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AN UPDATE ON THE STATE OF PRIVATE HIGHER EDUCATION AND FINANCIAL ANALYSIS

JUNE 30, 2013

BROWN EDWARDS

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TRINITY COLLEGE

AN UPDATE ON THE STATE OF PRIVATE HIGHER EDUCATION AND FINANCIAL ANALYSIS

June 30, 2013

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AN UPDATE ON THE STATE OF PRIVATE HIGHER EDUCATION

So, the Economy Has Improved ... Or Has It? Many of the Smallest--and Even Largest--Private Colleges and Universities Are Not Seeing Much Improvement

For 2013, Moody's Investor Services (Moody's) has down-graded the outlook for ALL of the higher education sector, from stable to negative. While the smallest institutions have been pulled down by the economic tightening since 2008-09 (and some have closed), now Moody's has included even the strongest, diversified institutions in its negative outlook. Cost reduction, including down to the core traditional academic programs, is the name of the game. But, for those institutions already having cut and cut and cut ... and cut..., how much deeper can they go?

<u>What are the Current Issues for Private Higher Education Institutions to Be Watching</u>?

To keep pace with the intensified challenges in the private higher education sector, institutional management and governance bodies must consider a hastened pace of change. In order to try to stay nimble enough to ride through the economic pressures that continue, albeit with perhaps a bit of loosening occasionally, institutions must remain in tune with several key issues of the day. These issues include deteriorating revenue streams, rising student debt burdens and defaults, greater government focus and public scrutiny, increased risk of more regulation, and increased activity by accrediting agencies.

- **Deteriorating revenue streams** – Colleges and universities continue to feel the effects of deteriorating revenue streams on several fronts. Moody's notes that, overall, the United States (U.S.) economy is experiencing "prolonged muted revenue growth." For example, Sentier Research, LLC, reports that median household income has dropped 7.3 percent since the recession began—decreasing from $55,438 in 2007 to $51,404 by February 2013 (pretax and adjusted for inflation and seasonal factors). Sentier also notes that median household incomes already were stagnant throughout the 2000s—before the recession. In June 2012, the U.S. Federal Reserve reported that "the average American family experienced a 39% decline in net worth during the three years ending 2012, bringing median net worth to its lowest level since 1992." This drop in household income affects the two most significant revenue streams of private colleges and universities – tuition and contributions. "Consumers" are less able to pay tuition and fees, and donors tend to be conservative with their gift-giving. Sallie Mae's annual study *How America Pays for College 2012* highlights that, "in academic year 2011-12, U.S. families spent, on average, 5% less on higher education than the prior year and price was of increasing importance in deciding where to attend college. The greatest impact of price sensitivity is felt by small-to-mid-sized less selective private colleges." As for contributions to higher education, donors have not pulled back like consumers of higher education have. The Council for Advancement and Support of Education reports that charitable giving to U.S. colleges increased to $31 billion in 2012 (around 2%).

  Another revenue stream of importance to higher education is the payout generated from investments, typically "endowment" investments. While investment performance turned positive in the first half of FY 2013 (July 1 to December 31, 2012) and has shown much improvement over the 12 months ended June 30, 2013, the international economy continues to temper prospects for long-term gains and, closer to home, uncertainty about the effects of new health care regulation and federal sequestration leave investors skittish about projections. Educational institutions are finding that, in this more conservative environment, the prudent action to conserve long-term purchasing power from endowment payout is to reduce the payout percentage, decreasing funds available from this revenue stream.

What are the Current Issues for Private Higher Education Institutions to Be Watching? (Continued)

Speaking of federal sequestration, the federal government continues to struggle with its own budget issues. Basically all federal expenditure categories are being scrutinized to determine where pull-backs will be made. While the U.S. government stresses the importance of higher education, cuts to federal student aid programs are occurring. In April 2013, the Associated Press reported that, "in all, the Education Department lost $2.6 billion as part of failed budget negotiations that forced deep spending cuts to reduce the nation's debt." Mark Kantrowitz, a nationally recognized financial aid expert who serves as a guest columnist for the *New York Times* and the *Huffington Post*, reports that the Federal Work-Study (FWS) and Federal Supplemental Educational Opportunity Grant (FSEOG) programs will be cut by $89.5 million (5.52%) for 2013-14, resulting in around 33,000 fewer FWS awards and 71,000 fewer FSEOG grants. Funding for the Iraq-Afghanistan Service Grant (IASG) and TEACH Grant programs also are being reduced, by 37.8% and 12.6%, respectively.

While reducing federal aid funds available, the U.S. government is also increasing loan fees. Specifically, loan fees for Federal Direct Stafford loans will increase from 1.0% to 1.051%, and the loan fees for the Federal Direct PLUS loan will increase from 4.0% to 4.204%. Recently all federal student loans were moved to a market-based interest rate.

In addition to student aid funding cuts and interest rate hikes, the federal government also is considering revised eligibility criteria. All of these federal aid recommendations tend to hurt smaller regional institutions, serving higher proportions of lower-income students. Kantrowitz notes that "if sequestration continues into FY 2014, the budget cuts next year will be more severe … and prospects for avoiding sequestration in FY 2014 are slim." So, while household incomes have plummeted, the federal government is reducing federal grant funding availability at the same time, exasperating the situation relative to ability to pay for a college education.

- **Rising student debt burdens and defaults –** Evolution of increasing debt burdens and defaults on student loans is diminishing the perception of the value of a college degree. Particularly in non-professional programs, where students "must" progress to a master's degree or PhD (etc.) to achieve "reasonable earning potential," the cost/benefit analysis may reveal a negative value to customers – especially in the short term. And when studies reveal that science, technology, engineering, and math (STEM) jobs do not necessarily require a bachelor's degree, the value proposition dims further. Specifically, a recent report from the Brookings Institute in Washington, *The Hidden STEM Economy*, noted that only 50.5 percent of STEM jobs nationally require a bachelor's degree. STEM jobs include a broad diversity of positions, including installation and maintenance jobs, and some of these lower-end jobs pay good salaries.

<u>What are the Current Issues for Private Higher Education Institutions to Be Watching</u>? (Continued)

As for student loan activity, in 1992-93, 30 percent of undergraduates obtained student loans; more than 50 percent took loans in 2011-12. Having nearly tripled since 1992-93, the average annual student loan now is nearly $10,000 – having increased by 55 percent since 2001-02. As the volume of student debt has grown, the percent of students defaulting also has grown. Statistics from the U.S. Department of Education show that the national two-year fiscal 2010 default rate has more than doubled since 2003, from 4.5 percent to 9.1 percent. This default trend is not as related per se to the volume of student loans (one might imagine the default percentage to remain constant) as to rising unemployment rates. The smaller traditional private institutions that rely most heavily on federal financial aid and lack brand reputation are most negatively affected by increased student loan default rates. Many of these institutions have missions geared toward enrolling students with higher debt needs and lower levels of college-preparedness. As a result, attrition rates are high and graduation rates are low for these colleges, driving default rates high as students are left with debt to pay without the benefits of a college degree.

- **Greater government focus and public scrutiny –** Government (federal and state) and the general public continue to increase their scrutiny of the cost/value of college degrees. This factor, in addition to the revenue and student debt pressures mentioned earlier, heighten the price sensitivity of customers in the higher education marketplace. In response to increased price sensitivity, colleges and universities either suppress increases in tuition sticker price and/or increase scholarship awards. Either tactic may lead to losses in net revenue – average per student and total net revenue, if increased volume (enrollment) does not offset these pricing dynamics. This net revenue compression is more significant for smaller, lesser well-known colleges, who do not have large endowments and adequate support from contributors to fund scholarships to the extent that larger, wealthier institutions can. Moody's reports that, "even with a median tuition discount of 29.5% in fiscal 2011, Baa-rated institutions were only able to yield 24.2% of admitted students, while Aaa-rated private universities were able to yield a median 50.2% of their admitted students at a 42.8% discount rate." The average net tuition per student of $21,505 at the Aaa-rated institutions was higher than the $18,216 at the Baa-rated institutions, even with the higher tuition discount percentage.

  Increased government focus is understandable in the current environment in which college prices have been escalating at rates in excess of inflation and family incomes – especially when the cost increases are resulting from institutional spending not directly related to instruction. The Joint Legislative Audit and Review Commission (JLARC) (Virginia) reported in June 2013 that "most spending by four-year institutions is on auxiliary enterprises, such as intercollegiate athletics, student housing, dining ... research, support services, and campus recreation." While JLARC's study focused on public institutions in Virginia, private colleges and universities find themselves in the same "arms race" to satisfy customer desires for amenities.

- **Increased risk of more regulation –** While heightened government focus on higher education began during the Bush administration, during 2012-2013 President Obama has placed significant focus on college affordability and educational outcomes. The expectation has been clearly announced that colleges and universities are to slow the rate of tuition increases – or participation in federal grant and loan programs may be curtailed. By the required disclosure of their net cost, by way of the net price calculator, institutions must be clear with students and families about their pricing. Obama has developed a small college affordability plan linking specific eligibilities for federal financial aid participation to the rate of tuition increases.

What are the Current Issues for Private Higher Education Institutions to Be Watching? (Continued)

State governments also are scrutinizing higher education. Virginia recently aggregated and published data regarding starting salary information for new college graduates by institution, degree, and program. Students and families can compare the information in this database to inform their decision as to the "best" institution to attend, based on outcomes. State-level performance-based funding also is gaining traction, as a result of Obama's focus on higher education. Many states have developed funding models, for both public and private institutions, based on such metrics as degree completion, retention, and faculty productivity. Several states are considering a total-cost (e.g., $10,000) four-year degree, to ensure that their states' citizens receive a cost-effective education. Some states also are considering mandating different tuition structures for different degree programs, based on the earning potential of the programs.

- **Increased activity by accrediting agencies –** With increased public and political focus on higher education, accrediting agencies have had no choice but to intensify their review procedures, resulting in a significant increase in sanctions by the regional accrediting agencies. Moody's reports that "negative accreditation actions taken against U.S. colleges and universities increased by almost 50 percent from 2009 through 2011 and remained at a similarly high level in 2012 in response to growing government criticism of poor disclosure about quality, pricing, and outcomes, as well as inefficient cost management." Moody's further states it's anticipation in seeing "heightened accreditation activity to increasingly impact not just smaller, weaker colleges that have traditionally been cited for various insufficiencies, but also larger universities with sound financial health and solid market demand," as a result of accreditation focus on a broad range of factors, including governance, integrity, and student outcomes.

What are Some Tactics to Consider in Addressing These Issues?

What can private colleges and universities, especially those that are most vulnerable, do to deal with the significant issues affecting the industry? Private institutions must be strategic in addressing these issues, and involvement of all constituents will be important to the efforts required. The list below offers some suggestions for consideration.

- **Reevaluate the traditional higher education cost structure**, considering all areas, including faculty salaries, shared governance, classroom instruction, and student services. Is guaranteed employment (tenure) still relevant? Can both faculty and administrative leadership guide institutions toward cost efficiency? Can more efficient models of instruction, besides traditional in-classroom instruction, be developed? How can student services be provided more cost-effectively? Institutions have relied on nonrecurring savings strategies in the past (e.g., leaving positions vacant, furloughs, early retirement plans, delayed capital expansion); however, now long-term changes in the core cost structure are necessary, likely resulting in the elimination of programs that are small and under-enrolled. Also, consolidating or integrating general education courses across curricula can free resources that might better be directed toward niche programs that can fuel enrollment growth.

