Trinity

FINANCIAL ANALYSIS AND THE STATE OF PRIVATE HIGHER EDUCATION

JUNE 30, 2015

BROWN EDWARDS
certified public accountants

TRINITY COLLEGE

FINANCIAL ANALYSIS AND
THE STATE OF PRIVATE HIGHER EDUCATION

June 30, 2015

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REPORT ON HIGHLIGHTS OF THE JUNE 30, 2015
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, 2015 and have issued our report thereon dated October 13, 2015. 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, 2015 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
October 13, 2015

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HIGHLIGHTS OF THE JUNE 30, 2015 FINANCIAL REPORT

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

June 30, 2015 was an exciting year for the College. The College has moved forward with the construction of the new academic center which will provide a beautiful facility that the College hopes to use to draw new students. The College had a satisfactory overall **increase in total net assets of $1.9 million, or a 2.45% return on average net assets**. Operationally, while still strong and positive, the College experienced a reduction in the unrestricted operating surplus. Student-driven revenues decreased significantly, while operating expenses increased by only 0.9%. *Overall, another good year operationally and a tribute to management's fiscal stewardship given the many downward pressures on operating revenue, and the upward pressures on operating costs.* Key highlights include the following (additional detail is included on the following pages):

- **Total assets** *increased* by $14.7 million; there were fairly large increases in most asset categories offset by a sizeable decrease in contribution receivables.
- **Total liabilities** *increased* by $12.8, primarily related to increases in accounts payable, debt, and the interest rate swap liability.
- **Operating revenues** *decreased* by $766,000; primarily related to a decrease in net tuition and fees.
- **Operating expenses** *increased* by only $281,000, or 0.9%, with only modest changes in functional categories.
- The largest changes in **non-operating** activities were significant *decreases* in gifts and private grants, investment return, and funds held in trust by others.

Cash and cash equivalents at June 30, 2015 increased from the prior year by $3.4 million, as reflected in the statements of cash flows on page 8 of the financial report. Net cash provided by operating activities totaled $3.6 million. Net cash used in investing activities, which includes student loans activity, purchases of land, building, and equipment, and investment activity, totaled $4.8 million. Net cash provided by financing activities, which includes contributions restricted for long-term investment, proceeds from new debt, and debt principal payments, totaled $4.6 million.

Receivables and other assets, net of allowance for doubtful accounts, decreased from the prior year by $216,000 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 decreased over the prior year by $4.0 million. The decrease is primarily attributable to significant payments on pledges received in prior years as part of the Second Century Campaign.

HIGHLIGHTS OF THE JUNE 30, 2015 FINANCIAL REPORT
(Continued)

Summary of Financial Highlights (Continued)

Investments increased from the prior year by $3.7 million. The increase is partly attributable to investing surplus cash. Note 4 of the financial report summarizes investment activity. Overall, College's **endowment investments** had an approximate total return of 0.7% as compared to 16.1% 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 0.5% based on average investments as compared to 5.9% in the prior year. Comparable indexes at the target asset allocations for the endowment for the fiscal year are as follows:

	Endowment Target Asset Allocation	2015	2014
Equities:			
Russell 1000 Growth	20.0%	10.6%	26.9%
Russell 1000 Value	20.0	4.1	23.8
Russell Midcap	15.0	6.6	26.9
MSCI EAFE	10.0	(4.2)	23.6
	65.0		
Fixed income:			
Barclays U.S. Aggregate	35.0	1.9	4.4
	100.0%		
Estimated total return using the above asset allocation for the entire year		4.2%	18.1%

	Approximate Total Asset Allocation	2015	2014
Equities:			
Russell 1000 Growth	4.9%	10.6%	26.9%
Russell 1000 Value	3.3	4.1	23.8
Russell Midcap	2.2	6.6	26.9
Russell 2000	1.3	6.5	23.6
Russell 2000	4.5	7.3	25.2
MSCI EAFE	3.6	(4.2)	23.6
	19.8		
Fixed income:			
Barclays U.S. Aggregate	80.2	1.9	4.4
	100.0%		
Estimated total return using the asset allocation for the entire year		2.6%	8.7%

Summary of Financial Highlights (Continued)

The Brown Edwards Top 10 total return on investments group median was 1.8% in 2015 and 16.6% in 2014.

Land, buildings, and equipment increased during the year by $11.8 million. This results from additions of $12.8 million, net of depreciation for the current year of $1.0 million. The additions are primarily related to construction in progress for the new academic center. Note 5 of the financial report summarizes land, buildings, and equipment.

Funds held in trust by others decreased by $34,000. This decrease is largely attributable to a less than favorable 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 $957,000 primarily due to the timing of processing invoice payments for construction in progress.

Interest rate swap increased by $739,000 due to the refinancing of debt at the end of the prior year, which involved the retirement of the previously held interest rate swap agreement and the addition of two new interest rate swap agreements. The valuation of interest rate swap agreements is based on the expected future interest rates as compared to current interest rates.

Debt increased by $11.1 million, which is the result of additional debt for the construction of the new academic center, net of scheduled principal payments (including capital leases) in the current year of $697,000. Note 7 of the financial report summarizes debt.

Net assets, which are summarized in Note 8, changed during the year ended June 30, 2015 as follows:

	In Millions
Unrestricted	$ 0.62
Temporarily restricted	1.32
Permanently restricted	(0.01)
	$ 1.93

This represents a 2.5% return on average net assets versus a 21.1% return in the prior year.

Summary of Financial Highlights (Continued)

Gross tuition and fees decreased during the year by $2.1 million. This was primarily attributable to a decrease in the number of full time equivalent students netted with a 4.6% undergraduate tuition and fees increase from the prior year. **Net tuition and fees from graduate programs decreased by $1.1 million. Net tuition and fees** decreased during the year ended June 30, 2015 by $2.8 million. This was the net result of the gross tuition and fee decrease and a $691,000 increase in financial aid. The College's tuition discounts can be summarized and compared to Moody's Investors Service and Standard & Poor's (fiscal 2014 median for small private institutions) and Brown Edwards' client median as follows:

	Rating Agencies		Brown Edwards Top 10 Client Median		Trinity College	
	S & P "BBB")	Moody's "Baa")	2015	2014	2015	2014
Non-funded			46.5%	45.0%	31.1%	29.6%
Funded			8.9	9.6	4.2	1.5
Total tuition discount	33.3%	42.6%	55.4%	54.6%	35.3%	31.1%

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 only $281,000. (The consumer price index for the year ended June 30, 2015 was 0.1%; and the Higher Education Price Index was 2.2%.) Salaries, wages, and benefits totaled 63.0% and 64.6% of operating expenses for the years ended June 30, 2015 and 2014, respectively.

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, 2015 and 2014, the change was $1.1 million and $2.9 million, respectively. The drop from the prior year was the result of a decrease in unrestricted operating revenues and slightly higher operating expenses. ***The Brown Edwards Top 10 percent change in operating expenses group median was 3.7% in 2015 and 2.0% in 2014.***

The **temporarily restricted change in net assets from operating activities** was $488,000 and $(270,000) for the years ended June 30, 2015 and 2014, 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.

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

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

<u>Financial strengths</u>:

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

  (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.
- 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 plus years, which has positioned the College well with the necessary financial wherewithal to move institutional initiatives forward within reason.

<u>Financial challenges</u>:

- Utilizing the College's financial strength to carrying out key strategic initiatives to 1) protect what has built over the past several years and 2) continue to position the College for long-term sustainability.
- Improving philanthropic support, including:
  - Continuing to grow expendable (unrestricted and temporarily restricted net assets, less plant assets net of related long-term debt) financial reserves for key institutional 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.
- Continuing to strategically manage debt while funding important institutional initiatives.

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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, 2011 through 2015 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.

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TRINITY COLLEGE
TREND ANALYSIS

INTRODUCTION TO THE TREND ANALYSIS

Trinity College is very similar in financial size to many other colleges in the Southeast. The College's operations, like most of its peers, is tuition dependent (net tuition and fees and auxiliary revenue) with student-driven revenue making up a large percent of total operating revenue. Income derived from the endowment for the purpose of supporting annual operations is an important but not a large portion of the operating revenue budget on a continuous basis. However, a significant portion of the expendable net assets, a major factor in assessing financial strength and liquidity in higher education, consists of accumulated net appreciation on endowment investments. Of course, while the investment markets have been bullish in recent years, the current year experienced modest returns that have impacted the trend analysis significantly. In addition, during 2015, the construction of the new academic center ramped up which has resulted in a significant increase in debt which is seen throughout the ratios and trend analysis.

Enrollment was on an upward trend during the trend period through 2013; however, enrollment has decreased each year for the last three years. Accordingly, net tuition and fees has followed this same trend with net undergraduate tuition and fees per undergraduate student being slightly up for the period; net graduate tuition has decreased significantly during the trend period. There have been increases in all operating expense categories over the past five years. Many of these issues 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 (the value of a private higher education being called into question, demographic shifts, competition, less government funding), uncertainty in investment markets with lower long-term returns expected, and rising costs (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 factors that affect the financial strengths and challenges of the College.

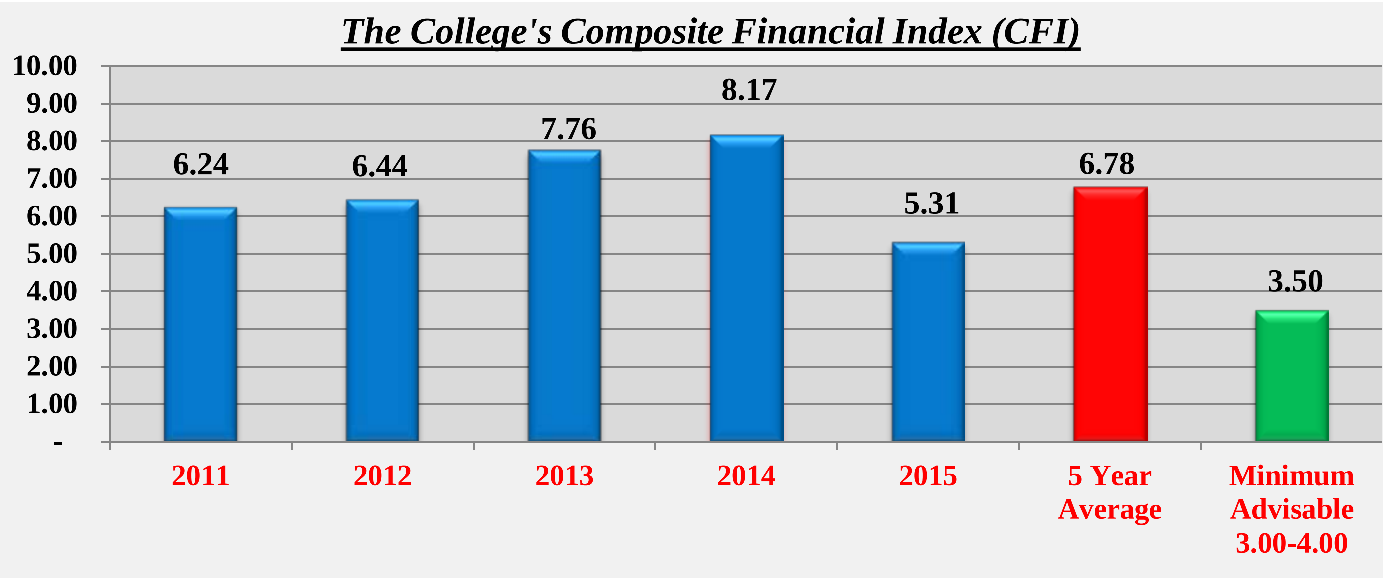
The Moody's and S&P median ratios throughout this analysis are for fiscal year 2014 as they are the most recent available which is inherent with most benchmarking data. Brown Edwards' group medians for 2015 are generally lower due to reduced operating margins, weak financial markets, and the resulting lower overall returns on net assets. Since the College was one of our Top 10 institutions (based on overall financial well-being as scored by their respective Composite Financial Index), the medians included herein are of that group.

