas' (UCA's) revenue bond ratings to A2 from A3. The rating outlook is stable at the new rating level. The rating action impacts the University's outstanding debt detailed below.

SUMMARY RATING RATIONALE:

The A2 rating and stable outlook reflect UCA's healthy size, relatively strong state support, return to healthy operations and progress in building liquid reserves. The rating and outlook also incorporate some uncertainty around achieving target enrollment given application declines in the coming fall and a still modest balance sheet and liquidity cushion relative to peers.

STRENGTHS

*Sound market position as regional public university with Fall 2010 full-time equivalent enrollment of over 10,000.

*Prudent fiscal management that has resulted in three consecutive years of healthy operations (average operating margin of 4.2% from FY2008 through FY2010) and recovery of liquid cash balances supporting debt and operations. Management projects continued positive results for FY2011.

*Continued state support through basically stable annual appropriations from FY2009 through budgeted FY2012, and robust annual scholarship support for tuition through student grants of up to $4,500 per student annually.

CHALLENGES

*Thin balance sheet and liquidity. Despite solid progress by current management to retain recent operating surpluses, resources and liquidity remain modest compared to peers. Expendable financial resources provide a limited 0.17 times coverage of debt and 0.15 times coverage of operations. Liquidity, at the close of FY2010 also provided a modest 39 days cash on hand.

*Declining application volume resulting in 90% selectivity in the fall of 2010 with expectations for further weakening in fall of 2011 as a result of the elimination of concurrent high school enrollment and uncertainty about the impact of the new application fee. Achieving a target entering class of 2000 may prove challenging in light of declining applications.

DETAILED CREDIT DISCUSSION

LEGAL SECURITY: The rated bonds are a general obligation of the Board of Trustees, as well as secured by three distinct revenue pledges for the various Series. For the Auxiliary Revenue Capital Improvement Bonds the additional bonds test includes a 120% historical coverage requirement. For the Student Fee Revenue Capital Improvement Bonds the additional bonds test includes a 110% historical coverage requirement. For the Student Housing System Revenue Bonds the additional bonds test includes a 125% historical coverage requirement. The Housing System bonds have a debt service reserve requirement equal to average annual debt service which is funded with cash.

INTEREST RATE DERIVATIVES: None; 100% fixed rate debt

RECENT DEVELOPMENTS

MARKET: Moody's expects University of Central Arkansas to continue to experience good student demand for its programs. UCA enrolled 10,002 full time equivalent student (89% undergraduate) in the fall of 2010, down from 10,663 in the fall of 2008. A significant portion of the decline last fall was from losses in concurrent enrollment of high school students with little revenue impact. For the fall of 2011, management instituted a small application fee. In addition, the previous practice of all regional graduating high school seniors automatically applying to UCA has been discontinued. As a result, management expects total application volume to fall significantly and yield on accepted students to increase. Applications for the fall of 2011 are at 3,122, compared to 4,005 in the fall of 2009. UCA accepted 3,418 students in the fall of 2010 in order to reach target enrollment. While management notes particular strength in housing deposits which are largely indicative of fall enrollment, Moody's notes potential for stress on freshman enrollment in the fall.

Undergraduate tuition remains affordable especially in light of a new state-funded lottery scholarship program which began in the fall of 2010. In-state undergraduates will pay $7,182 in the coming academic year in tuition and fees. With the typical lottery award of $4,500 per year, the net cost of attendance will be dramatically reduced for those who maintain the merit and academic progress qualifications.

OPERATIONS: UCA remains highly reliant on two major sources of revenue; student charges were 55% of total revenues in FY2010 and state appropriations comprised 38%. Following healthy tuition revenue growth in FY's 2008 and 2009 given managements tighter controls on discounting, FY's 2010 and 2011 saw more modest growth of this line item, largely as a result of moderate enrollment declines. Management expects net tuition revenue to grow at a modest healthy pace going forward as a result of expectations for stable to increasing enrollment. State appropriations have remained flat in FY 2011 from FY 2010 with expectations for continued basically flat support in FY2012.

Following several years of weak financial control that resulted in annual operating deficits and thin cash balances, UCA's new management team has now seen three consecutive years of healthy operations (average margin of 4.2% for FY 2008-FY 210) providing average debt service coverage of 2.0 times, with expectations of similar results for FY 2011. As a result, UCA has been able to regain a comfortable level of liquidity. From negative cash balances (net of use of an operating line of credit) 4 years ago, the University ended the 2010 fiscal year with $14 million of monthly liquidity, equating to a still modest, but much improved 39 days cash on hand. Management projects that cash reserves will increase to healthier $19.1 million at the close of the current 2011 fiscal year and expects to maintain cash balances close to that level going forward.

BALANCE SHEET: Balance sheet resources have improved, but remain modest compared to the level of outstanding debt. Expendable financial resources of $20.8 million provide a thin 0.2 times coverage outstanding debt of $121.2 million. Total financial resources of $45 million for FY 2010 include $26 million of resources held by UCA's Foundation. The assets at the Foundation ($28.1 million at 3/31/2011) are invested in equity/fixed income allocations and held by several different managers.

Outlook

Our stable outlook reflects expectations for continued positive operations resulting in maintenance of at least stable cash reserves. It is also predicated on a basically stable student enrollment, healthy coverage of debt service by pledged revenues and the ability to increase net student revenue over time.

What Could Change the Rating - UP

The rating could improve if the University continues to build financial reserves and maintains student market strength and operating support from the State while limiting additional debt.

What Could Change the Rating - DOWN

Decline in liquid cash position; deterioration in operating performance; reduction in state support or student-derived revenues; declining enrollment

KEY INDICATORS (FY 2010 Financials, Fall 2010 enrollment)

Total Enrollment: 10,002 full-time equivalent students

Total Pro Forma Debt: $121.2 million

Total Financial Resources: $45.1 million

Expendable Resources to pro forma Debt: 0.17 times

Expendable Resources to Operations: 0.15 times

Average Operating Margin: 4.2%

Operating Cash Flow Margin: 12.8%

Monthly Liquidity: $14.4 million

Monthly Days Cash on Hand (unrestricted funds available within 1 month divided by operating expenses excluding depreciation, divided by 365 days): 39 days

Reliance on State Funding: 37.8%

State of Arkansas GO Rating: Aa1, stable

RATED DEBT

Housing System Revenue Bonds Series 2007C: A2, insured by FGIC

Housing System Revenue Bonds Series 2006F, 2006A: A2; insured by Ambac

Student Fee Revenue Bonds, Series 2007B, 2004A, 2004B: A2, insured by FGIC

Student Fee Revenue Bonds, Series 2006E, 2006B, 2003A, 1998: A2; insured by Ambac

Auxiliary Revenue Bonds, Series 2007A: A2, insured by FGIC

Auxiliary Revenue Bonds, Series 2006D, 2006C, 2003B: A2; insured by Ambac

Auxiliary Revenue Series 2010A, Student Fee Series 2010B, Housing Series 2010C: A2

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METHODOLOGY

The principal methodology used in this rating was Public College and Universities published in November 2006.

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