What are Some Tactics to Consider in Addressing These Issues? (Continued)

- **Increase on-line offerings**—which might mean actually reducing investments in student services and capital facilities and reducing the cost of course delivery. An on-line presence also minimizes geographic campus constraints—in recruiting both students and faculty. On-line market opportunities include specific distance learning programs, degree completion offerings, hybrid classes, fully on-line degrees, and Massive Online Open Course (MOOC). Several efficiencies exist in online education, including distribution of faculty (do not need office space on campus); lower faculty costs (more part-time/adjunct faculty, who do not require benefits and can be paid less); fewer tenured faculty (allowing hiring flexibility and avoiding long-term locked-in personnel costs); e-texts (the use of electronic textbooks, allowing traditional campus "book" stores to carry more retail items with higher profit margins and to avoid losing book sales to online competitors such as Amazon); and pedagogical flexibility (incorporation of various learning mechanisms, such as simulations, video, and other electronic learning tools—more easily than in the classroom).
- **Diversify program "products**," by offering career program certificates, individual course completion certificates, job-market degrees, licenses, developmental/remedial "boot camps." Institutions also should be mindful of program needs from students outside of the U.S.; many international students see the U.S. degree as "the most prestigious."
- **Continue to stress the long-term value of postsecondary degrees**—especially higher income earning potential and lower unemployment rates:

Bureau of Labor Statistics, Current Population Survey (rounded)				
	Earnings		Unemployment Rate	
	2007	2011	2007	2011
High School	$31,000	$32,000	4.5%	9.0%
Bachelor's	$51,000	$55,000	1.8%	4.6%
Master's	$55,000	$65,000	1.5%	3.8%
Doctoral	$60,000	$80,000	1.0%	2.8%

- **Ensure that students graduate in four years (or less!)**. In this regard, helping the institution's staff and faculty understand the role of debt in students' lives and encouraging faculty and staff to develop and participate in initiatives to ensure timely or expedited graduation is critical.
- **Consider "anywhere" education**. For example, more and more high school students desire to earn college credit before they complete high school. In addition to bringing local high school students to their own campuses (not to be discouraged because of its marketing angle), private institutions might take the professor to the high school class – either in person or in an online format. Colleges and universities also are taking their educational opportunities to venues where the adult learner can be reached easily and conveniently. Venues such as company conference rooms, shopping malls (vacant stores and even movie theaters), military installations, and even prisons offer excellent facilities for classes to be taught. (Regarding prisons, do not focus only on the employees – those that are incarcerated can be ambitious students, particularly through "incarcerated re-entry programs.")
- **Evaluate tuition levels**, perhaps minimizing tuition increases and even lowering tuition. Other mechanisms for enhancing affordability include freezing tuition for students' entire undergraduate college careers (up to four years, perhaps) or allowing students to pay for up to four years up front at a discounted rate. These options provide greater transparency, allowing for easier student/family budget planning.

What are Some Tactics to Consider in Addressing These Issues? (Continued)

- **Teach financial literacy skills** to students (and their families), to help them understand basic money management skills, such as budgeting/saving, completing financial aid documents, handling credit and debt, and planning financially for a career/graduate school. With this information, they can not only complete their education without getting into financial difficulty, they can carry this solid foundation into a lifetime of financial success, becoming supportive alumni to their alma mater.
- **Partner with other colleges and universities**, creating consortia offering greater programing diversity, while allowing more niche specialization within individual institutions, reducing costs while enhancing specific program reputation at these colleges. As several states consider consolidating campuses within public systems (Georgia, Louisiana, West Virginia, and New Jersey), private institutions just as well benefit from similar operating efficiencies and reduced overhead. Shared services models can reduce duplication of administrative functions and generate efficiencies in areas such as human resources, fundraising, financial services, information technology, internal audit, and purchasing. Academic synergies may be developed jointly through dual enrollment programs and joint bachelor/master programs.
- **Manage cash flow tightly**, including maintenance of cash reserves. Consider having a line of credit available, even if it is never used – especially in light of potential delays in release of federal (and state) funds, not to mention slower payment by individuals.
- **Manage debt structure carefully**, including awareness that debt capacity levels are tighter than previously, because of the general volatility in the higher education marketplace. That is, institutions (especially small, less well-known ones) cannot assume that the flow of students will remain steady, to support increased debt service. Consideration should be given to incurring more fixed-rate than variable-rate debt, again because of the volatility in the higher education marketplace and general economic concerns.
- **Commercialize intellectual property**, encouraging and supporting faculty to be innovative in their research pursuits, even at the smaller colleges and universities.
- **Continue to automate**, including: online distribution of materials, reports, documents, etc.; electronic timekeeping for employees; digitized document storage; e-procurement/payment; consolidation of technology (e.g., desktop printers); and cloud computing. Additional technology transitions include outsourcing technology infrastructure (e.g., servers) and system hosting services (email service) – going to "the cloud." Internal virtualization also is proving cost effective, where desktop personal computers in offices and technology laboratories are replaced with "thin clients" (like monitors) that link to central servers for necessary software.
- **Identify alternative revenue streams**, such as continuing education seminars, adult-learning short courses, enrichment certifications, and corporate-sponsored achievement milestones. Institutions might also consider winter terms or summer programs – not only for their own current students, but also for those students returning home for their breaks from other institutions and for students from other localities (even international) who desire special program and travel opportunities. Other revenue diversity opportunities include revenue-generating partnerships (space-sharing), auxiliary programming (economic analysis centers, tourism coordination hubs, local or regional history/heritage resource archives, cultural symposia festivals, and after school programming sites), and entrepreneurial activities (life-long learning initiatives, intellectual property development, and alumni branding opportunities).

<u>What are Some Tactics to Consider in Addressing These Issues</u>? (Continued)

- **Evaluate and tweak fundraising strategies**, perhaps considering longer-term pledge periods, mini-campaigns that are focused, elimination of "distracting campaigns" to focus on annual fund and scholarship giving, and evaluation of existing restricted fund balances as an occasion to reconnect with donors.
- **Evaluate endowment policies**. As the investment markets appear to be improving, now is a great time especially to consider adjustments to the payout formula – perhaps calculating spending based on a blend of market value percentage and inflationary increases in payout amounts – to better preserve the endowment for the future, while also achieving strong support from the endowment on a current basis.

<u>Outlook in Key Areas</u>

Various indicators specifically relevant to the economy are helpful to review as colleges and universities attempt to remain nimble while addressing various key issues. The outlook for the economy certainly is related to the U.S. government's approach to resolving its budget deficit situation, as well as how international markets address their problems in areas such as the Eurozone.

- **General Economic Outlook** – Kiplinger's economic outlook notes that, although 2013 began with a strong economic start in the U.S., momentum "faded as furloughs for some civil servants and curtailments in contracts mandated by an $85 billion reduction in government spending contributed to a third consecutive spring swoon, and continue to take a bite from economic activity." The Kiplinger report describes evidence that points to a brighter outlook by the end of 2013 (although slow and unsteady), particularly as improvement in the housing market will continue.

  However, a potential fly in the ointment: Congress and the Obama administration continuing to brawl about raising the debt limit, authorizing spending measures and other key issues regarding government operations.

  Some economists are a bit more pessimistic about the economy, noting concerns about inflation falling and weaker future job growth, resulting both from the Affordable Care Act and a mismatch between open jobs and those looking for jobs.
- **Gross Domestic Product (GDP)** – GDP measures the output of goods and services produced by labor and property located in the United States and is considered the best barometer of the country's economic standing. GDP increased at an annual rate of 1.8 and 1.7 percent in the first and second quarters of 2013, respectively. GDP growth for 2013 is expected to be 1.4 – 1.7 percent. This continues to be the slowest-paced rebound from the recession since World War II. Economists suggest that the strongest economic signs currently are in business inventory accumulation, monthly job gains, rising home prices, and increased automobile sales – and that these indicators point toward growth in GDP during the rest of 2013 and early 2014. GDP declined in 2009 by 3.1 percent, followed by increases of 2.4 percent in 2010, 1.8 percent in 2011, and 2.2 percent in 2012. 2010 through 2012 comprised the three slowest consecutive years of economic growth, outside of a recession or depression, since the 1930's. However, through the first quarter of 2013, GDP had grown for 15 consecutive quarters, since economic recovery had begun during the second half of 2009.

Outlook in Key Areas (Continued)

- **Inflation** – Economists note that inflation appears to be fairly stable. Overall inflation for the 12-month period ended June 30, 2013, (as measured by the Consumer Price Index for All Urban Consumers – CPI-U) was 1.8 percent. Current estimates reflect that inflation is projected to come in around 1.5 – 2.1 percent for 2013 and 2014. Present key factors predicted to continue to keep inflation low are a lofty 7.4% unemployment rate (which restrains wages), slack demand in the international markets for U.S. goods, abundance of oil in the U.S., the end of the commodity boom, and ongoing reduction of high household debt (that is, low household purchasing). The greatest risks of higher prices currently are in food prices, caused by last year's drought across a great portion of the U.S., and in energy prices, because of increased business growth.
- **Employment** – Employment actually is gauged based on the unemployment rate – the percentage of working-age men and women who want jobs but are unable to find them. The 12-month unemployment rate for 2012 was 8.1 percent, down from its recent high points of 9.3 percent in 2009, 9.6 percent in 2010, and 8.9 percent in 2011, but still the fifth highest in at least 65 years. After hitting a high point of 10.0 percent in October 2009, the unemployment rate remained at 8.5 percent or higher until dropping to 8.3 percent in January 2012; the rate did not fall below 8.0 percent until September 2012. For the period January 2013 through July 2013, unemployment has averaged 7.4 percent, still high as compared to the early 2000s, but at least moving in the right direction. While manufacturing industries continue to suffer, recent increases in employment have occurred in the business and professional services areas (temporary help, sales, accounting, auditing, legal, engineering, and health care), leisure and hospitality (food/beverage services), and retail trade. Federal officials project the unemployment rate to drop as low as 7.2 percent by the end of 2013 and even lower by the end of 2014, to between 6.5 and 7.1 percent.
- **Consumer Income/Spending Growth** – While personal income continues to grow slowly, personal consumption remains bumpy. After decreasing 4.4 percent in January 2013, personal income, in current dollars, rose by the following percentages in February, March, April, and May 2013: 1.2, 0.2, 0.1, and 0.5. Meanwhile, personal spending fluctuated in percentage changes over these five months (January through May 2013), respectively, as follows: 0.1, 0.7, 0.2, (0.3) – negative, 0.3. April's drop in consumer spending was the largest drop since 2009. These statistics reflect that consumers remain very cautious with their money, but are, perhaps, becoming a bit more comfortable with spending. But consumers still are choosing to save, rather than to spend. The savings rate percentages for the period of January through May 2013, respectively, were: 2.2, 2.6, 2.6, 3.0, and 3.2. For calendar years 2009, 2010, 2011, and 2012, respectively, personal savings rates averaged over 4.0 percent, so the fact that they have dropped below 4.0 percent for each month in 2013 so far indicates increasing consumer comfort in spending their income. Economists project that the economy will expand at a modest rate but that a significant growth spurt is unlikely.

<u>Outlook in Key Areas</u> (Continued)

- **Consumer Confidence –** The Conference Board Consumer Confidence Index is a barometer of the health of the U.S. economy from the perspective of the consumer. (An index of 90 indicates a healthy economy. Consumer confidence in the U.S. has not been at that level since the Great Recession began in December 2007. The index fell to an all-time low of 25.3 in February 2009, and the recession was declared to have ended in June 2009. The all-time high was 144.7 in January 2000.) July 2013's index decreased to 80.3, from 81.4 in June 2013 (1985 = 100). Says Lynn Franco, Director of Economic Indicators at The Conference Board: "Consumer Confidence fell slightly in July, precipitated by a weakening in consumers' economic and job expectations. However, confidence remains well above the levels of a year ago. Consumers' assessment of current conditions continues to gain ground and expectations remain in expansionary territory despite the July retreat. Overall, indications are that the economy is strengthening and may even gain some momentum in the months ahead. "The Consumer Confidence Survey is administered monthly to a representative sample of 3,000 U.S. households, by The Nielson Company for The Conference Board. The Conference Board was founded in 1916 and is an objective, independent source of economic and business knowledge. Factors affecting consumer confidence include expectations for business conditions in the near future, anticipation of investment market returns, unemployment predictions, and GDP projections.
- **Interest Rates** – The Prime Interest Rate is the interest rate charged by banks to their most creditworthy customers; the rate is almost always the same among major banks and usually is adjusted in correlation to the adjustments of the Federal Funds Rate. (The Prime Interest Rate is equal to the Federal Funds Rate plus 3.) The prime rate charged by banks has been at a fifty-year low, 3.25 percent, since January 2009, having decreased from 5.00 percent during the course of fiscal year 2008-09. (The last time that the prime rate was as low as 3.25 percent was in August 1955. The U.S. prime rate historic high was 21.50 percent, in December 1980.) At its June 2013 meeting, the Federal Open Market Committee (FOMC) held short-term interest rates at their current levels; therefore, the Prime Interest Rate remains at 3.25 percent. In its June report, the FOMC stated that, "to support continued progress toward maximum employment and price stability, … the Committee anticipates that this exceptionally low range for the federal funds rate will be appropriate at least as long as the unemployment rate remains above 6.5 percent, inflation between one and two years ahead is projected to be no more than 2.5 percent, and longer-term inflation expectations continue to be well anchored." Predictions are that the prime rate is unlikely to climb until late 2014 or into 2015.