<u>Composite Financial Index</u>

Brown Edwards provides you with many ratios as a value-added part of the audit process, but we place a greater focus on the Composite Financial Index (CFI). CFI is a combination of four financial metrics that **measures the overall financial health of the institution**. To fully understand CFI, it is important to understand its components which are indicators of specific areas of financial strengths and weaknesses and can provide you with important insights as to where to focus your efforts for improvement and transformation. A more detailed discussion of the CFI can be found at the end of this trend analysis.

<u>Composite Financial Index</u> (Continued)

The College's CFI trend is as follows:



The Brown Edwards Top 10 CFI group median, including institutions all fairly similar in size and within reasonable geographic proximity to the College, was5.06 in 2015 and 7.00 in 2014.

Our Analysis & Comments on Your CFI

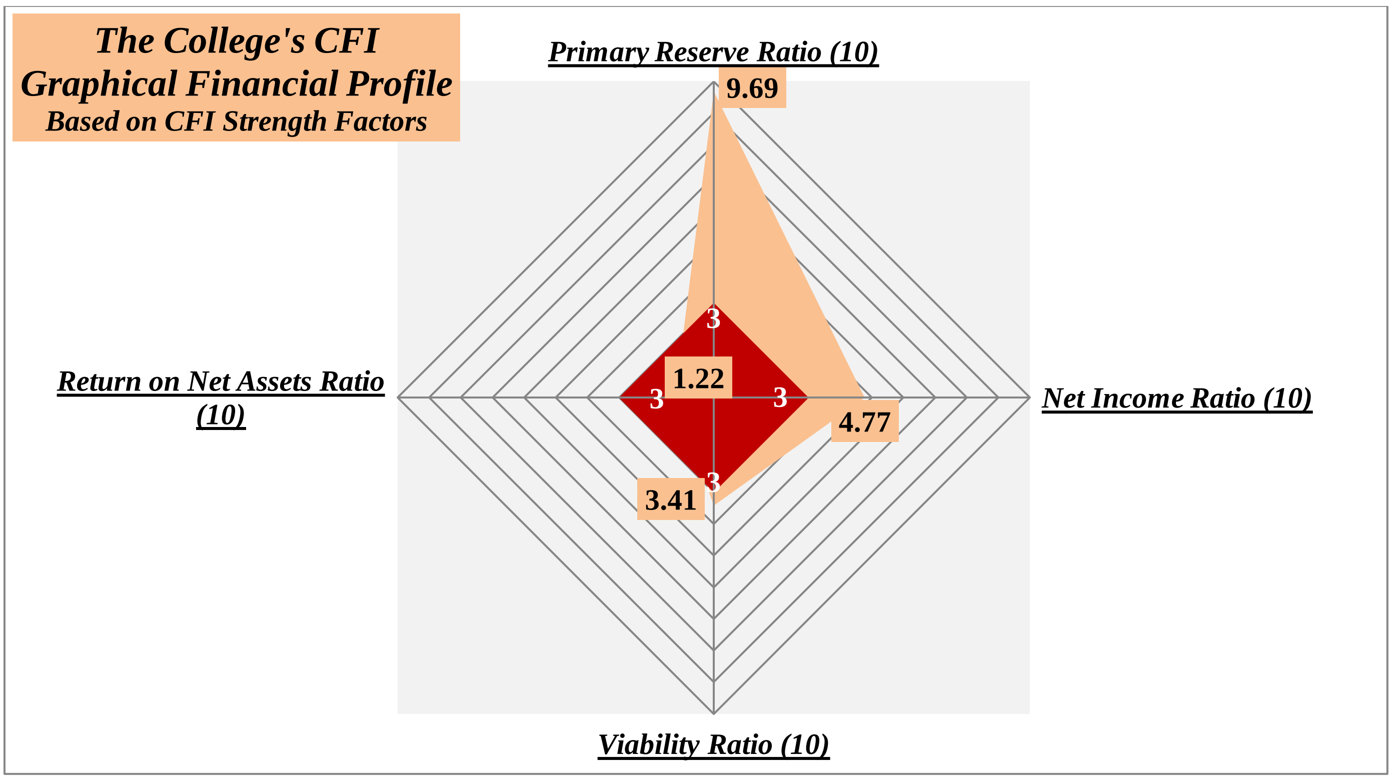
The trend of the College's CFI has been very strong during the trend period, averaging over 6.78 and peaking in 2014; however, 2015 saw a significant decrease. The current year decline was impacted by much smaller investment returns and a continuing slide in the change in net assets from unrestricted operating activities. Seventy percent of the input into the CFI calculation is based on accumulated financial wealth on the balance sheet, or expendable net assets. A large portion of expendable net assets is the accumulated net appreciation on investments. Net appreciation rises and falls with the financial markets. The volatility in the financial markets suggests that management and the Board look at the CFI over more than one year. In addition, the operating size of the College, measured in terms of total operating expense, has increased over the past five years. This increase demands higher expendable net asset levels to maintain the strength of financial position. Even considering this, the College's expendable net assets relative to operating expenses are currently very good.

<u>Composite Financial Index</u> (Continued)

Our Analysis & Comments on Your CFI (Continued)

Overall, the College's CFI indicates a very financially healthy institution that is well capitalized and that 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 three of the College's values are. One of the College points is very close to the maximum ten position.) A summary of the College's scoring: **a) Primary reserve ratio** – financial reserves relative to operating size (operating expenses) are excellent and very close to the top of the scale with a ratio of 1.29, or a 15-month reserve (the Brown Edwards Top 10 primary reserve group median was 1.37 in 2015 and 1.36 in 2014); **b) Net income ratio** – operating returns dropped significantly this year but remains strong in 2015 at 3.34% (the minimum advisable range is 2% - 4% of unrestricted operating revenues); **c) Viability ratio** – debt levels are presently reasonable given the current level of expendable net assets; and) **d) Return on net assets ratio** – the College has generated an outstanding overall return on net assets during the trend period, averaging an incredible 16.91%; however, the ratio dropped to 2.45% in 2015.

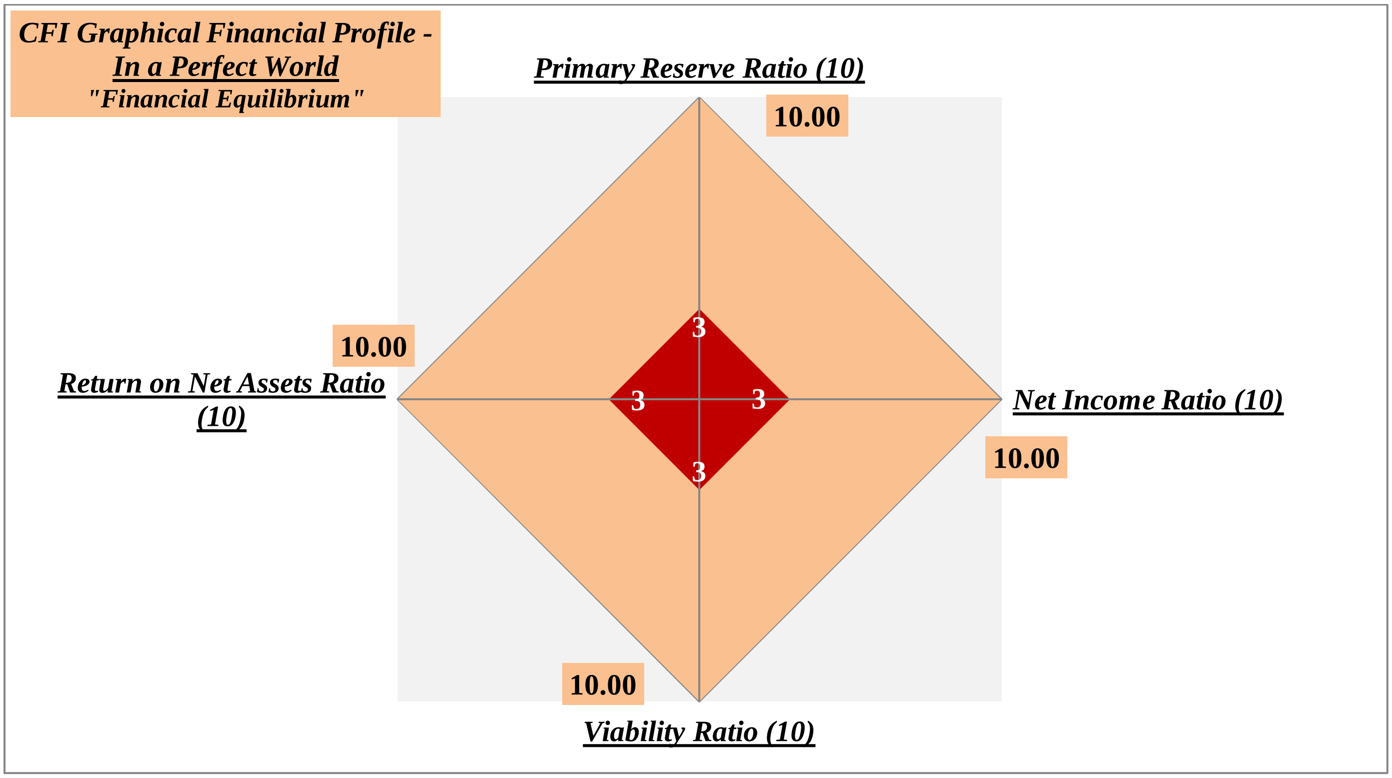
The College's current CFI and trend indicates that it has the financial resources to continue to move robust strategic initiatives forward, within reasonable limits, that will preserve the College's financial strength, continue to improve competitiveness, and continue to position the College for long-term financial sustainability.



