

QUICK POLL:

Outlook 2009: Higher Education Concerned About Impact of Investment Portfolios on Credit Ratings

The **Nonprofit Management Research Panel** recently conducted a Quick Poll specific to executives and investment committee members responsible for overseeing endowments for colleges and universities. The poll was completed by 57 executives overseeing asset pools ranging in size from \$25 million to over \$1 billion. None of the participating organizations were SEI institutional clients. Below is a summary of the key findings.

2009 Outlook for Higher Education Institutions

In January 2009, Moody's Investors Service issued a report entitled "2009 U.S. Higher Education Outlook," claiming it was the first negative outlook for all sectors of higher education since the credit-rating agency started publishing higher-education outlooks in the mid-1990s¹.

According to the report overview, at least four critical risks face U.S. higher education institutions, including:

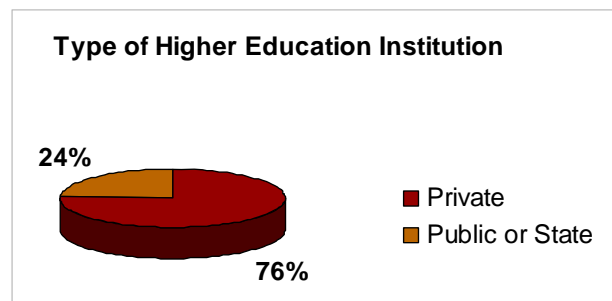
- Increased pressure on tuition and financial aid
- Broad impact of investment losses on operations and philanthropy
- Illiquidity of balance sheets, amplified by alternative investments
- Volatility in debt markets and debt structures².

One aspect of the report explored whether colleges and universities could be facing credit rating downturns. With that as the backdrop, this survey addresses these institutions' investment portfolios and the potential impact on their overall financial management. Specifically, the survey polled financial executives and investment committees to gather their insights and experiences in several key areas. What are the issues of greatest concern? How are investment portfolios being managed? What changes are higher education institutions taking in light of these concerns?

Organizations polled

Depending on the type and size of the organization, the challenges can differ greatly. Here is a breakdown of participating organizations based on size of invested endowment assets:

- 8% under \$25 million
- 13% between \$26 and \$50 million
- 21% between \$51 and \$100 million
- 26% between \$101 and \$300 million
- 13% between \$301 and \$500 million
- 8% between \$501 and \$999 million
- 11% over \$1 billion

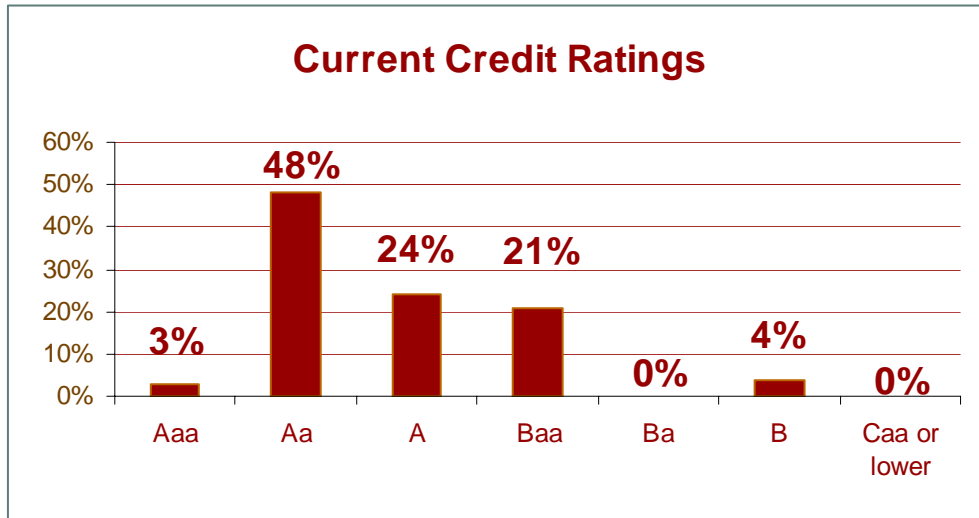


¹ "Moody's Sees Stiff Challenges for Colleges—Especially Private Ones—in Next Year" The Chronicle of Higher Education (Jan. 6, 2009)