<u>Outlook in Key Areas</u> (Continued)

- **Equity and Fixed Income Markets** – Fiscal year 2012-13 (through June 30, 2013) has included continued recovery in the investment performance of most U.S. and international markets, with slightly weaker performance in emerging markets and continued weak performance in fixed income instruments, as reflected in the following well-known market indices:

Annualized Returns as of June 30, 2013	One-Year	Three-Year	Five-Year
S&P 500	20.6%	18.5%	7.0%
Russell 1000	21.2%	18.6%	7.1%
Russell 2000	24.2%	18.7%	8.8%
Russell 3000	21.5%	18.6%	7.3%
MSCI EAFE International	18.6%	10.0%	(0.6)%
Barclays Capital U.S. Aggregate Bond	(0.7)%	3.5%	5.2%

- **HEPI (Higher Education Price Index)** – HEPI, issued annually by Commonfund Institute, is an inflation index that tracks the main cost drivers in higher education. This index is a more accurate indicator of the fluctuations in costs for colleges and universities than the Consumer Price Index (CPI), because it measures the average relative level of prices in a fixed basket of goods and services purchased by colleges and universities each year through educational and general expenditures (exclusive of research). Beginning in fiscal year 2009, Commonfund began making available HEPI calculated by U.S. region. The regional HEPI numbers are calculated using the appropriate faculty salary and fringe benefit information for each region, while holding the other six HEPI cost factors constant. The chart below shows HEPI (and CPI) and the categories of operational costs included in calculating it; the South Atlantic region includes Delaware, District of Columbia, Florida, Georgia, Maryland, North Carolina, Puerto Rico, South Carolina, Virginia, and West Virginia:

Cost Factor	Weighting	Preliminary FY 2013 (7/22/2013)	Official FY 2012	Official FY 2011	Official FY 2010	Official FY 2009
Faculty salaries	35.0%	1.7%	1.8%	1.4%	1.2%	3.4%
Administrative salaries	11.0	2.9	2.7	1.7	2.0	5.4
Clerical salaries	18.0	1.9	1.7	2.0	1.4	2.7
Service employee salaries	8.0	1.6	1.1	1.4	1.4	2.9
Fringe benefits	13.0	2.9	1.8	3.7	2.1	3.6
Miscellaneous services	2.0	1.8	1.7	1.8	1.1	2.7
Supplies and materials	6.0	(11.6)	5.2	8.2	(1.3)	0.9
Utilities	7.0	2.1	(4.9)	4.1	(9.5)	(15.1)
HEPI (all institutions)	100.0%	**1.6%**	**1.7%**	2.3%	0.9%	2.3%
HEPI (private baccalaureate)		Not yet available	1.6%	1.9%	0.2%	2.7%
HEPI (private master's)		Not yet available	1.4%	1.8%	0.1%	3.6%
HEPI (South Atlantic)		Not yet available	1.2%	1.5%	0.9%	2.0%
CPI (Consumer Price Index) (June 2013 – 12 mos)		**1.8%**	**1.7%**	3.6%	1.1%	(1.4)%

BROWNEDWARDS
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REPORT ON HIGHLIGHTS OF THE JUNE 30, 2013
FINANCIAL REPORT

To the Board of Trustees and Management of
Trinity College
Washington, D.C.

We have audited the financial statements of Trinity College as of and for the year ended June 30, 2013 and have issued our report thereon dated September 25, 2013. Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. The accompanying supplemental information, Highlights of the June 30, 2013 Financial Report, is presented for purposes of additional analysis and is not a required part of the financial statements of Trinity College. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has not been subjected to the auditing procedures applied in the audit of the financial statements, and accordingly, we do not express an opinion or provide any assurance on it.

Brown, Edwards & Company, L.L.P.
CERTIFIED PUBLIC ACCOUNTANTS

Roanoke, Virginia
September 25, 2013

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HIGHLIGHTS OF THE JUNE 30, 2013 FINANCIAL REPORT
(Continued)

Independent Auditor's Report

Our independent auditor's report is an unmodified opinion, also referred to as a "clean" opinion. This is the highest level of assurance that we can offer as certified public accountants on your financial statements. Our audit considers internal controls as a basis for designing appropriate audit procedures. However, we do not express an opinion on the effectiveness of internal controls.

Summary of Financial Highlights

For the year ended June 30, 2013, the economic recovery from the challenging recessionary years continued albeit at a very slow pace. However, **the College experienced another exceptional year financially**. The College experienced an **increase in total net assets of $14.3 million.** Key highlights include the following (additional detail is included on the following pages):

- **Total assets** increased by $13.2 million; the most significant increases were in contributions receivable, investments, and funds held in trust by others; these increases were accompanied by a small decrease in cash and cash equivalents.
- **Total liabilities** decreased by $1.1 million; primarily related to decreases in the interest rate swap liability and debt.
- **Operating revenues** increased by $322,000; primarily related to an increase in net tuition and fees and a small decrease in auxiliary services.
- **Operating expenses** increased by $1.4 million; the largest increases were in instruction, academic support, and institutional support which were partially offset by a small decrease in auxiliary services.
- The largest changes in **non-operating** activities were significant increases in gifts and private grants, investment return, the change in value of interest rate swap, and the change in value of funds held in trust by others.

Cash and cash equivalents at June 30, 2013 decreased from the prior year by $1.0 million, as reflected in the statements of cash flows on page 8 of the financial report. Net cash provided by operating activities totaled $7.2 million. Net cash used in investing activities, which includes student loans activity, purchases of land, building, and equipment, and investment activity, totaled $8.2 million. Net cash provided by financing activities, which includes contributions restricted for long-term investment, proceeds from new debt, and debt principal payments, totaled $15,000.

Receivables and other assets, net of allowance for doubtful accounts, decreased from the prior year by $155,000 primarily related to the timing of requests for federal grant funds. Note 2 of the financial report provides some detail of the assets included in this line item on the financial statements.

Contributions receivable increased over the prior year by $6.1 million. The increase is primarily attributable to pledges received as part of the Second Century Campaign.

Summary of Financial Highlights (Continued)

Investments increased from the prior year by $7.4 million. The increase is partly attributable to investing $4.2 million of surplus cash. Note 4 of the financial report summarizes investment activity. Overall, College **endowment investments** had an approximate total return of 9.00% as compared to 1.20% in the prior year, as reported by Wells Fargo. **Total investments**, which in addition to endowment investments also include operational funds substantially invested in fixed income vehicles, had an approximate total return of 3.0% based on average investments as compared to 1.7% in the prior year. Comparable indexes at the target asset allocations for the fiscal year are as follows:

	Endowment Target Asset Allocation	2013	2012
Equities:			
Russell 1000 Growth	20.00%	17.07%	5.76%
Russell 1000 Value	20.00%	25.32%	3.01%
Russell Midcap	15.00%	25.41%	(1.65)%
MSCI EAFE	10.00%	18.6%	(13.80)%
	65.00%		
Fixed income:			
Barclays U.S. Aggregate	35.00%	(0.70)%	7.50%
	100.00%		
Estimated total return using the above asset allocation for the entire year		13.90%	2.75%

	Approximate Total Asset Allocation	2013	2012
Equities:			
Russell 1000 Growth	6.00%	17.07%	5.76%
Russell 1000 Value	6.00%	25.32%	3.01%
Russell Midcap	4.50%	25.41%	(1.65)%
MSCI EAFE	3.50%	18.6%	(13.80)%
	20.00%		
Fixed income:			
Barclays U.S. Aggregate	80.00%	(0.70)%	7.50%
	100.00%		
Estimated total return using the asset allocation for the entire year		3.78%	5.97%

Land, buildings, and equipment increased during the year by $12,000. This results from additions of $1.1 million, net of depreciation and disposals for the current year of $1.0 million. Note 5 of the financial report summarizes land, buildings, and equipment.

<u>Summary of Financial Highlights</u> (Continued)

Funds held in trust by others increased by $767,000. This increase is largely attributable to a good year in the financial markets this year versus the prior year. Note 6 of the financial report summarizes funds held in trust by others.

Accounts payable and accrued expenses increased by $57,000 primarily due to the timing of processing invoice payments.

Interest rate swap decreased by $512,000 due to the expected rise in interest rates in the coming years.

Debt decreased by $667,000, which is the result of scheduled principal payments (including the termination of a capital lease) in the current year of $672,000, net of amortization of bond discount of $5,000. Note 7 of the financial report summarizes debt.

Net assets, which are summarized in Note 8, changed during the year ended June 30, 2013 as follows:

Unrestricted	$ 6,326,000
Temporarily restricted	7,045,000
Permanently restricted	957,000
	$ 14,328,000

This represents a 25.7% return on average net assets versus a 14.3% return in the prior year.

Gross tuition and fees increased during the year by $957,000. This was primarily attributable to a 2.0% Board-approved undergraduate tuition and fees increase and a 37-student (average number of undergraduate full-time equivalent students for each academic year) increase. **Net tuition and fees** increased during the year ended June 30, 2013 by $582,000. This was the net result of the gross tuition and fee increase and a $375,000 increase in financial aid. The College's **undergraduate tuition discounts** can be summarized and compared to Moody's Investors Service and Standard and Poor's (fiscal 2012 median for small private institutions) as follows:

	Rating Agencies		2012	Trinity College	
	S & P "BBB")	Moody's "Baa")	Brown Edwards Client Median	2013	2012
Non-funded			37.9%	27.4%	27.6%
Funded			8.6	1.3	1.9
Total tuition discount	30.7%	39.0%	46.5%	28.7%	28.8%

Most institutions in all the benchmarks must discount much more significantly to attract student than the College. The College's discount rates are more in line with similar urban institutions.

Operating expenses increased by $1.4 million; operating expenses per FTE increased by 2.3%. (The consumer price index for the year ended June 30, 2013 was 1.8%; and the Higher Education CPI was 1.6%.) Salaries, wages, and benefits totaled 63.1% and 61.3% of operating expenses for the years ended June 30, 2013 and 2012, respectively.

Summary of Financial Highlights (Continued)

Change in net assets from unrestricted operating activities represents the College's unrestricted operating surplus (deficit) during the year. For the years ending June 30, 2013 and 2012, the change was $5.3 million and $6.3 million, respectively. The drop from the prior year was the result of a modest increase in unrestricted operating revenues and a slightly higher increase in operating expenses.

The **temporarily restricted change in net assets from operating activities** was $238,000 and $352,000 for the years ended June 30, 2013 and 2012, respectively.

The **non-operating income** section of the statement of activities represents contributions of a capital nature and other restricted contributions, including promises to give, investment income, investment return, net of amount available to support current operations, and the change in value of split-interest agreements.

Below is a summary of some of the College's financial strengths and challenges:

Financial strengths:

- A seasoned management team and Board focused on achieving ***financial equilibrium***

  (Financial equilibrium is defined as simultaneously maintaining balanced financial operations that include funding for capital additions, depreciation expense and deferred maintenance, preserving physical assets, maintaining the purchasing power and continuing to grow the endowment, and nourishing the human resources of the College).
- An ideal urban location and a strong reputation that translate into marketability and the ability to attract students.
- Healthy enrollments; net tuition and fees continue to grow each year at an exceptional rate while tuition discounts compare favorably to benchmarks. Undergraduate enrollment has grown on average by over 10% per year in the last five years.
- Generating a strong positive change from operations and total activities, good cash reserves and excellent cash flow generated from operating activities.
- A financial transformation has taken place at the College over the past five years, which has positioned the College well with the necessary financial wherewithal to move institutional initiatives forward.

Financial challenges:

- Utilizing the College's financial strengths to carrying out key strategic initiatives to 1) protect those strengths and 2) continue to position the College to compete and thrive into the future.
- Continuing to grow expendable (unrestricted and temporarily restricted net assets, less plant assets net of related long-term debt) financial reserves for future needs, e.g. mission-driven strategic initiatives, technological improvements, deferred maintenance, campus improvements, etc.
- Continuing to grow the endowment and increasing the amount per FTE student.
- Strategically managing debt while funding important campus improvements.

REPORT ON FINANCIAL ANALYSIS

To the Board of Trustees and Management of
Trinity College
Washington, D.C.

We have prepared, from information derived from the financial statements of Trinity College (the "College") for the years ended June 30, 2009 through 2013 the ratio and trend analysis. The analysis uses selected financial position and operating ratios developed by leading consultants to the higher education industry, a major credit rating agency, and the U.S. Department of Education. We have selected these ratios as a concise group of important indicators and trends that can be used, through analysis and informed decision making, to help facilitate the sustainability of small liberal arts colleges and universities.