TRINITY COLLEGE
TREND ANALYSIS
(Continued)

<u>Composite Financial Index</u> (Continued)

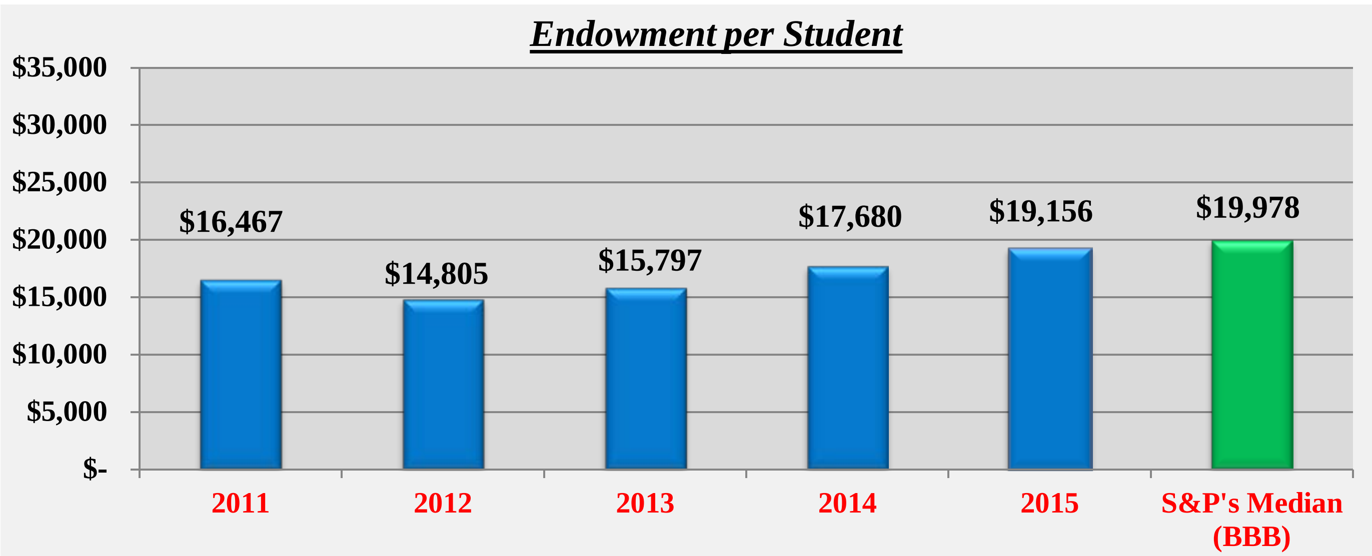
Our Analysis & Comments of Your CFI (Continued)



TRINITY COLLEGE
TREND ANALYSIS
(Continued)

<u>Endowment per Student</u>

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.



The Brown Edwards Top 10 endowment per student group median was approximately $56,600 in 2015 and $58,500 in 2014.

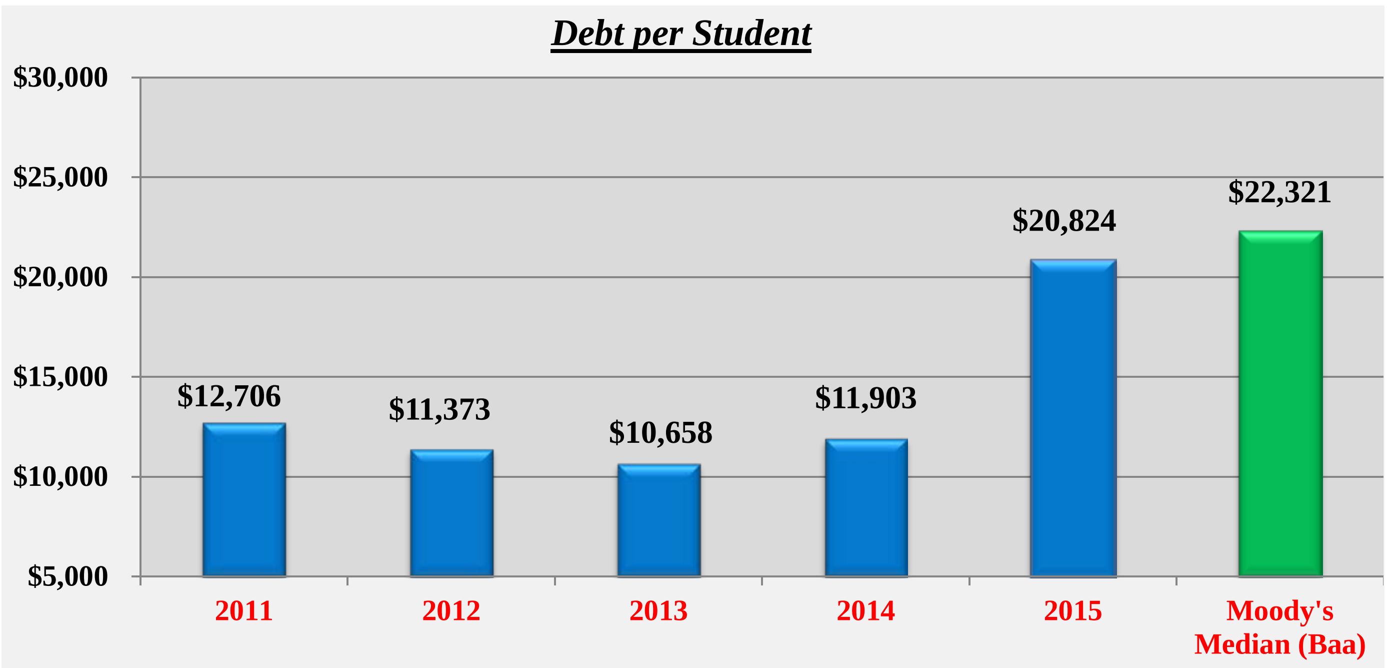
Our Analysis & Comment on Your Endowment per Student

With the exception of 2012 and again in 2015, the value of the College's endowment has steadily increased over the trend period in line with an improving economy and increasing financial markets. Undergraduate enrollment fluctuations and additional contributions have also factored into the increase. Endowment spending makes up a small percent of total operating revenue, so one year changes are not as critical as long-term performance. However, an endowment can never be too big given today's operational student financial aid needs. Some advocate that a good rule of thumb for the appropriate size of an endowment for a small private college or university is five times the annual operating budget. This would provide a) the support needed for any potential structural shortfalls of student-driven fees versus annual operating expenses, b) funding of 20-25% of annual operating income, and c) allow an institution to maintain a normalized and advisable annual endowment draw of 4-5%.

Financial markets have been very strong in recent years, but not a certainty 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 portion of total operating revenue, so one year changes are not as critical as long-term performance. **Overall, the College's endowment per student is strong and virtually equal to the S&P median for institutions rated "BBB"**.

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. Below is the College's **debt per student** trend. The trend is dramatically impacted by the decrease in enrollment over the past three years and the significant increase in debt related to the new academic center.



The Brown Edwards Top 10 debt per student group median was approximately $24,300 in 2015 and $20,300 in 2014.

Critical to strategically managing debt is monitoring key components of a sound debt policy such as debt affordability and capacity measures. Most small private institutions should focus 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. Balance sheet leverage generally is a limiting factor only for the less wealthy institutions since a weak balance sheet limits access to the capital markets. For most institutions, debt capacity is of interest primarily from a credit rating and peer comparison perspective. 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. Some key ratios to provide a quantitative assessment of debt affordability and debt capacity are as follows:

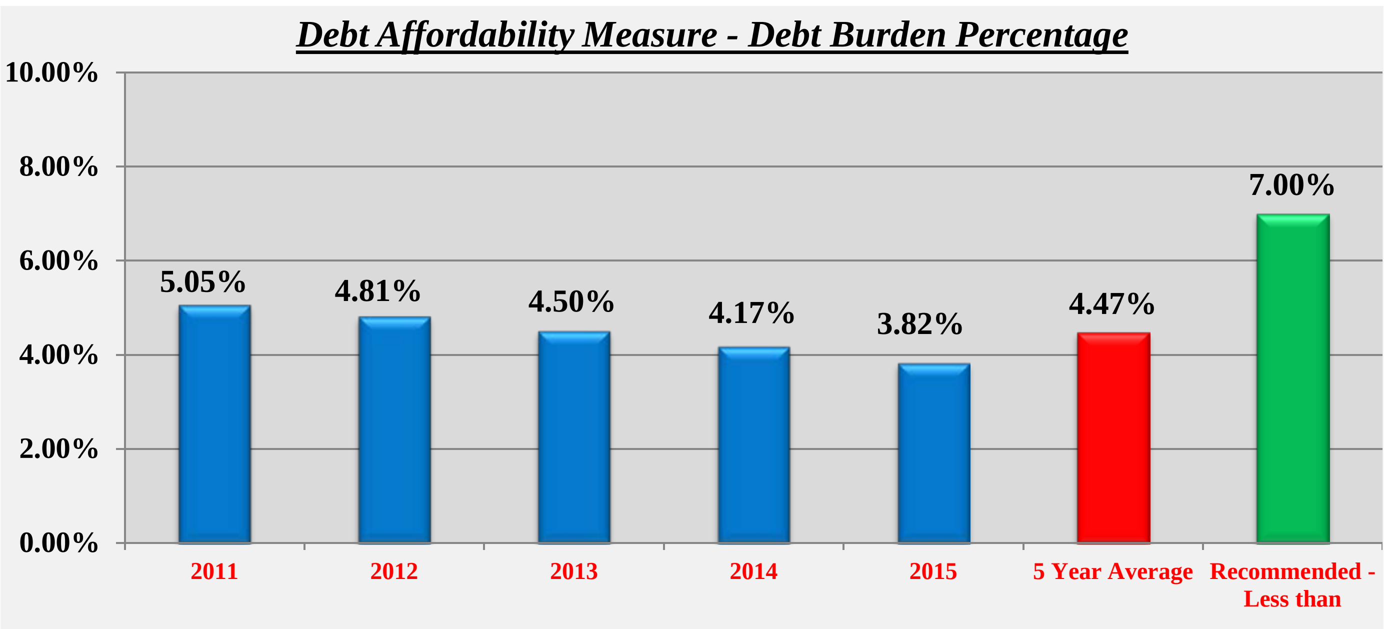
TRINITY COLLEGE
TREND ANALYSIS
(Continued)

__Strategically Managing Debt__ **(Continued)**

Debt Affordability Measures

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). The target for this ratio is intended to maintain long-term operating flexibility to finance existing requirements and new initiatives.



The Brown Edwards Top 10 debt burden percentage group median was approximately 6.42% in 2015 and 7.50% in 2014.