² "U.S. Higher Education Outlook" Overview Moody's Global Credit Research (Jan. 5, 2009)

Credit ratings have held through economic downturn

According to poll results, downgrades have not significantly impacted colleges and universities and ratings are still strong. While not all higher education institutions have credit ratings, almost three-quarters (74%) of the poll participants said their institution was rated by a rating agency. The accompanying chart shows the current standing of institutions with ratings:



Credit ratings worse for private institutions vs. public or state

The Moody's report suggested that private higher education institutions could face financial challenges as families might look for lower-cost alternatives among public or state schools. While both types of organizations are still experiencing relatively strong credit ratings, there was a distinct difference between the two.

- *All (100%) of the public or state universities with a credit rating reported a rating of Aa or better compared to only 38% for private institutions*
- *One third (33%) of the private institutions said their credit rating was Baa or worse*

Colleges and universities taking on debt

More than half (53%) of the poll participants said their organization had taken on debt in the past 12 months. Public institutions appear to be borrowing at a much greater rate as 88% of that group said they had taken on debt. In contrast, only 41% of the private institutions had done so.

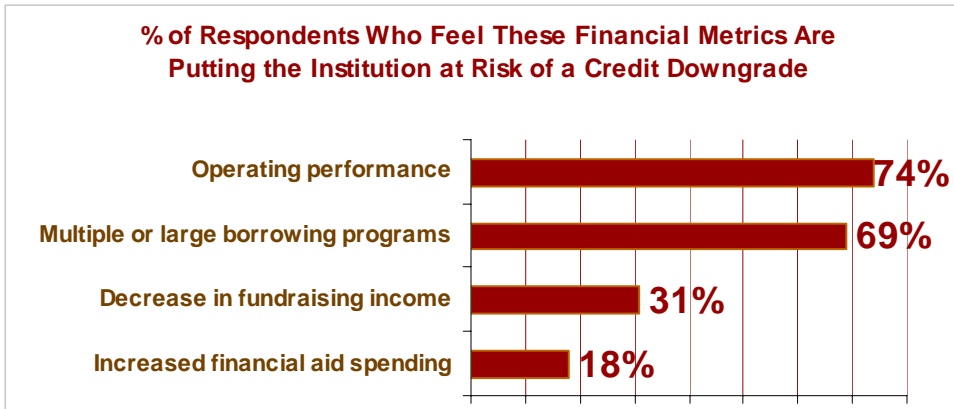
Poll results show no correlation between an organization's endowment size and its debt increase. Half (50%) of the organizations with endowments of \$100 million or less took on debt in the past 12 months compared to 54% of those with more than \$100 million.

Credit downgrades are a concern

While none of the poll participants said their organization has experienced a credit downgrade in the past 12 months, almost all (97%) said current financial metrics have put colleges and universities at risk for a downgrade.

Current financial metrics are putting organizations at risk

Higher education institutions feel that current economic conditions have created a difficult environment for managing crucial financial metrics.



Concerns around investment management of endowment

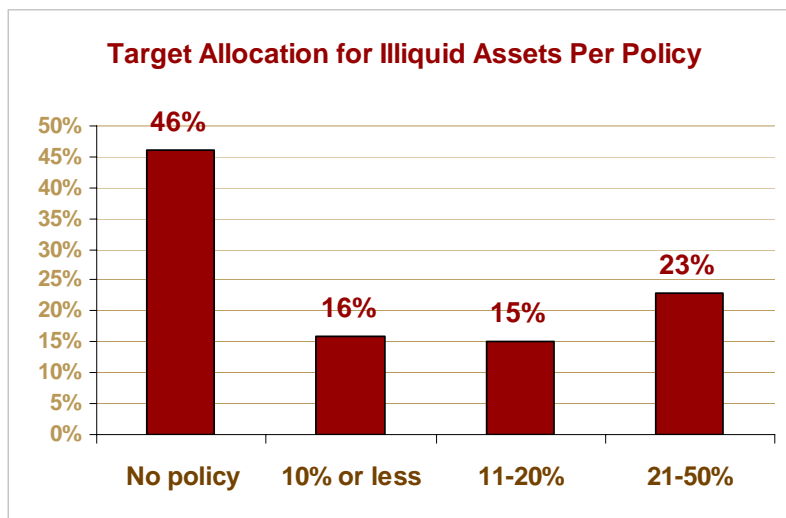
While the financial metrics listed above were of concern to poll participants, the greatest concerns stem from the endowment's investment strategy and its potential impact on the organization's overall finances.