The information provided herein is not audited and no assurance is provided for its accuracy as an indicator of financial strength or weakness. These financial ratios and analysis are not intended to be all inclusive. Consequently, this report should be read in conjunction with the financial statements of the College and other analysis. This analysis is intended solely for the use of Management and governing body of Trinity College and is not intended to be, and should not be, used by anyone other than the specified parties. We encourage Management and the Trustees to consider the information and trends in conjunction with the College's strategic plan. All strategic plans are different as the missions and goals of each college or university are different.

We would be pleased to meet with you and discuss how these indicators relate to specific events of the past few years and how planned events are likely to affect the indicators going forward. Using this information in this manner is considered by many to be an excellent tool for weaving desired financial goals into the non-financial goals of a college or university.

Brown, Edwards & Company, L.L.P.

CERTIFIED PUBLIC ACCOUNTANTS

Roanoke, Virginia
September 25, 2013

TRINITY COLLEGE
TREND ANALYSIS

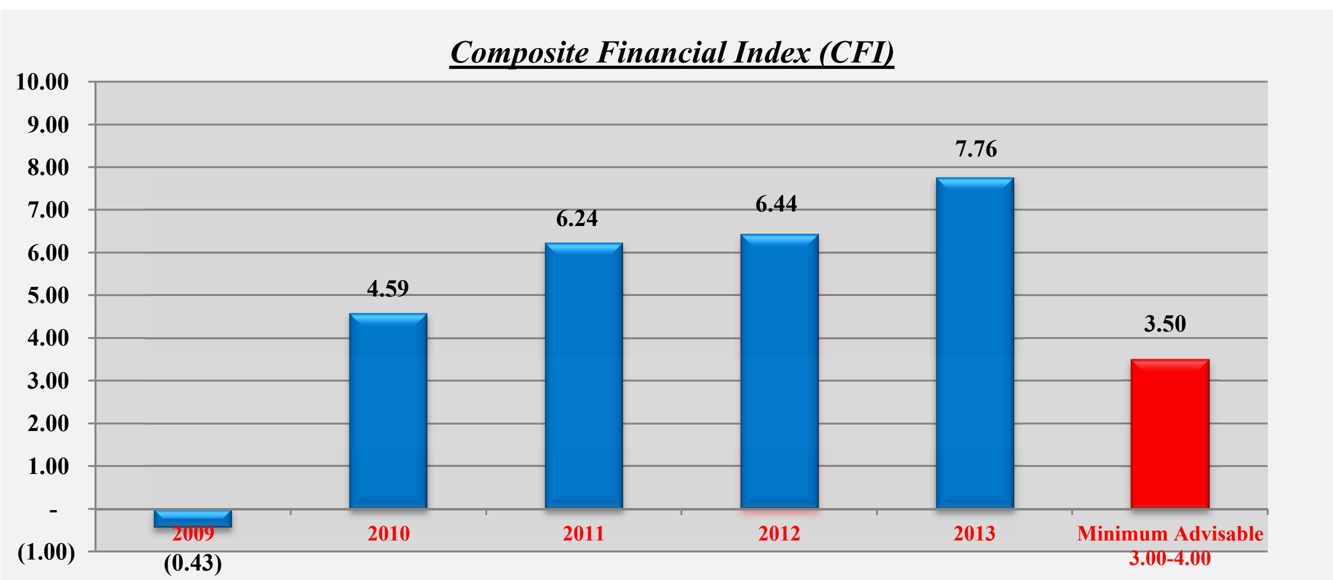
INTRODUCTION TO THE TREND ANALYSIS

Trinity College is very similar in financial size to many other colleges in the Southeast. Based on information from credit analysts, its financial position is probably stronger than many of the liberal arts colleges of similar size. The College is substantially tuition dependent as endowment spending and other income amounts to a small percentage of the operating revenue budget on a continuous basis. A portion of the expendable net assets, a big factor in assessing financial strength and liquidity in higher education, consists of accumulated net appreciation on endowment investments. Over the past three to five years, the investment markets have been anything but stable. Enrollment (undergraduate) has increased substantially during the trend period and contrary to the industry as a whole, tuition discounting has remained low. As a result, net tuition has grown on average over 10% per year during the trend period. There have been increases in all expense categories over the past five years, but at a much lower rate (slightly above 4% per year on average). The revenue trends are contrary to the industry, while the expense trends can be seen in most colleges of similar size, financial strength and mission. The major factors facing higher education over the recent and next few years have been and will continue to be pressure on tuition and other revenue (demographic shifts, competition, less government funding), uncertainty in investment markets, and rising costs (for ever-changing technologies, managing increased regulations, etc). These factors make it even more important to fairly assess financial strength and growth potential in developing strategic plans.

The following trends give further insight into financial factors that affect the financial strength of Trinity College.

Composite Financial Index

The Composite Financial Index (CFI) is a combination of four financial metrics that measures the overall financial health of the Institution. A more detailed discussion of CFI can be found later in our financial analysis. The College's CFI trend is as follows:



TRINITY COLLEGE
TREND ANALYSIS
(Continued)

Composite Financial Index (Continued)

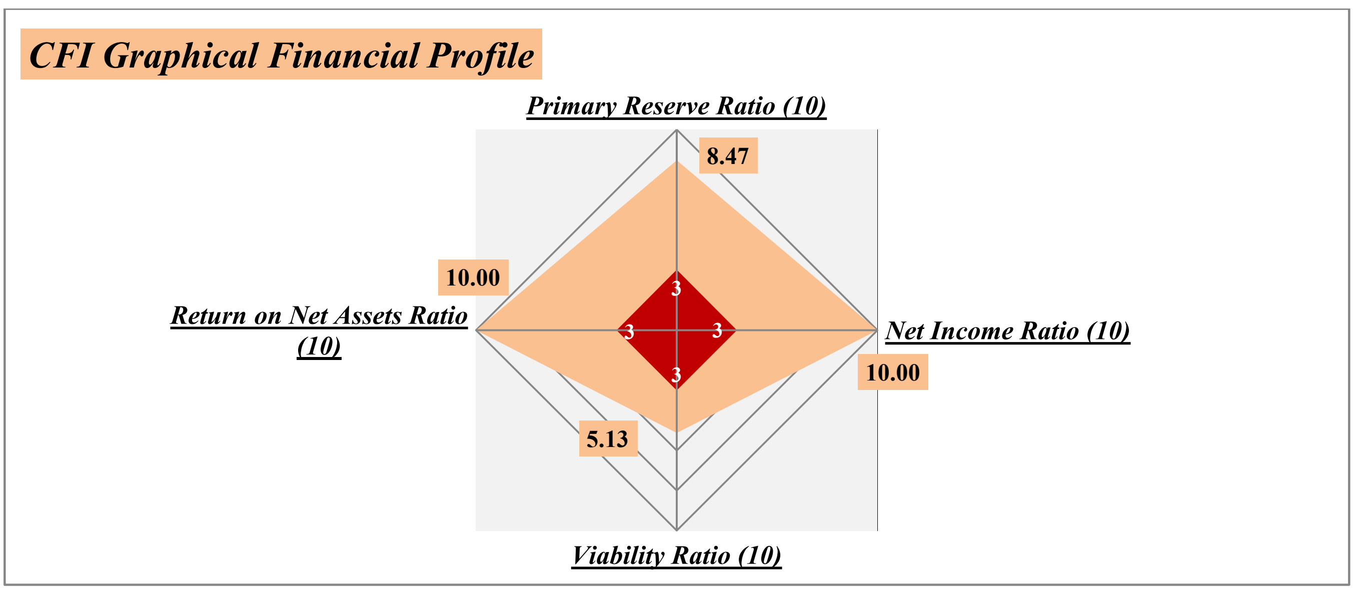
Our Analysis & Comments on Your CFI

The College's trend is nothing short of remarkable. The CFI trend follows the College's strong performance from operations with small fluctuations related to the financial markets. The major dips in financial markets occurred in 2009 and again at the end of 2012. After a tough 2009, the College has consistently been well above the minimum advisable range and has moved to a position of financial strength.

Overall, the College's CFI indicates a very financially healthy institution that is well capitalized and has produced substantial returns on current activities as well as on total net assets. To analyze underlying strengths and areas to work on, **view the CFI Graphical Financial Profile diamond below** (which is *based on input ratio strength factors*). (The dark red inner diamond represents the desired minimum strength of three. The light outer diamond represents the maximum scale score of ten. Ideally, a goal is to have all College points outside the inner diamond and pushing toward the maximum outer diamond.), which all the College's values are. Two of the College points are at maximum ten positions. Financial reserves relative to operating size (operating expenses) are also very good (**primary reserve ratio**). The College is generating an exceptional overall return (**return on net assets ratio**). Debt levels are below the optimal level for the College (**viability ratio**). Operating returns (**net income ratio**) are also exceptional, given a minimum advisable 2% - 4% range. With the strength of the College being annual performance, to maintain and build on past successes the College will need to continue producing health annual returns, albeit not necessarily at recent trend levels.

The College's current CFI and trend indicates that it has the financial resources to move robust strategic initiatives forward that will preserve the College's financial strength and continue to improve competitiveness over the long-term.

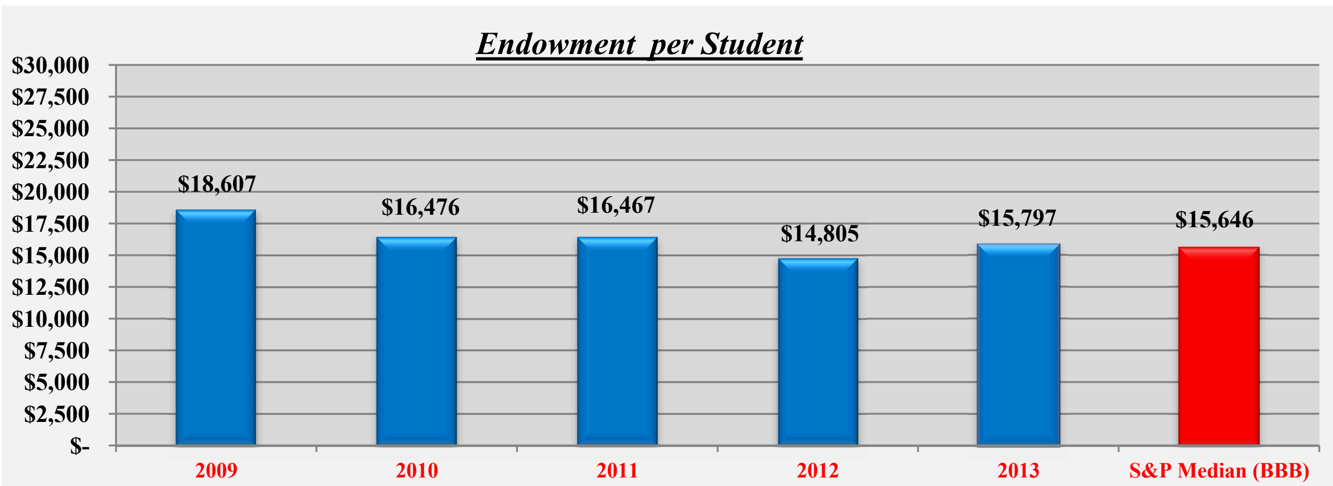
The Brown Edwards' CFI group median was 4.35 in 2012 and 4.88 in 2011.



TRINITY COLLEGE
TREND ANALYSIS
(Continued)

Endowment per Student

The Endowment per Student Ratio compares the market value of the endowment funds to the student enrollment (FTEs). **(Note that all references in this document to students and FTEs refers to undergraduate students only unless otherwise indicated.)** This ratio is an indicator of the institution's overall accumulated financial wealth.



Our Analysis & Comment on Your Endowment per Student

The value of the College's endowment has fluctuated in recent years but not nearly so much as many endowments of small private colleges. The College's total endowment has increased over this trend period on average by about 8% per year. However, undergraduate student enrollment has grown from 918 to 1,520 during this period. The dramatic increase in FTEs requires a larger endowment to keep in step with the per student amount. With these factors as well as a turbulent economy and financial markets during this trend period, the College's endowment per student is now in line with the S&P median.