Debt Service Coverage Ratio

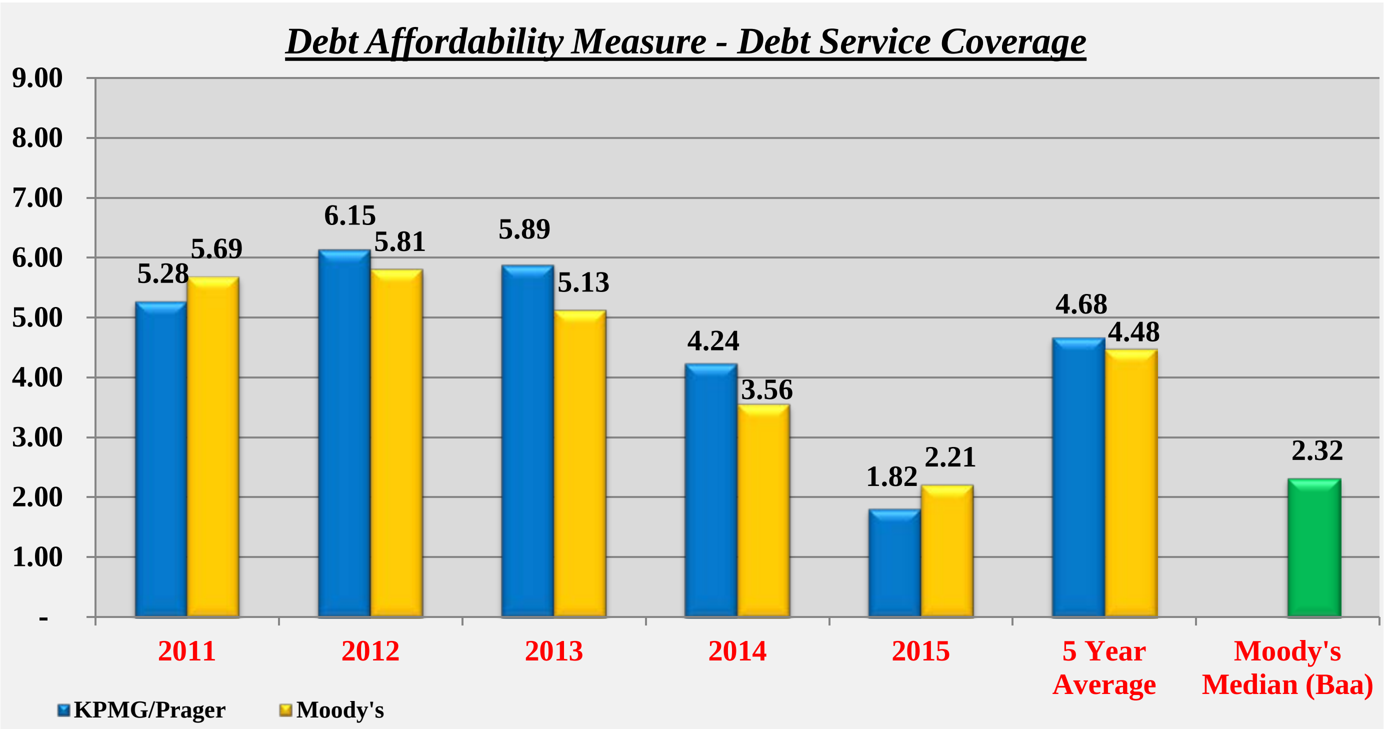
This ratio measures the College's ability to cover debt service requirements with revenues available for operations. The target established is intended to ensure that operating revenues are sufficient to meet debt service requirements and that debt service does not consume too large a portion of income. ***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.

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

Debt Affordability Measures (Continued)

Debt Service Coverage Ratio (Continued)



The Brown Edwards Top 10 debt service coverage group medians were approximately 2.60 for KPMG/Prager and 2.08 for Moody's in 2015 and 3.31 for KPMG/Prager and 2.04 for Moody's in 2014.

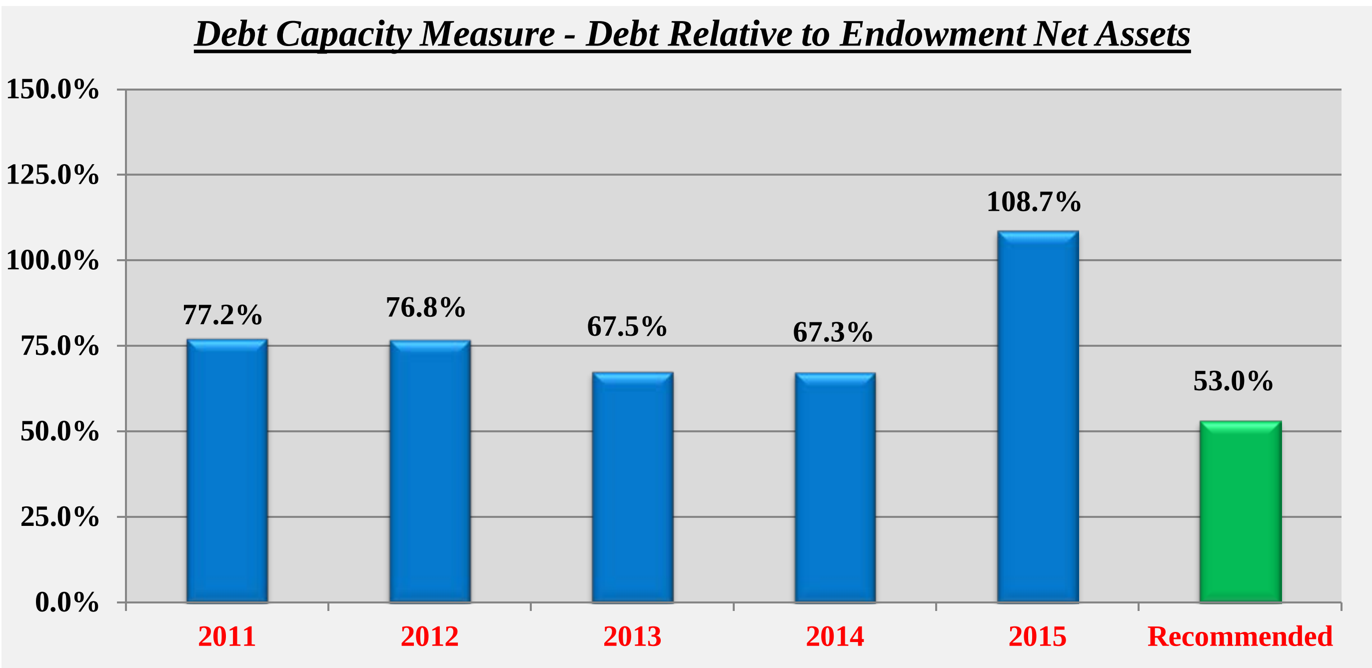
As one of its debt covenants, the College is required to meet a 1.10 cash flow to debt service ratio that is calculated more closely, but not exactly, to the KPMG's ratio. The College's was in compliance with this covenant at June 30, 2015.

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

Debt Capacity Measures

Debt Relative to Endowment Net Assets

Another debt capacity measure is **debt compared to endowment net assets**. Cambridge Associates, an international investment consultant, provides many benchmarks for colleges and universities based on their client base.

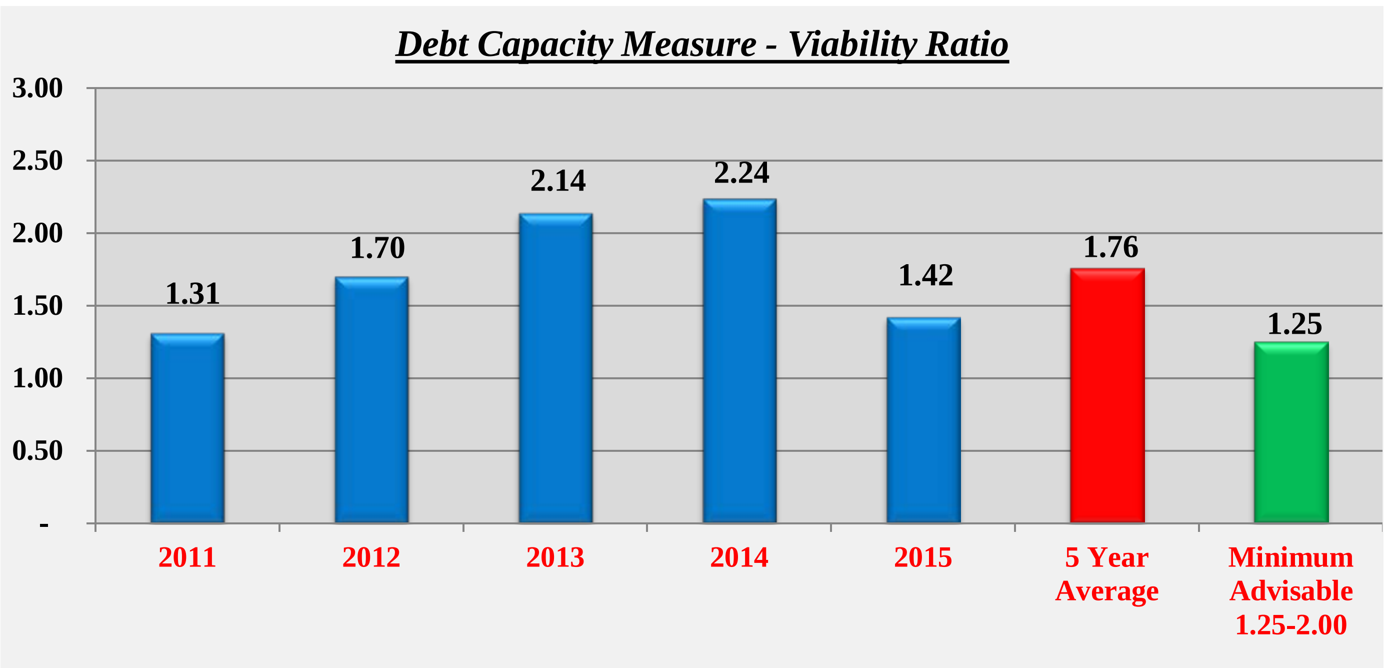


The Brown Edwards Top 10 debt relative to endowment net assets group median was approximately 39.1% in 2015 and 34.8% in 2014.

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

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 Top 10 viability ratio group median was 1.67 in 2015 and 2.05 in 2014.

Strategically Managing Debt (Continued)

Debt Capacity Measures

Other Debt Capacity Measures

Another debt capacity measure required as part of the College's debt covenants is that the College maintain no less than $11.0 million ($15.0 million in 2017 and forward) in "unencumbered unrestricted liquidity". This ratio is calculated by taking the sum of cash and cash equivalents and long-term investments and reducing it by restricted net assets (temporarily and permanently restricted less contributions receivable). The College exceeded the required amount significantly in 2015.