- **84%** of the poll participants said they feel that credit rating agencies would view a lack of diversification in the endowment's investment portfolio as a reason for downgrade
- **65%** feel that agencies would view a lack of liquidity in the endowment's investment portfolio as a reason for downgrade
- **Two-thirds (66%)** of the respondents did not feel that poor investment performance would result in a credit downgrade

Liquidity management in investment portfolio could be placing institutions at risk

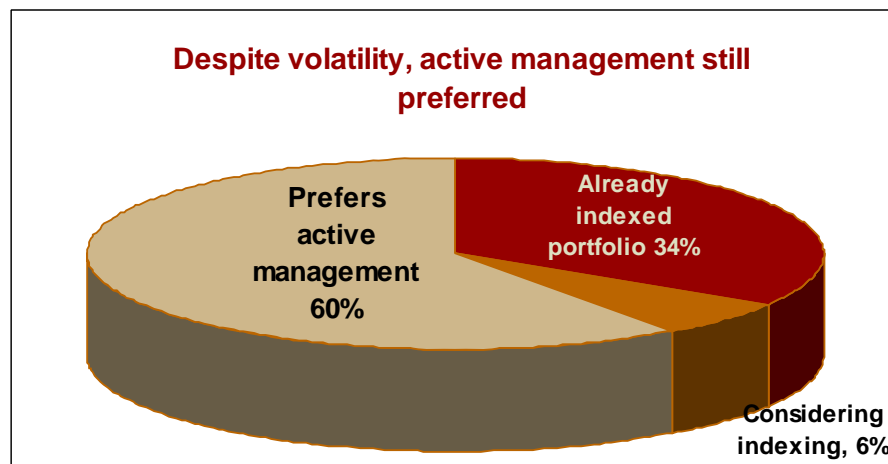
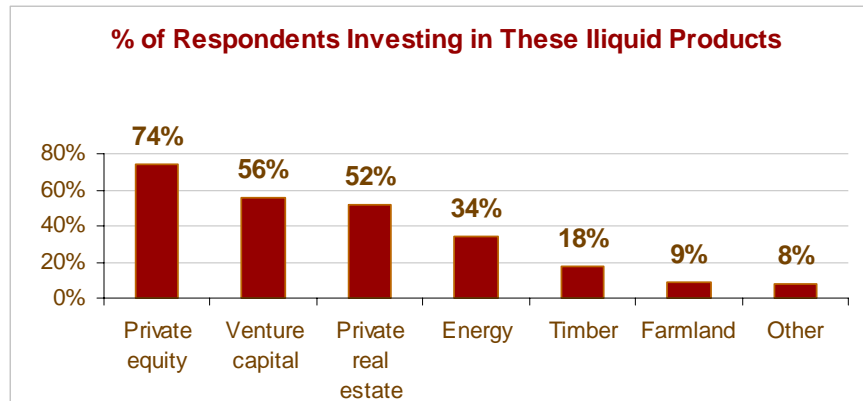
While almost two-thirds of those polled feel the lack of liquidity is putting the organization at risk of a credit downgrade, practices for managing liquidity could come under question.

Almost half (46%) of the poll participants said the organization's investment committee does **NOT** have a formal liquidity policy.



Use of illiquid products and preference for active management

Almost all (89%) of the organizations polled said they do currently invest in illiquid asset classes. Here is a breakdown of which products are most popular:



Conclusion

The results of this poll support that higher education institutions are concerned not just about potential credit downgrades, but the overall management of organizational finances. Focus is on diversifying the overall investment portfolio with liquidity a main concern. Despite this activity, organizations could be making reactive changes without a full evaluation of the overall investment management process and how it impacts overall finances. Without this type of evaluation, the organization could be putting itself at risk for credit downgrades as well as additional financial challenges. As investment committees maintain an actively managed strategy, they should seek an approach that aligns with their overall organizational needs and goals. Requests for more information or questions can be emailed to seiresearch@seic.com.

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