Further, financial markets have been very strong over the past year, but are no more certain as the overall economy continues to grow modestly and is susceptible to any of a number of potential disruptions. Endowment spending only makes up a small percent of total operating revenue, so one year changes are not as critical as long-term performance. The Brown Edwards' endowment per student group median was approximately $35,000 in 2012 and $36,000 in 2011. However, this group consist of more rural institutions that tend to have much larger endowments, which in turn must be utilized to subsidize tuition to maintain enrollment.

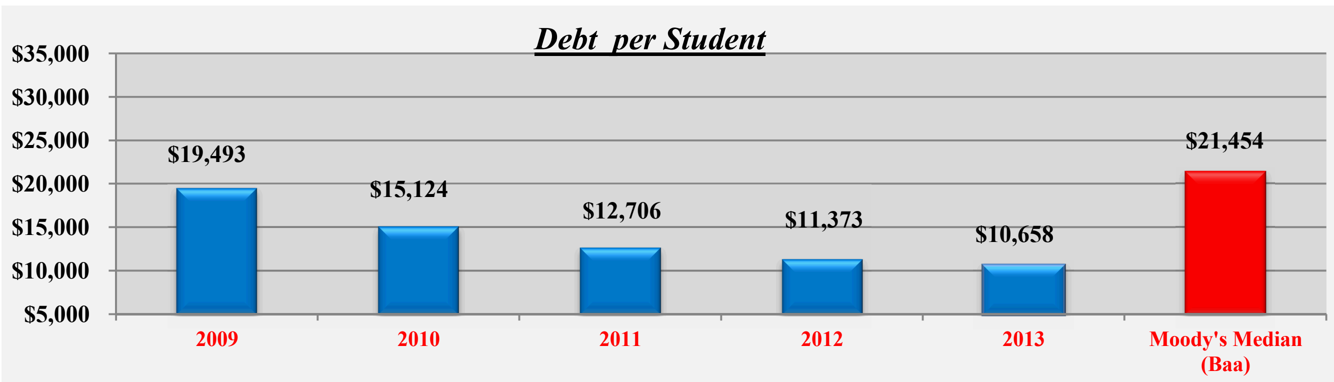
Strategically Managing Debt

Debt is a critical component of the resources available to an institution to fund capital projects. If used strategically and under a program designed to maximize the use of debt to achieve institutional goals, taking on additional debt increases the likelihood of an institution meeting its mission.

TRINITY COLLEGE
TREND ANALYSIS
(Continued)

Strategically Managing Debt (Continued)

Below is the College's debt per student trend. The trend is dramatically impacted by the substantial increase in enrollment during this period. Accordingly, even with relatively level amounts of debt, the per student amount has dropped significantly.



Critical to strategically managing debt is monitoring key components of a sound debt policy such as debt affordability and debt capacity measures. Most small private institutions should focus primarily on debt affordability, rather than debt capacity. **Debt affordability** highlights the concept that the institution's operating budget usually is the constraint limiting the incurrence of additional debt. This is in contrast to **debt capacity** which focuses solely on the institution's balance sheet; debt funding as a percentage of total capital. An organization should consider many factors in assessing its debt affordability and debt capacity including its strategic plan, market position, and alternative sources of funding. A couple of key ratios to provide a quantitative assessment of debt affordability and debt capacity are indicated below.

Debt Affordability Measures

Debt Service Coverage Ratio

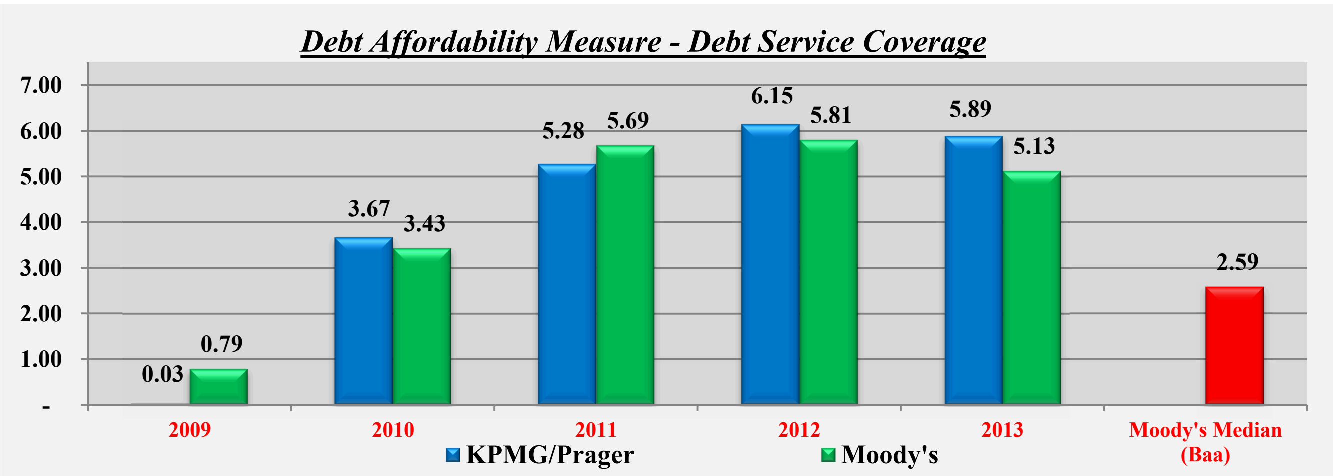
This ratio measures the College's ability to cover debt service requirements with revenues available for operations. The target established is intended to ensure that operating revenues are sufficient to meet debt service requirements and that debt service does not consume too large a portion of income. A high ratio is considered advantageous while a very low ratio or decreasing trend signifies financial difficulty. There are several ways to calculate this ratio.

Included in your financial analysis, the **KPMG/Prager debt service coverage ratio** is calculated by using the total change in unrestricted net assets (operating & non-operating) plus depreciation and interest divided by debt service (principal and interest). This ratio is significantly influenced by investment returns. The **Moody's ratio** is similar except that it uses the change in unrestricted operating net assets.

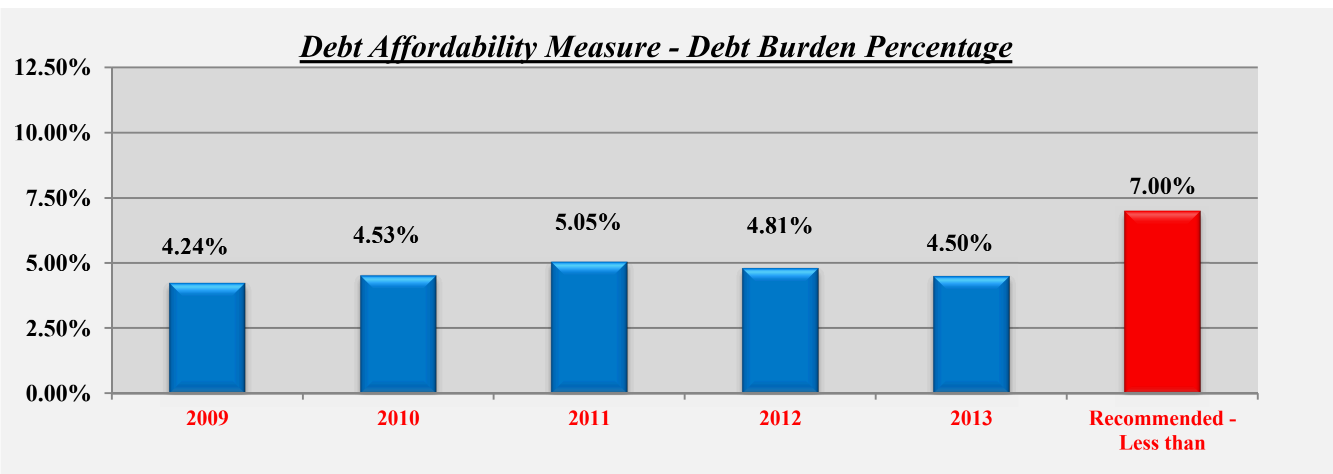
As one of its debt covenants, the College is required to meet a 1.10 debt service coverage ratio that is calculated more closely, but not exactly, to the Moody's ratio. The College's debt service coverage ratio calculated in this fashion was 5.17.

<u>Strategically Managing Debt</u> (Continued)

Debt Affordability Measures (Continued)



Another debt affordability measure is the **debt burden percentage**. This ratio measures the College's debt service burden (principal and interest) as a percentage of total operating expenses (which typically is a relatively stable base).

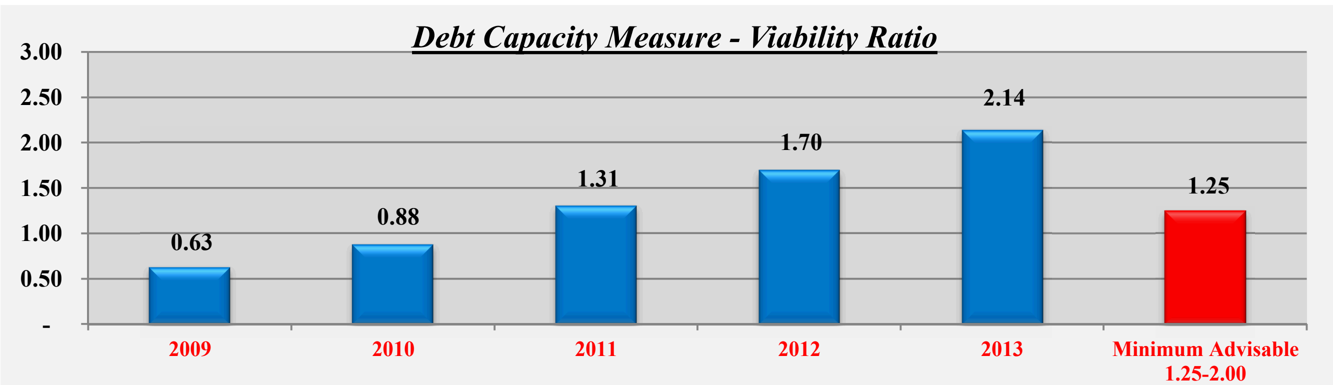


<u>Strategically Managing Debt</u> (Continued)

Debt Capacity Measures

Viability Ratio

This ratio, which is included in the CFI composite score, indicates one of the most basic determinants of financial health by measuring the medium to long-term health of the institution's balance sheet and debt capacity. Its purpose is to assess the availability of expendable net assets (unrestricted and temporarily restricted less plant assets net of related long-term debt) to cover debt should the institution need to settle its obligations as of the balance sheet date. The Brown Edwards' viability ratio group median viability ratio was 1.08 in 2012 and 1.15 in 2011.



Other Debt Capacity Measure

Another debt capacity measure required as part of the College's debt covenants is the "cushion ratio". This ratio is calculated by taking the sum of cash and cash equivalents and unrestricted long-term investments and dividing it by debt service (principal and interest). The College must achieve a ratio of 4.00 to be in compliance and for 2013 the College's "cushion ratio" totaled 15.92.

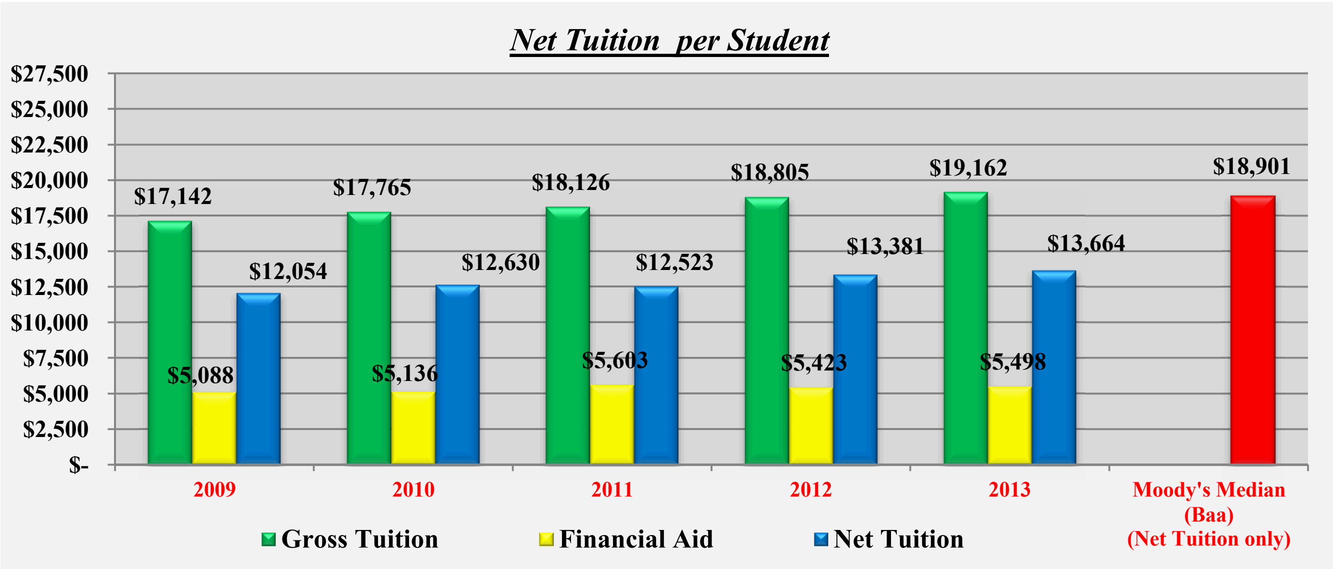
Our Analysis & Comments on Debt Measurements

All the College's debt measurements have moved to much stronger positions during the last five years. The ratios indicate that the College, as compared to benchmarking medians and recommended targets, is in a very healthy debt position with available affordability and capacity. The College is generating more than sufficient resources necessary to cover principal and interest payments on its debt. From a debt affordability standpoint, it is always important that management develop and closely manage budgets and financial plans with appropriate stress testing to assess potential vulnerabilities.