Our Analysis & Comments on Debt Measurements

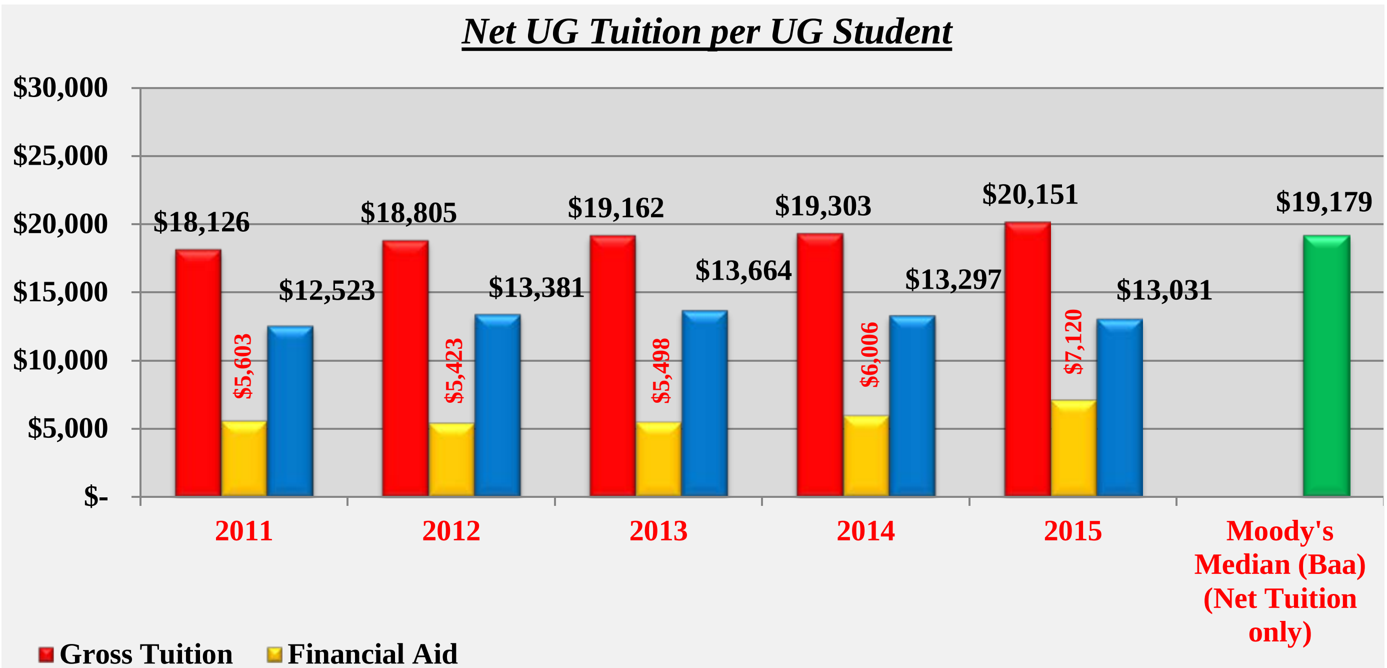
The College's debt increased significantly in the current year with the additional debt related to the new academic center. The College continues to generate more than sufficient resources necessary to cover principal and interest payments on its debt but the margin varies depending on the measure. The debt affordability ratio with the most stable base, the debt burden percentage, has consistently trended well below the recommended 7%. The KPMG/Prager and Moody's debt service coverage ratios have been on a downward trend for the past several years. The debt capacity ratios indicate that the College, as compared to benchmarking medians and recommended targets, is still in a reasonable position, but trending towards the upper level of debt for the College. ***The ratios only include debt at year end and do not include the full $15.0 million draw of the District of Columbia C Series 2014B Bonds or any other anticipated debt; there is an additional $1.5 million to be drawn.***

Overall, 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 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) at about 69% (desirable range is 50% - 85%). ***The Brown Edwards Top 10 capitalization ratio % group median was 78.3% in 2015 and 77.3% in 2014***. This ratio further indicates that the College is appropriately leveraging its assets to potentially increase income and future financial wealth. The College's equity is comprised of a reasonable mix of financial assets (financial net asset ratio of about 77%) versus physical net assets which further indicates financial flexibility. ***The Brown Edwards Top 10 financial net assets ratio % group median was 71.5% in 2015 and 72.7% in 2014.*** Managing all these factors to equilibrium is imperative and crucially important to the long-term success of the institution.

Net Tuition per Student

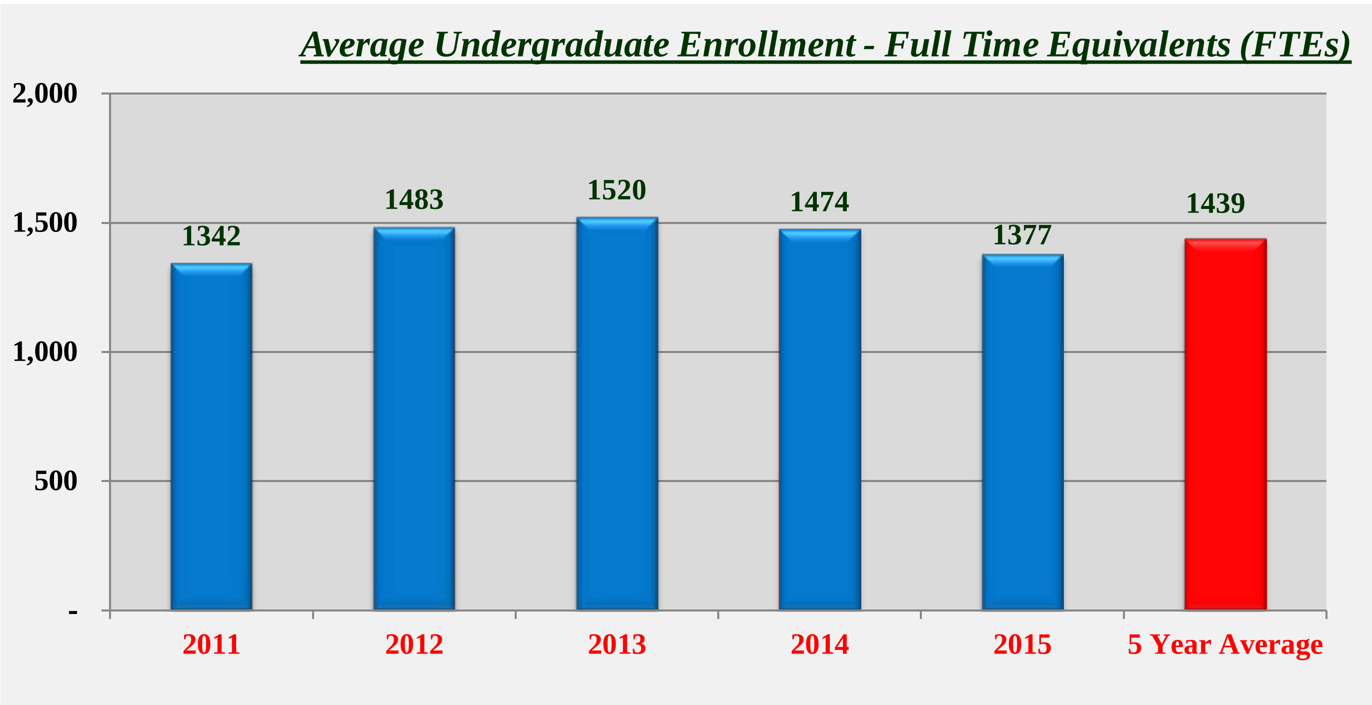
The **Net Tuition per Student Ratio** compares tuition and fee revenue, net of tuition discounts, to student enrollment (FTEs). This ratio indicates the average tuition paid per student.



The Brown Edwards Top 10 net tuition per student group median was $13,102 in 2015 (gross tuition median $30,510; financial aid median $18,203) and $13,513 in 2014 (gross tuition median $29,579; financial aid median $16,422).

<u>Net Tuition per Student</u> (Continued)

As is the case with many other small, private colleges and universities, the College has been hit with declining enrollments over the past few years.



The Brown Edwards Top 10 enrollment FTE group median was 1358 in 2015 and 1317 in 2014.

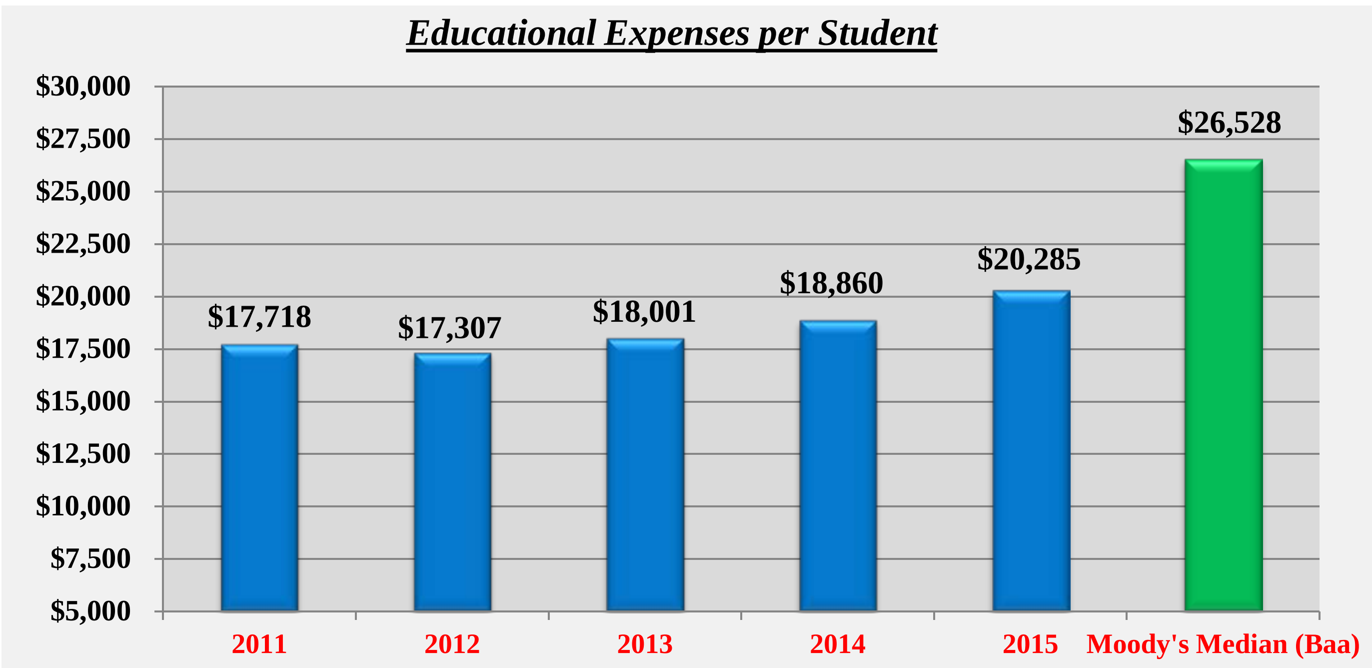
Our Analysis & Comments on Your Net Tuition per Student

Most institutions are struggling mightily to maintain or increase enrollments, and the College is no different in this respect. 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 (this is partially due to the decline in enrollment over the past few years). The College has accomplished this while holding the level of financial aid granted to below average levels, causing net tuition per student hold its ground even with the decline in enrollment. 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.

It is also important to note that tuition discounts are based on tuition only and do not include other auxiliary student fee factors such as room and board charges, and the net margin on these auxiliary services have averaged approximately 2% during the trend period. ***The Brown Edwards Top 10 auxiliary services gross margin percent median was 29.3% in 2015 and 28.2% in 2014.***

<u>Educational Expenses per Student</u>

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.