The College also continues to maintain good overall financial flexibility to respond to its future potential capital needs with a capitalization ratio (total net assets divided by total assets) in the 70% range (desirable range is 50% - 85%). This ratio indicates that the College is appropriately leveraging its assets to potentially increase income and future financial wealth. Additionally, the College's equity is comprised of a healthy mix of financial assets (financial net assets ratio of about 85% and higher) versus physical net assets which further indicates financial flexibility. Obviously managing all these factors to equilibrium is imperative but crucially important to the long-term success of the institution.

Net Tuition per Student

The Net Tuition per Student Ratio compares tuition and fee revenue, net of tuition discounts, to student enrollment (FTEs). This ratio indicates the average tuition paid per student.



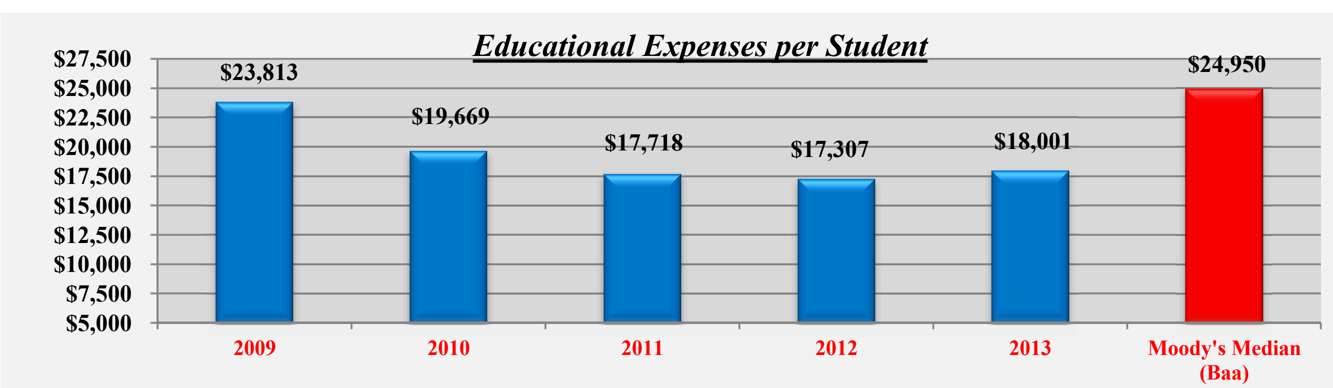
Our Analysis & Comments on Your Net Tuition per Student

Contrary to the industry as a whole, the College has successfully increased enrollment and net tuition dramatically in recent years. The College has elected to keep net tuition very affordable and accordingly is well below the Moody's median but very close to the Brown Edwards median. Most institutions are struggling mightily just to maintain enrollments. The College has accomplished this while holding the level of financial aid granted to below average levels, causing a steady increase to net tuition per student. Net tuition amounts to a substantial portion of operating revenue, so this is a critical focus area. It is important to note that tuition discounts are based on tuition only and do not include other student fee factors such as room and board charges.

The Brown Edwards' net tuition per student group median was $13,381 in 2012 and $13,373 in 2011.

Educational Expenses per Student

The Educational Expenses per Student Ratio compares operating expenses less auxiliary service expenses to student enrollment (FTEs) and indicates the average educational expenses per student.



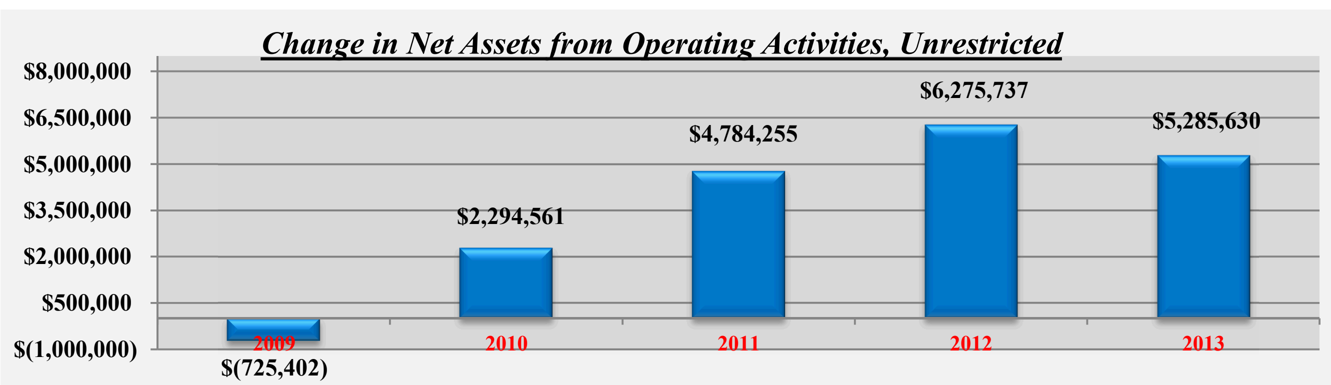
<u>Educational Expenses per Student</u> (Continued)

The College has held educational expenses to a reasonable level over the trend period of on average about 5% per year. This is during a time when enrollment was increasing on average by well over 10% per year. Also, as mentioned elsewhere there are significant pressures on rising costs in higher education.

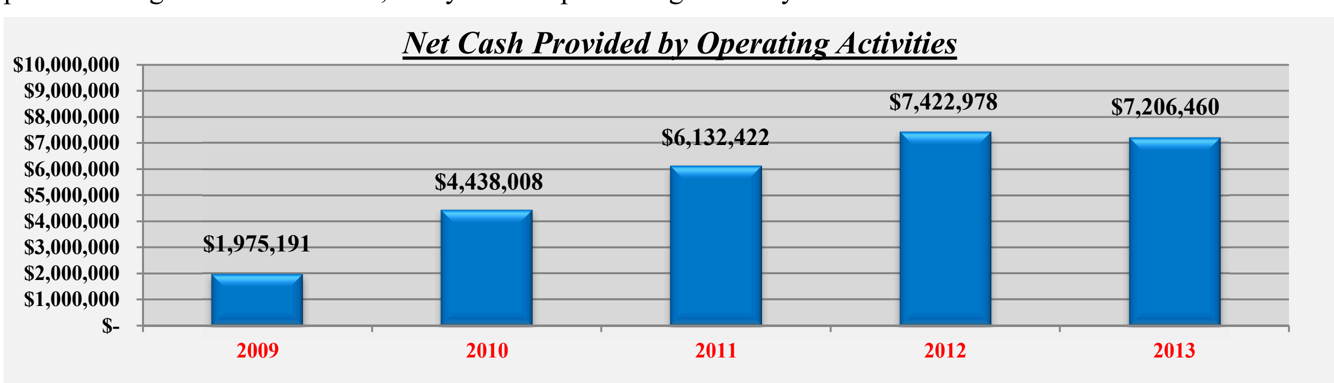
The education expenses per student came down dramatically over this period due partially to being spread over significantly more students. Undergraduate student enrollment has grown from 918 to 1,520 during this period. Just as net tuition per student is well below the Moody's median (Baa) so are educational expenses per student. The Brown Edwards' educational expenses per student group median was $21,804 in 2012 and $21,494 in 2011.

<u>Change in Net Assets from Operating Activities, Unrestricted and Net Cash Provided by Operating Activities</u>

The **change in net assets from operating activities, unrestricted** measures whether operating results indicate an institution is functioning within its available resources. It indicates whether unrestricted activities resulted in a surplus or deficit. A positive amount indicates a surplus and the larger the surplus, the stronger the financial performance for the year. A negative amount indicates a loss for the year. A small deficit can be manageable particularly by a financially strong institution. However, large, recurring deficits are almost always a bad sign. This operating measure is the closest measure on the financial report to the institution's operating budget. It does include depreciation and interest costs whereas many institutions' operating budgets do not.



Net cash provided by operating activities is another operational measure focused on cash. Most institutions have historically struggled to achieve positive cash flow from operating activities. However, in more recent years as a result of significant reengineering of operations necessary due to the many pressures on small private colleges and universities, many have improved significantly.



TRINITY COLLEGE
TREND ANALYSIS
(Continued)

Change in Net Assets from Operating Activities, Unrestricted and Net Cash Provided by Operating Activities (Continued)

Our Analysis and Comments on Your Change in Net Assets from Operating Activities, Unrestricted and Net Cash Provided by Operating Activities

After 2009, the College has had strong operating results and it has been a financial strength. Management should be commended for this trend as it is in the face of major financial pressures such as the difficult economic conditions, strong competition for students and significant pressures on rising operating costs. In the current year, operating revenue was up modestly, while operating expenses were up by more resulting in a strong positive, but reduced operating result from the prior year.

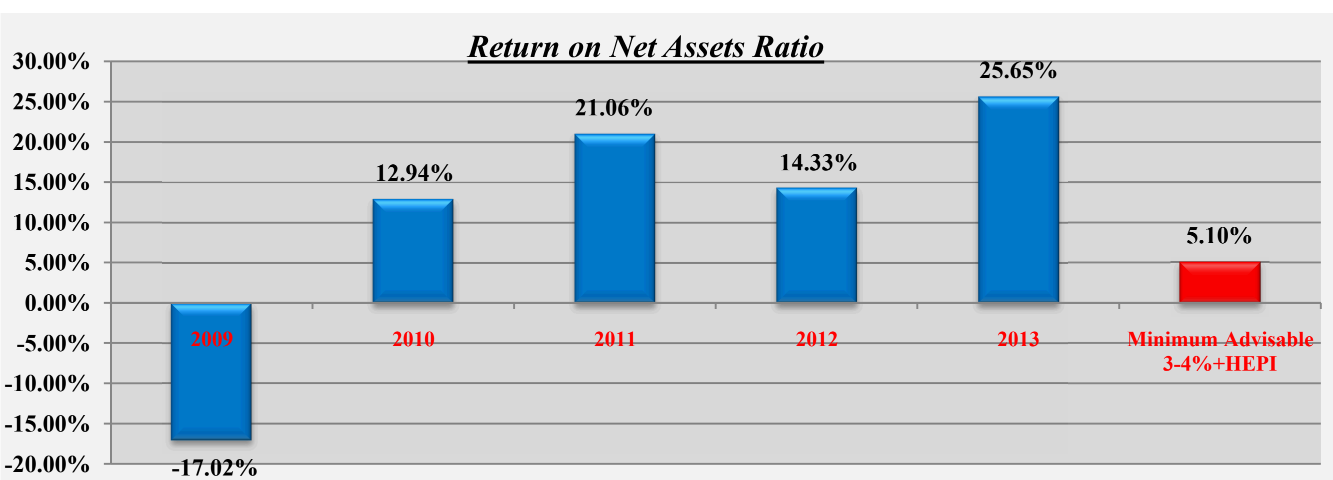
This positive change in operating net assets also translates into an excellent current year net income ratio (which reflects the change in unrestricted operating activities divided by unrestricted operating revenue) of 14.65%. The average net income ratio for the trend period is close to 12.00%. The Brown Edwards' net income ratio group median was 3.83% in 2012 and 2.98% in 2011.

Net cash provided by operations also remains strong, and as the old accountant saying goes, "cash is king". Generating a healthy stream of cash flows from operations is always a good thing. The Brown Edwards' net cash provided by operations group median was $1.8 million in 2012 and $1.25 million in 2011.

Return on Net Assets Ratio

The Return on Net Assets Ratio compares the change in net assets to average net assets during the year. **The ratio determines whether the institution is financially better off by measuring total economic return versus only operating return. It measures the institution's performance in generating net assets compared to the capital base used to produce those net assets.** A decline in this ratio may be appropriate and even warranted if it reflects a strategy to better fulfill the institution's mission. On the other hand, an improving trend in this ratio indicates that the institution is increasing its net assets and able to set aside financial resources to strengthen its future financial flexibility.

An increasing trend indicates that more funds are being made available for the future. A target rate of return should be approximately 3 to 4 percent plus the actual inflation index (CPI or HEPI). Brown Edwards typically uses HEPI.

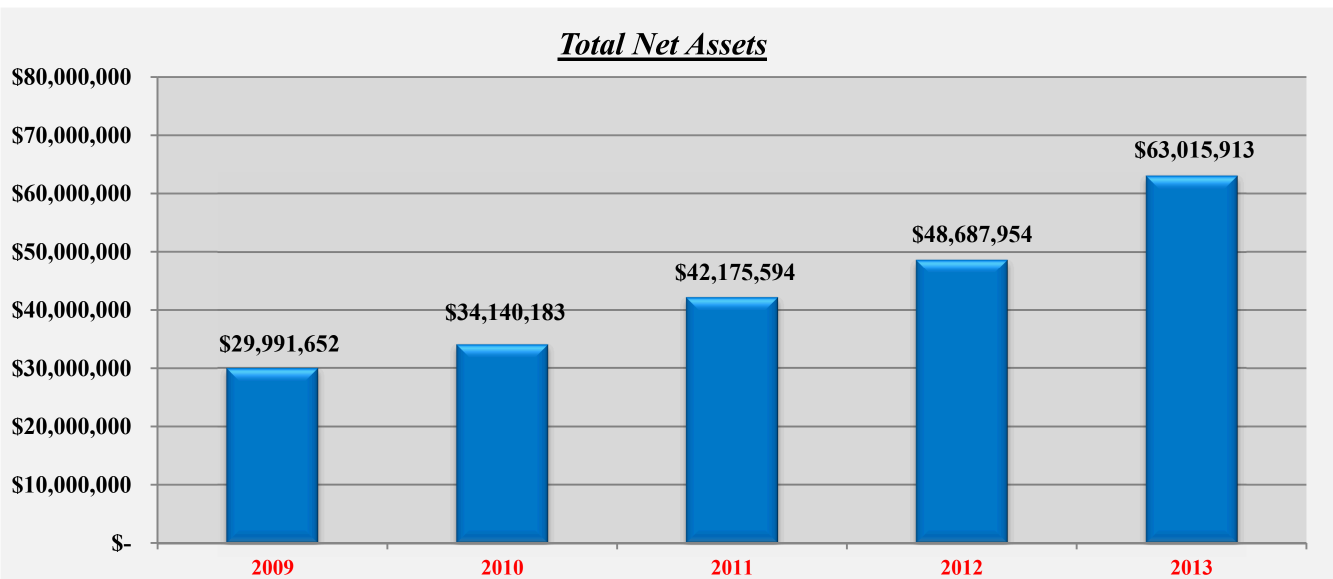


<u>Return on Net Assets Ratio</u> (Continued)

Our Analysis and Comments on Your Return on Net Assets Ratio

This indicator has fluctuated from year to year, primarily due to economic and financial market conditions, but has averaged over 11.00% during the five years. To illustrate the volatility of this ratio, the Brown Edwards' return on net assets ratio group median was -0.30% in 2012 and 10.79% in 2011.

Long-term sustainability of this ratio is necessary to build expendable net assets and improve short-term strength and liquidity. A strong measure over an extended time period is a desired goal. As a result of the College's consistent and significant positive Return on Net Assets Ratio, total net assets have incredible growth over this period**.** The Brown Edwards' total net assets group median was $97.8 million in 2012 and $97.3 million in 2011.



TRINITY COLLEGE

RATIO ANALYSIS IN HIGHER EDUCATION

The "**Ratio Analysis in Higher Education**" developed by BearingPoint, Inc., KPMG, and Prager, Sealy & Co. focuses on the evaluation of an institution's use of financial resources to achieve its unique mission. These ratios quantify the status, sources, and uses of these resources and the debt paying ability of an institution. They are categorized into four areas of measurement and are designed to answer the following basic questions:

- Are financial resources sufficient and flexible enough to support the mission?
- Do operating results indicate the institution is functioning within available resources?
- Does financial asset performance support the strategic direction?
- Is debt managed strategically to advance the mission?

A unique concept with this analysis is the integration of a key ratio from each of the four categories into a combined, single measurement of the overall level of financial health of an institution. This measure is called the Composite Financial Index (**CFI**). **CFI** can be useful to an institution in helping to understand its financial position in the marketplace and in assessing its financial viability. It is best used as a component of financial goals in an institution's strategic plan.

CFI is based on four core ratios, further described below, that represent measurement of key components in relation to institutional risk that must be consistently addressed:

- Balance sheet measurements reflecting wealth accumulation and financial flexibility, each with 35% weighting
  - **Primary Reserve** – compares operating commitments to expendable accumulated wealth or financial cushion; expendable net assets/expenses; a ratio of .40 or better is the minimum advisable reserve (resources to cover operating expenses for about 5 months (.40 of 12 months).
  - **Viability** – measures debt capacity; compares outstanding long-term obligations to expendable wealth; expendable net assets/debt; a ratio of 1.25 to 2 is considered a minimum advisable range. A ratio of 1 indicates an institution has the expendable resources to pay off its debt.
- Operating measurements indicating annual operating performance
  - **Net Income** – measures, on a short-term basis, the ability to live within your means; change in unrestricted operating net assets/unrestricted operating revenues; an institution should target two to four percent as a goal and that target may vary from year to year depending on institutional strategic initiatives. Metric most within the control of management. 10% weighting.
  - **Return on Net Assets** – measures the ability to generate overall return against all net resources; a real return of three to four percent plus the higher education price index (HEPI) might be considered a reasonable target, depending on the institution's specific strategic plan. 20% weighting.

These four ratios are properly weighed and scored on a common scale to arrive at **CFI**. Using a single score is superior to the individual measurement of each ratio because it allows a weakness in a particular ratio to be offset by strength in another ratio, similar to the use of GPA (grade point average) for students. Note that **CFI** and all these ratios deal only with the financial aspects of an institution and must be blended with key performance indicators in areas such as academics, infrastructure, and student and faculty satisfaction to understand a complete measure of institutional strength.

CFI is quantified on a progressive scale of one to ten, with one indicating the need to assess the viability to survive and ten indicating strong financial conditions and flexibility. Once **CFI** is determined, it can be compared to the following scale for an indicator of the range of overall institutional well-being, appropriately considering nonfinancial indicators. The scores overlap because the index is not intended to represent financial health as a precise point on the chart, but rather as a range for a particular level of health.

Given the **CFI** score, there are also suggested actions that an institution should consider which are summarized in the table below.

Ratio Analysis in Higher Education – CFI: Scoring Scale

Scale Level	CFI Scoring Range	Action
One	-1 to 1	Severe financial stress – assess viability; Can the college survive?
Two Three	0 to 2 1 to 3	Moderate financial stress – reengineer the institution.
Four Five	2 to 4 3 to 5	Direct resources toward becoming a stronger institution and moving to the next level.
Six Seven	**4 to 6** **5 to 7**	**Focus resources to compete in the future.**
Eight	**6 to 8**	**Experiment with new initiatives.**
Nine	7 to 9	New initiatives. Design a robust mission.
Ten	> 9	Deploy resources to achieve a robust mission.

It may be more appropriate to review **CFI** over a period of three to five years and to evaluate the trend (See page 8). To improve **CFI**, the components of the individual ratios suggest where to focus attention.

If you calculate **CFI** (for an institution with long-term debt) by using the advisable indicators for the four core ratios and assuming a consumer price index of 3.0%, **a minimum advisable or target CFI would be 3-4.**

Ratio Analysis in Higher Education**

	Advisable Indicator	Trinity College		
		Current Year	Prior Year	2nd Prior Year
MEASURING OVERALL FINANCIAL HEALTH				
1) **Composite Financial Index** - measures the financial component of an institution's well-being using four core ratios: **primary reserve, net income, return on net assets and viability**	At least 3.00 - 4.00 (Also, see CFI Scoring Scale)	7.76	6.44	6.24
MEASURING RESOURCE SUFFICIENCY AND FLEXIBILITY				
2) **Primary reserve** - measures how long the institution could operate without relying on additional net assets generated by operations	0.40 or better	1.13	0.98	0.81
3) **Secondary reserve** - an assessment of the significance of permanently restricted net assets in relation to operating size	Increasing trend	0.63	0.63	0.68
MEASURING OPERATING RESULTS				
4) **Net income** - indicates whether total unrestricted activities resulted in a surplus or a deficit (using an operating indicator)	2.00 - 4.00% and higher	14.65%	17.61%	14.87%
5) **Cash income** - indicates whether unrestricted activities, excluding gains, resulted in a net cash inflow or outflow	Increasing trend	19.40%	20.78%	18.93%
6) **Operating income** - measures institutional self-sufficiency	"	112.38%	118.03%	111.35%
7) **Contributed income** - measure of the institution's dependency on externally generated resources, other than debt, to finance operations	Increasing trend	7.44%	7.86%	8.32%
8) **Educational core services** - measures whether core services are using a growing or dwindling share of institutional resources	Stable or increasing trend	31.00%	30.13%	33.38%
9) **Educational support** - measures whether educational support services are using a growing or dwindling share of institutional resources	Stable or increasing trend	24.86%	23.94%	22.18%
10) **General support** - measures whether general support expenses are using a growing or dwindling share of institutional resources	Stable trend	25.35%	25.14%	26.13%
11) **Facilities maintenance** - measures the percentage of educational and general income allocated to plant maintenance	Stable or increasing trend	11.31%	11.63%	13.29%
MEASURING FINANCIAL ASSET PERFORMANCE				
12) **Return on average net assets** - measures the institution's performance in generating net assets compared to the capital base used to produce those net assets	3.00 - 4.00% plus CPI and higher	25.65%	14.33%	21.06%
13) **Capitalization** - measures total financial flexibility to respond to additional capital or programmatic needs over a specified period of time; **total net assets/total assets**	50%-85%	73.13%	66.73%	63.46%
14) **Financial net assets ratio** - measures the % of financial net assets to total net assets; ***equity resources available for new initiatives***	These 2 ratios must be in equilibrium for best financial flexibility	85.89%	97.03%	97.15%
Physical net assets ratio - measures the investment in physical plant to total net assets; ***too high % reduces financial flexibility***		14.11%	2.97%	2.85%
MEASURING STRATEGIC MANAGEMENT OF DEBT				
15) **Viability** - measures availability of net assets to cover debt should the institution need to settle its obligations as of the balance sheet date	1.25 - 2.00 and higher	2.14	1.70	1.31
16) **Debt burden** - measures the institution's dependence on borrowed funds as a source of financing its mission and the relative cost of borrowing to overall expenditures	7% or less	4.50%	4.81%	5.05%
17) **Debt coverage** - measures the excess of income over adjusted expenses available to cover annual debt service payments	High ratio	5.89	6.15	5.28
18) **Leverage** - measure of debt in relation to unrestricted and temporarily restricted assets in the institution's capital structure	2.00 and higher	2.69	1.79	1.38
19) **Age of plant** - measures the relative age of plant assets and equipment	Low ratio; 14 or less	24.49	23.02	22.65
20) **Debt capitalization** - measure of what percent of capital comes from debt; debt/ total net assets plus debt	< 20%	20.5%	25.7%	28.8%

** **Taken from the book, *Strategic Financial Analysis for Higher Education* jointly published by BearingPoint, Inc., KPMG, LLP and Prager, Sealy & Co.**

Trinity College
Composite Financial Index
"Measuring The Overall Level of Financial Health"

Current Year

RATIO	RATIO VALUE	STRENGTH FACTOR**	WEIGHTING FACTOR*	SCORE	MAXIMUM POSSIBLE SCORE
Primary Reserve	1.13	8.47	35%	2.96	3.50
Net Income**	14.65%	10.00	10%	1.00	1.00
Return on Net Assets	25.65%	10.00	20%	2.00	2.00
Viability	2.14	5.13	35%	1.80	3.50
	Composite Financial Index			7.76	10.00

Prior Year

RATIO	RATIO VALUE	STRENGTH FACTOR**	WEIGHTING FACTOR*	SCORE
Primary Reserve	0.98	7.36	35%	2.58
Net Income**	17.61%	10.00	10%	1.00
Return on Net Assets	14.33%	7.17	20%	1.43
Viability	1.70	4.09	35%	1.43
	Composite Financial Index			6.44

Second Prior Year

RATIO	RATIO VALUE	STRENGTH FACTOR**	WEIGHTING FACTOR*	SCORE
Primary Reserve	0.81	6.12	35%	2.14
Net Income**	14.87%	10.00	10%	1.00
Return on Net Assets	21.06%	10.00	20%	2.00
Viability	1.31	3.14	35%	1.10
	Composite Financial Index			6.24

* Institution with long-term debt
** Net income ratio calculated using an operating indicator
Note: Taken from the book, *Strategic Financial Analysis for Higher Education* jointly published by BearingPoint, Inc., KPMG, LLP and Prager, Sealy & Co.