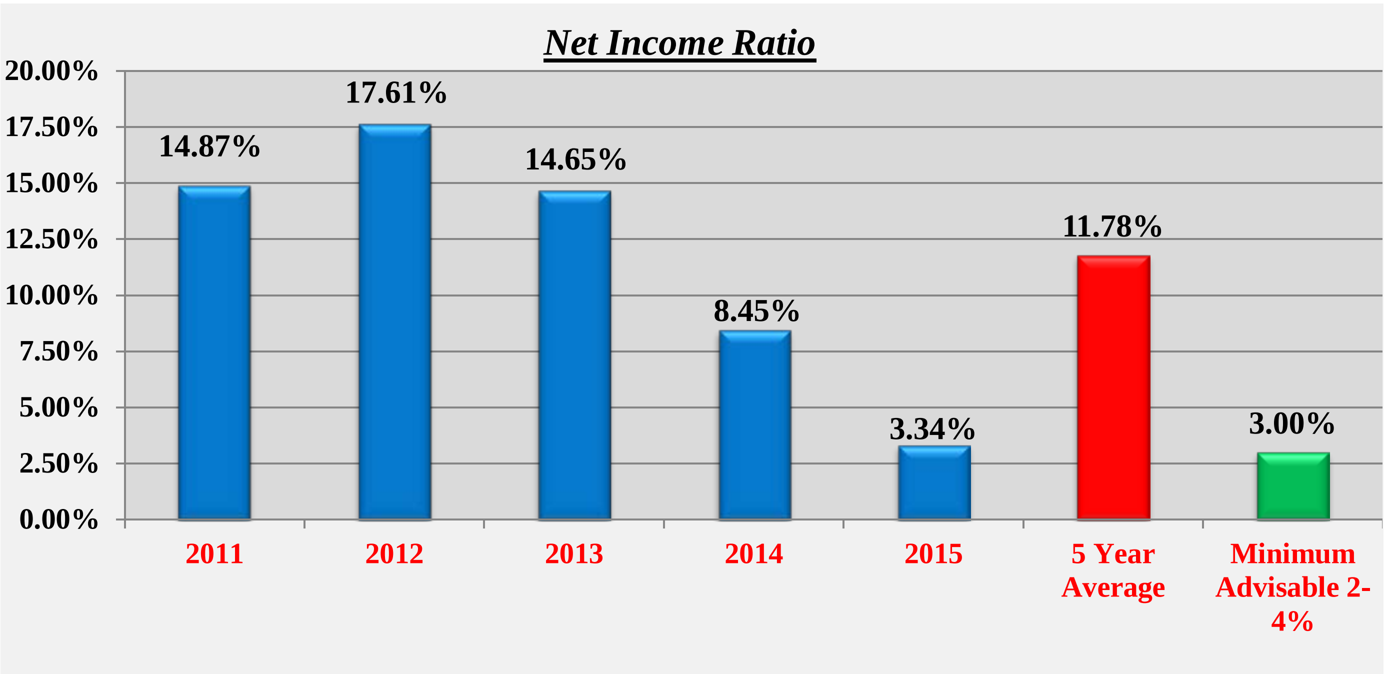
The Brown Edwards Top 10 educational expense per FTE group median was $26,120 in 2015 and $24,982 in 2014.

Our Analysis & Comments on Your Educational Expenses per Student

The College has held educational expenses to a reasonable level over the trend period. Also, as mentioned elsewhere there are significant pressures on rising costs in higher education. Just as net tuition per student is below the Moody's median, so are education expenses per student.

<u>Net Income Ratio, Change in Net Assets from Operating Activities, Unrestricted and Net Cash Provided by (Used in) Operating Activities</u>

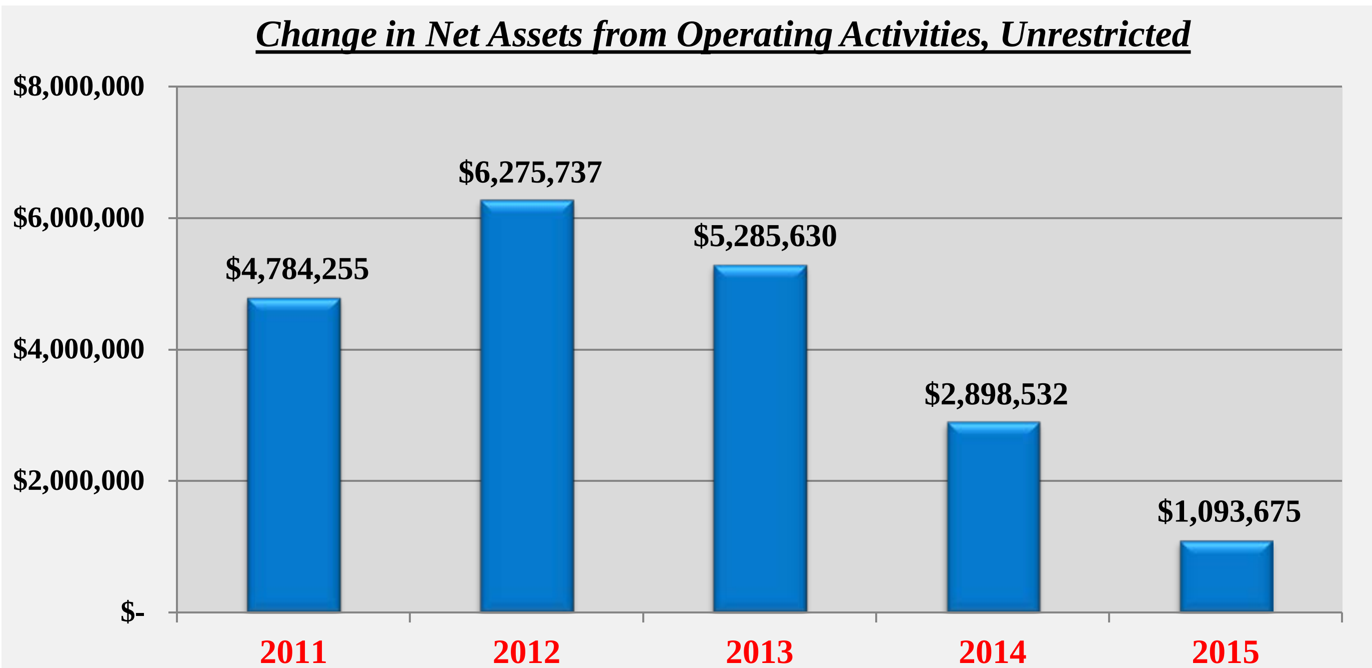
The **Net Income Ratio**, also included in the CFI calculation, was **developed to measure whether operating results indicate an institution is functioning within its available resources**. It is calculated as the **unrestricted operating indicator** or change in unrestricted net assets divided by total **unrestricted operating revenue**. It indicates whether unrestricted activities resulted in a surplus or deficit. A positive ratio indicates a surplus and the larger the surplus, the stronger the financial performance for the year. A negative ratio 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 not a good sign. A target rate of 2 to 4 percent is a reasonable goal, but could be modified based on strategic initiatives in play.



The Brown Edwards Top 10 net income ratio group median was2.28% in 2015 and 3.06% in 2014.

<u>Net Income Ratio, Change in Net Assets from Operating Activities, Unrestricted and Net Cash Provided by (Used in) Operating Activities</u> (Continued)

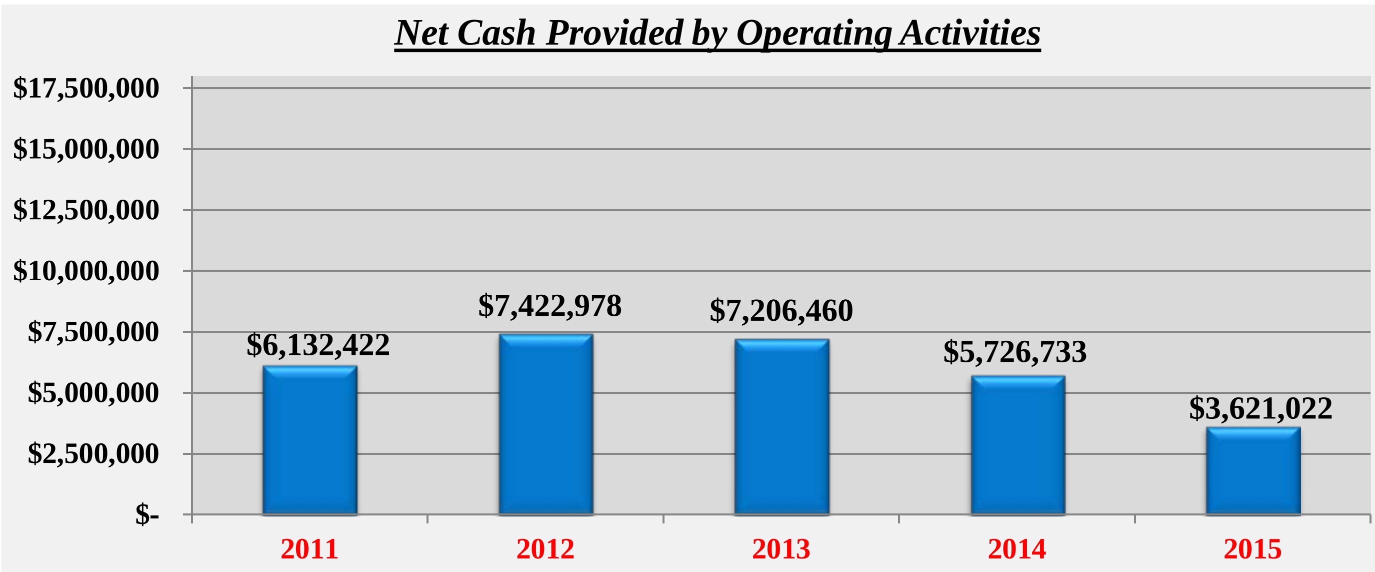
The sister to the net income ratio is the **Change in Net Assets from Operating Activities, Unrestricted**. This operating measure is the closest measure on the financial report to the institution's operating budget. It does include depreciation and interest costs whereas as many institution operating budgets do not.



The Brown Edwards Top 10 change in net assets from operating activities, unrestricted group median was $0.91 million in 2015 and $1.28 million in 2014.

<u>Net Income Ratio, Change in Net Assets from Operating Activities, Unrestricted and Net Cash Provided by (Used in) Operating Activities</u> (Continued)

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. The endowment draw is not included in this operating indicator.



The Brown Edwards Top 10 net cash provided by operations group median was $2.81 million in 2015 and $2.68 million in 2014.

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

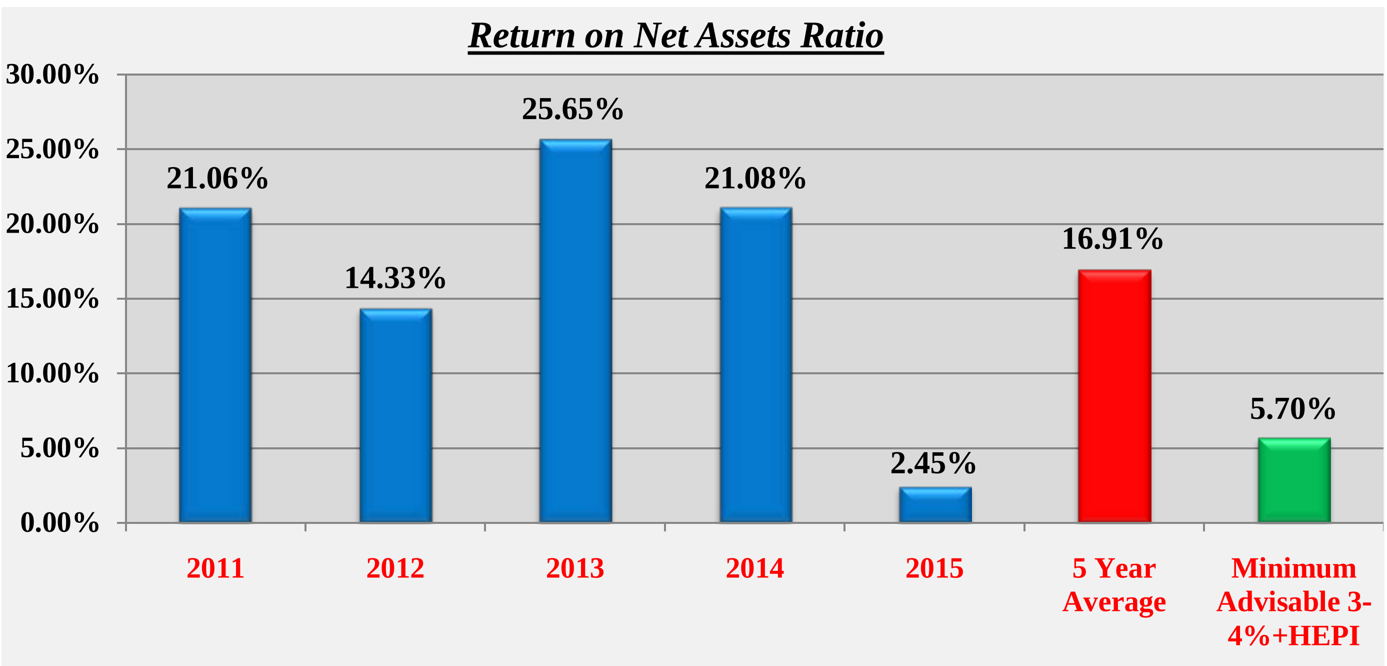
The College has had strong operating results during this period averaging a net income ratio of 11.78%, and it has been a financial strength. The net income ratio and the change in net assets from operating activities, unrestricted measures have both been on a downward decline over the past few years. This downward trend is indicative of the decrease in enrollment over the past few years.