TRINITY COLLEGE

MOODY'S AND STANDARD & POORS' RATIOS

Moody's and Standard & Poors view higher education as a business enterprise that must be concerned with the demand and pricing for its service and its market niche. These rating agencies look at five key areas in assessing the financial viability of an organization.

- Market position. Student demand translates into revenue streams.
- Financial performance. Is the institution financially sound?
- Debt position. An examination of the role of debt in the capital structure of the organization as well as issues surrounding deferred maintenance.
- Legal structure. How is the debt of the organization secured?
- Management. Does the management team have a credible financial and market strategy, and has it shown it can execute that strategy?

To complete their assessments, Moody's and Standard & Poors also considers environmental factors that influence financial health, such as government, the economy, and demographics.

*Moody's Ratios****

MARKET DATA AND RATIOS	Baa Benchmark*	Trinity College Current Year	Prior Year
Total Enrollment FTE, undergraduate	2012	1520	1483
Net tuition per student, undergraduate	$ 18,901	$ 13,664	$ 13,381
Educational expenses per student, all	$ 24,950	$ 18,001	$ 17,307
Institutional tuition discount, undergraduate	N/A	27.36%	27.57%
Total tuition discount, undergraduate	39.00%	28.69%	28.84%
Tuition rate, undergraduate	N/A	$ 20,550	$ 20,150
Tuition increase over prior year, undergraduate	4.2%	2.0%	2.0%
FINANCIAL DATA			
Total Financial Resources **	$ 77,914	$ 54,033	$ 47,241
Total Debt **	$ 36,855	$ 16,200	$ 16,867
Total Revenues **	$ 61,388	$ 45,116	$ 35,874
Total Cash and Investments**	$ 87,717	$ 55,355	$ 48,256
Total Expenses**	$ 59,090	$ 30,788	$ 29,361
Total Gift Revenue**	$ 4,765	$ 8,484	$ 2,407
CAPITAL RATIOS			
Unrestricted financial resources to debt (x)	0.50	1.79	1.42
Expendable financial resources to debt (x)	0.98	2.13	1.70
Total financial resources to debt (x)	2.06	3.34	2.80
Total cash and investments to debt (x)	2.10	3.42	2.86
Debt service to operations	5.70%	4.45%	4.74%
Capital Spending Ratio (x)	1.09	1.03	1.39
Age of plant (number of years)	14.00	24.49	23.02
BALANCE SHEET RATIOS			
Unrestricted financial resources to operations (x)	0.37	0.94	0.82
Expendable financial resources to operations (x)	0.63	1.12	0.98
Free expendable financial resources to operations (x)	-0.02	0.60	0.40
Expendable financial resources to total net assets	N/A	54.87%	59.03%
Total financial resources per student	$ 41,772	$ 35,548	$ 31,855
Debt per student	N/A	$ 10,658	$ 11,373
OPERATING RATIOS			
Operating margin	4.50%	14.65%	17.61%
Operating margin, excluding gifts	-2.20%	12.50%	15.46%
Operating cash flow margin	12.90%	19.46%	22.70%
Actual debt service coverage (x)	2.59	5.13	5.81
Return on average net assets	0.10%	25.65%	14.33%
Return on financial resources	-2.90%	13.41%	14.21%
NONOPERATING RATIOS			
Market value of investments and FHIT by others**	N/A	$ 48,579	$ 40,462
Total return on investments and FHIT by others	N/A	4.0%	-0.1%
Investments and FHIT by others per student	N/A	$ 31,960	$ 27,284
CONTRIBUTION RATIOS (% of total unrestricted operating revenue)			
Net tuition and auxiliaries	82.20%	93.04%	93.32%
Grants and contracts	1.70%	0.91%	1.13%
Investment income (including gains)	6.30%	0.36%	0.28%
Gifts and pledges	5.80%	2.46%	2.54%
Other	1.90%	0.78%	0.93%
	97.90%	97.56%	98.20%
Net assets released from restriction	2.10%	2.44%	1.80%
	100.00%	100.00%	100.00%

* Moody's - Medians for small, private colleges and universities rated "Baa"; fiscal 2012 data (dated August 14, 2013).

** In thousands (x) Indicates times or a multiple

*** Moody's adjusts total unrestricted operating revenue to limit investment income to 5% of average of previous three year's ending value of cash and investments. This has not been done on the college's ratios above and will cause variances from those calculated by Moody's.

Standard and Poor's Ratios

	*Benchmark	Trinity College Current Year	Trinity College Prior Year
DEMAND AND OTHER DATA			
FTE Enrollment, undergraduate	3,195	1,520	1,483
Investments and FHIT by others Market Value**	$ 50,532	$ 48,579	$ 40,462
Investments and FHIT by others Market Value per FTE, UG	$ 15,646	$ 31,960	$ 27,284
STATEMENT OF ACTIVITIES RATIOS			
REVENUE DIVERSITY - a diversified revenue base is advisable			
Tuition	76.90%	86.72%	86.14%
Grants and Contracts	1.10%	0.74%	0.91%
Gifts and Pledges	1.20%	1.98%	2.07%
Investment and endowment income	0.90%	0.29%	0.23%
Auxiliary operations	12.80%	7.66%	8.43%
EXPENSE AND FINANCIAL AID - ability to reduce costs if revenues decline; a low ratio of fixed to variable cost is advisable			
Instruction	28.50%	26.87%	25.89%
Tuition discount, total, undergraduate	31.20%	28.69%	28.84%
Financial aid burden	24.90%	20.56%	20.75%
STATEMENT OF FINANCIAL POSITION RATIOS			
LIQUIDITY RATIOS - ability to continue to operate without taking on additional revenue			
Cash and investments to operations	66.10%	142.83%	130.24%
Unrestricted resources to operations	21.90%	74.96%	64.64%
Expendable resources to operations	36.90%	89.22%	77.57%
Cash and investments to debt	121.80%	341.70%	286.11%
Unrestricted resources to debt	41.40%	179.34%	142.00%
Expendable resources to debt	71.40%	213.44%	125.73%
DEBT RATIOS			
Total debt, including any current financing**	$53,292	$16,200	$16,867
Current debt service burden (advisable = less than 10%)	3.80%	1.84%	1.92%
Average age of plant	12.10	24.49	23.02
FULL-TIME EQUIVALENT MEASURES (Undergraduate only)			
Net tuition per FTE	$ 16,903	$ 13,664	$ 13,381
Total operating revenue per FTE	$ 33,289	$ 23,377	$ 23,259
Total operating expenses per FTE (all operating expenses)	$ 24,515	$ 25,498	$ 24,984
Total outstanding debt per FTE	$ 17,939	$ 10,658	$ 11,373
Unrestricted resources per FTE	$ 7,767	$ 19,114	$ 16,150
Expendable resources per FTE	$ 11,701	$ 22,748	$ 14,300

* Median averages of private colleges and universities with a debt rating of "BBB" by Standard & Poor's: fiscal 2012 data (dated July 11, 2013)

** In thousands

Note: Generally, Standard & Poor's treats financial aid/scholarships as an expense (versus the FASB approach of netting against tuition and fees).

TRINITY COLLEGE

OTHER ANALYSIS INCLUDING THE U.S. DEPARTMENT OF EDUCATION COMPOSITE SCORE

Included on the following page is some other key financial analysis such as **sources of revenue, expenses by function and percent change from the prior year, some key fundraising ratios, inflationary indexes, auxiliary services net margin and the U.S. Department of Education Composite Score.**

The **U.S. Department of Education** has also adopted Financial Responsibility Standards for institutions participating in student financial-assistance programs under Title IV. Failure to meet these minimums will result in being monitored by the Department. Their ratios provide a measure of an institution's financial health by focusing on the ability to meet debt obligations, the level of reserves available to support current operations, as well as the ability to function within its means in a given operating cycle.

The U.S. Department of Education's Responsibility test ***should not be confused with the Composite Financial Index***. The Financial Responsibility test uses a composite score based upon three ratios, two of which are ratios also used in the **CFI**, the primary reserve ratio and the net income ratio. The third ratio in the Department of Education's methodology is the equity ratio, which is a measure of financial strength indicating an institution's ability to borrow. This financial responsibility index was developed for the Department of Education by KPMG to determine eligibility for Title IV funds. Its purpose is primarily to identify institutions that are at increased financial risk (using a scale of -1 to 3) to the student financial aid program in a short time horizon.

The CFI methodology presents a more complete picture of an institution's financial strengths and weaknesses (using a scale of –X to 10). Moreover, CFI assists institutions in understanding the affordability of their strategic plans and to monitor and evaluate the financial results of implementing those strategic initiatives over a longer time horizon.

The Brown Edwards' group median for the ED Composite Score was 2.71 in 2012 and 3.00 in 2011.

Other Analysis

	Trinity College	
	Current Year	Prior Year
Revenue Sources as a Percent of Total Revenues, Gains and Other Support		
Tuition & fees, net	66.8%	82.5%
Contributions	18.8%	6.7%
Investment income spent	1.6%	1.7%
Government grants	0.7%	1.1%
Auxiliary services	7.6%	10.3%
Other income	1.8%	-0.8%
Investment total return retained	1.0%	-0.2%
Change in funds held in trust	1.7%	-1.3%
Total revenues, gains and other support	100.0%	100.0%
Fundraising ratio (cost of fundraising as a percent of total contributions)	7.1%	21.1%
Fundraising expense ratio (cost of fundraising as a percent of total expenses)	2.0%	1.7%
Functional Expenses as a Percent of Total Expenses		
Instruction	33.9%	32.7%
Public service	0.1%	0.6%
Academic support	11.9%	10.6%
Student services	15.3%	15.8%
Institutional support	27.7%	27.7%
Auxiliary services	11.1%	12.6%
Total operating expenses	100.0%	100.0%
Percent increase in operating expenses/FTE	2.3%	-3.0%
Percent increase in operating expenses	4.9%	7.2%
CPI (June to June)	1.8%	1.7%
Higher Education PI (by Commonfund) *(CY Preliminary Forecast)*	1.6%	1.7%
Auxiliary Services Net Margin	-0.1%	0.1%
Department of Education Title IV Financial Responsibility Standards (A composite score of 1.5 or higher is considered financially responsible)		
Primary Reserve Ratio		
Ratio (Expendable Net Assets / Total Expenses)	1.275	0.905
Strength Factor (Primary Reserve ratio x 10)	3.000	3.000
Score (Strength Factor x 40%)	1.200	1.200
Equity Ratio		
Ratio (Modified Net Assets/Modified Assets)	0.731	0.667
Strength Factor (Equity ratio x 6)	3.000	3.000
Score (Strength Factor x 40%)	1.200	1.200
Net Income Ratio		
Ratio (Change in Unrestricted Net Assets / Total Unrestricted Income)	0.170	0.187
Strength Factor (Factor when Net Income ratio is positive)	3.000	3.000
Score (Strength Factor x 20%)	0.600	0.600
Composite Score (Sum of above ratios)	3.00	3.00

Interpretation of Composite Score Range	Composite Score	Regulatory Result
School is financially healthy enough to participate without additional monitoring	1.5 to 3.0	Financially Responsible
"In the zone," additional monitoring needed to participate	1.0 to 1.4	Financially Responsible
School is not financially healthy enough to be considered financially responsible	-1.0 to .9	Not Financially Responsible

TRINITY COLLEGE

OTHER ANALYSIS INCLUDING THE U.S. DEPARTMENT OF EDUCATION COMPOSITE SCORE
(Continued)