Net cash provided by operations 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.

<u>Return on Net Assets Ratio</u>

The **Return on Net Assets Ratio**, another of the CFI core ratios, 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, which was 2.2% percent in 2015.



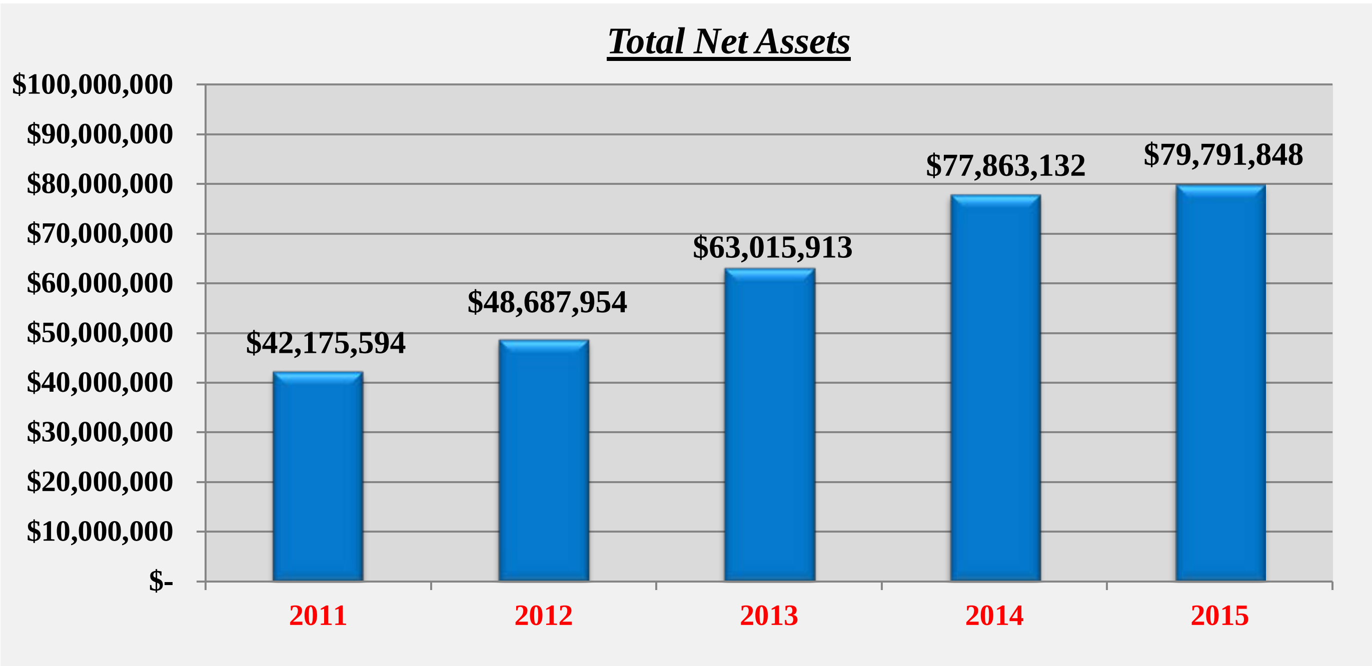
The Brown Edwards Top 10 return on net assets ratio group median was 2.37% in 2015 and 12.76% in 2014.

<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 16.91% during the five years.

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 Top 10 total net assets group median was $152.5 million in 2015 and $140.4 million in 2014.

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.

RATIO ANALYSIS IN HIGHER EDUCATION
(Continued)

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. 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	Trinity College Prior Year	Trinity College 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)	5.31	8.17	7.76
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	1.29	1.25	1.13
3) Secondary reserve - an assessment of the significance of permanently restricted net assets in relation to operating size	Increasing trend	0.64	0.65	0.63
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	3.34%	8.45%	14.65%
5) Cash income - indicates whether unrestricted activities, excluding gains, resulted in a net cash inflow or outflow	Increasing trend	11.24%	16.46%	19.40%
6) Operating income - measures institutional self-sufficiency	"	94.04%	102.42%	112.38%
7) Contributed income - measure of the institution's dependency on externally generated resources, other than debt, to finance operations	Increasing trend	10.26%	10.69%	7.44%
8) Educational core services - measures whether core services are using a growing or dwindling share of institutional resources	Stable or increasing trend	36.50%	33.45%	31.00%
9) Educational support - measures whether educational support services are using a growing or dwindling share of institutional resources	Stable or increasing trend	31.18%	26.94%	24.86%
10) General support - measures whether general support expenses are using a growing or dwindling share of institutional resources	Stable trend	31.22%	27.59%	25.35%
11) Facilities maintenance - measures the percentage of educational and general income allocated to plant maintenance	Stable or increasing trend	14.44%	12.68%	11.31%
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	2.45%	21.08%	25.65%
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%	68.67%	76.73%	73.13%
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	76.70%	76.66%	85.89%
Physical net assets ratio - measures the investment in physical plant to total net assets; ***too high % reduces financial flexibility***	for best financial flexibility	23.30%	23.34%	14.11%
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	1.42	2.24	2.14
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	3.82%	4.17%	4.50%
17) Debt coverage - measures the excess of income over adjusted expenses available to cover annual debt service payments	High ratio	1.82	4.24	5.89
18) Leverage - measure of debt in relation to unrestricted and temporarily restricted assets in the institution's capital structure	2.00 and higher	2.07	3.28	2.69
19) Age of plant - measures the relative age of plant assets and equipment	Low ratio; 14 or less	25.59	24.07	24.49
20) Debt capitalization - measure of what percent of capital comes from debt; debt/ total net assets plus debt	< 20%	26.4%	18.4%	20.5%

**** 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	1.29	9.69	35%	3.39	3.50
Net Income**	3.34%	4.77	10%	0.48	1.00
Return on Net Assets	2.45%	1.22	20%	0.24	2.00
Viability	1.42	3.41	35%	1.19	3.50
	Composite Financial Index			5.31	10.00

Prior Year

RATIO	RATIO VALUE	STRENGTH FACTOR**	WEIGHTING FACTOR*	SCORE
Primary Reserve	1.25	9.41	35%	3.29
Net Income**	8.45%	10.00	10%	1.00
Return on Net Assets	21.08%	10.00	20%	2.00
Viability	2.24	5.37	35%	1.88
	Composite Financial Index			8.17

Second Prior Year

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

* 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	1870	1377	1474
Net tuition per student, undergraduate	$ 19,179	$ 13,031	$ 13,297
Educational expenses per student, all	$ 26,528	$ 20,285	$ 18,860
Institutional tuition discount, undergraduate	N/A	31.13%	29.60%
Total tuition discount, undergraduate	42.60%	35.33%	31.11%
Tuition rate, undergraduate	N/A	$ 21,930	$ 20,970
Tuition increase over prior year, undergraduate	2.0%	4.6%	2.0%
FINANCIAL DATA			
Total Financial Resources **	$ 104,926	$ 61,201	$ 59,693
Total Debt **	$ 41,387	$ 28,674	$ 17,544
Total Revenues **	$ 60,369	$ 33,594	$ 46,232
Total Cash and Investments**	$ 108,817	$ 75,849	$ 68,824
Total Expenses**	$ 54,828	$ 31,665	$ 31,385
Total Gift Revenue**	$ 5,983	$ 4,094	$ 11,180
CAPITAL RATIOS			
Unrestricted financial resources to debt (x)	0.70	1.19	1.86
Expendable financial resources to debt (x)	1.39	1.42	2.24
Total financial resources to debt (x)	2.54	2.13	3.40
Total cash and investments to debt (x)	2.60	2.65	3.92
Debt service to operations	5.80%	3.78%	4.12%
Capital Spending Ratio (x)	0.82	12.19	1.96
Age of plant (number of years)	14.87	25.59	24.07
BALANCE SHEET RATIOS			
Unrestricted financial resources to operations (x)	0.46	1.08	1.04
Expendable financial resources to operations (x)	0.98	1.29	1.25
Free expendable financial resources to operations (x)	0.31	0.38	0.69
Expendable financial resources to total net assets	N/A	51.15%	50.46%
Debt capitalization	21.60%	26.44%	18.39%
Total financial resources per student	$ 59,453	$ 44,445	$ 40,498
Debt per student	$ 22,321	$ 20,824	$ 11,903
OPERATING RATIOS			
Operating margin	0.80%	3.34%	8.45%
Operating margin, excluding gifts	-5.40%	1.02%	6.55%
Operating cash flow margin	11.90%	8.09%	13.42%
Actual debt service coverage (x)	2.32	2.21	3.56
Return on average net assets	8.50%	2.45%	21.08%
Return on financial resources	11.60%	2.49%	9.95%
NONOPERATING RATIOS			
Market value of investments and FHIT by others**	N/A	$ 58,478	$ 54,812
Total return on investments and FHIT by others	N/A	0.4%	6.1%
Investments and FHIT by others per student	N/A	$ 42,468	$ 37,186
CONTRIBUTION RATIOS (% of total unrestricted operating revenue)			
Net tuition and auxiliaries	80.20%	89.33%	92.02%
Grants and contracts	1.30%	1.29%	0.84%
Investment income (including gains)	7.90%	0.31%	0.37%
Gifts and pledges	6.20%	2.34%	2.04%
Other	2.10%	0.96%	0.65%
	97.70%	94.23%	95.92%
Net assets released from restriction	2.30%	5.77%	4.08%
	100.00%	100.00%	100.00%

* Moody's - Medians for small, private colleges and universities rated "Baa"; fiscal 2014 data (dated July 6, 2015).

** 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	3,318	1,377	1,474
Endowment Market Value**	$ 64,256	$ 26,378	$ 26,061
Endowment Market Value per FTE, UG	$ 19,978	$ 19,156	$ 17,680
STATEMENT OF ACTIVITIES RATIOS			
REVENUE DIVERSITY - a diversified revenue base is advisable			
Student-generated revenue (tuition, fees and auxiliaries)	88.90%	91.83%	93.73%
Grants and Contracts	1.10%	0.99%	0.66%
Gifts and Pledges	1.00%	1.80%	1.61%
Investment and endowment income	1.70%	0.23%	0.29%
Auxiliary operations	N/A	9.46%	8.18%
EXPENSE AND FINANCIAL AID - ability to reduce costs if revenues decline; a low ratio of fixed to variable cost is advisable			
Instruction	27.20%	25.52%	26.48%
Tuition discount, total, undergraduate	33.30%	35.33%	31.11%
Financial aid burden	25.50%	21.43%	21.15%
STATEMENT OF FINANCIAL POSITION RATIOS			
LIQUIDITY RATIOS - ability to continue to operate without taking on additional revenue			
Cash and investments to operations	75.40%	188.19%	172.90%
Unrestricted resources to operations	N/A	84.90%	82.08%
Expendable resources to operations	54.50%	101.26%	98.71%
Cash and investments to debt	151.70%	264.52%	392.28%
Unrestricted resources to debt	N/A	119.33%	186.22%
Expendable resources to debt	88.80%	142.33%	223.95%
DEBT RATIOS			
Total debt, including any current financing**	$55,019	$28,674	$17,544
Current debt service burden (advisable = less than 10%)	3.40%	3.27%	3.28%
Average age of plant	12.80	25.59	24.07
FULL-TIME EQUIVALENT MEASURES (Undergraduate only)			
Net tuition per FTE	N/A	$ 13,031	$ 13,297
Total operating revenue per FTE	N/A	$ 26,144	$ 23,725
Total operating expenses per FTE (all operating expenses)	N/A	$ 29,269	$ 27,005
Total outstanding debt per FTE	$ 18,088	$ 20,824	$ 11,903
Unrestricted resources per FTE	N/A	$ 24,848	$ 22,165
Expendable resources per FTE	N/A	$ 29,638	$ 26,370

* Median averages of private colleges and universities with a debt rating of "BBB" by Standard & Poor's: fiscal 2014 data (dated July 10, 2015)

** 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 Financial 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.

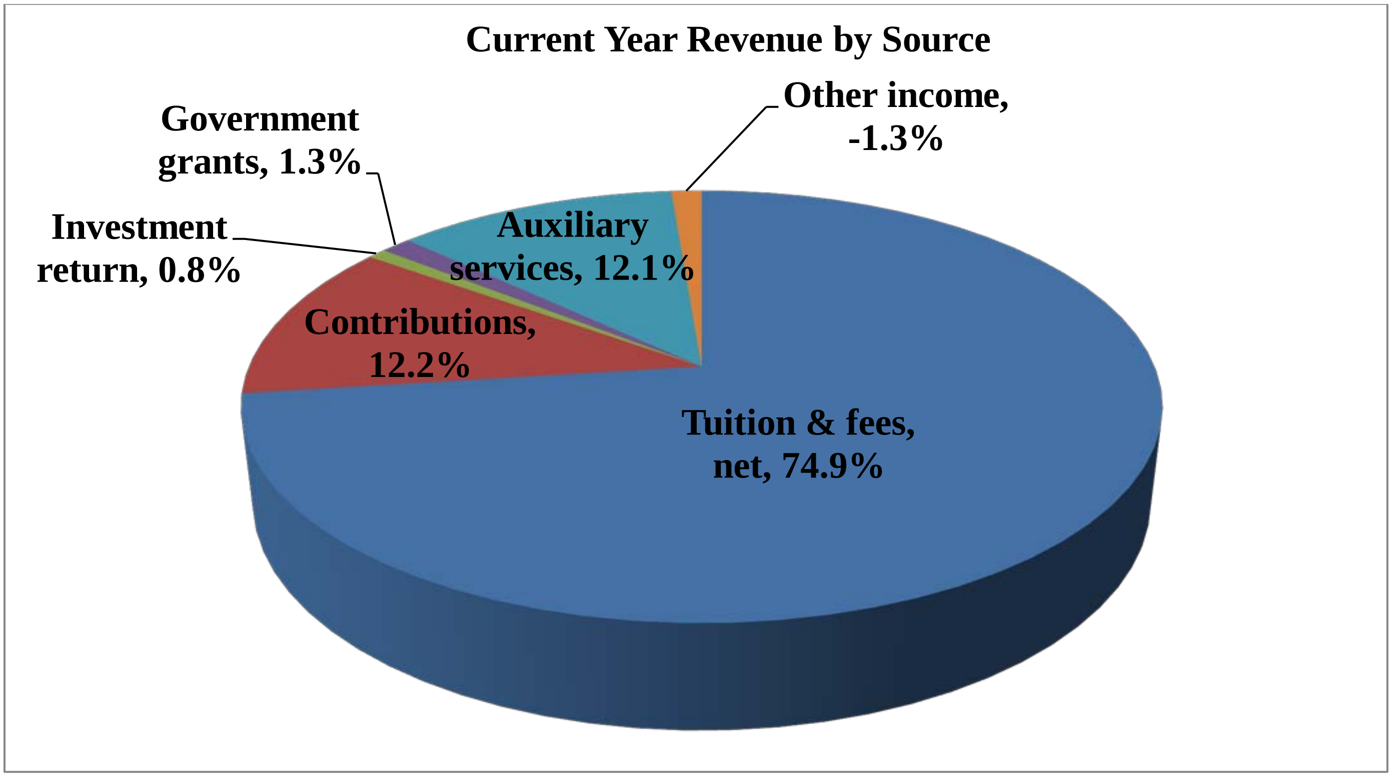
The CFI methodology presents a more complete picture of an institution's financial strengths and weaknesses (using a scale of –X to 10). Moreover, CFI assists institutions in understanding the affordability of their strategic plans and to monitor and evaluate the financial results of implementing those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

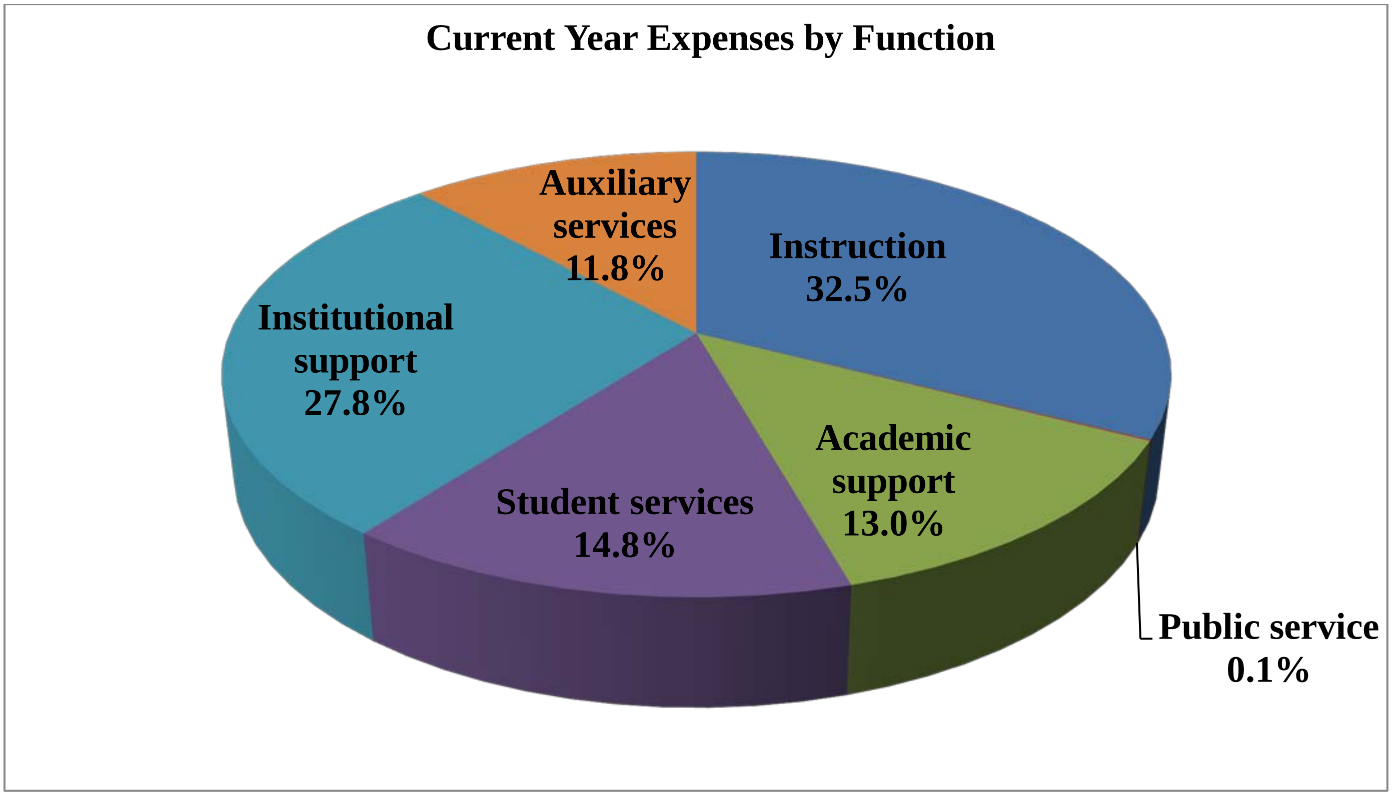
The Brown Edwards Top 10 group median for the ED Composite Score was 2.90 in 2015 and 3.00 in 2014.

Other Analysis

	Trinity College Current Year	Prior Year
Revenue Sources as a Percent of Total Revenues, Gains and Other Support		
Tuition & fees, net	74.9%	60.6%
Contributions	12.2%	24.2%
Investment income spent	2.1%	1.6%
Government grants	1.3%	0.6%
Auxiliary services	12.1%	7.7%
Other income	-1.2%	-0.2%
Investment total return retained	-1.3%	3.8%
Change in funds held in trust	-0.1%	1.7%
Total revenues, gains and other support	100.0%	100.0%
Fundraising ratio (cost of fundraising as a percent of total contributions)	15.8%	6.2%
Fundraising expense ratio (cost of fundraising as a percent of total expenses)	2.0%	2.2%
Functional Expenses as a Percent of Total Expenses		
Instruction	32.5%	33.5%
Public service	0.1%	0.1%
Academic support	13.0%	12.6%
Student services	14.8%	14.6%
Institutional support	27.8%	27.8%
Auxiliary services	11.8%	11.4%
Total operating expenses	100.0%	100.0%
Percent increase in operating expenses/FTE	8.0%	5.1%
Percent increase in operating expenses	0.9%	1.9%
CPI (July to June) *USDL-Bureau of Labor Statistics*	0.1%	2.1%
Higher Education PI (*Commonfund*) *(CY Preliminary Forecast)*	2.2%	3.0%
Auxiliary Services Net Margin	7.8%	-0.5%
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)	1.728	1.704
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)	0.687	0.767
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)	0.019	0.108
Strength Factor (Factor when Net Income ratio is positive)	1.967	3.000
Score (Strength Factor x 20%)	0.393	0.600
Composite Score (Sum of above ratios)	2.79	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


Current Year Revenue by Source
Government grants, 1.3%
Other income, -1.3%
Investment return, 0.8%
Auxiliary services, 12.1%
Contributions, 12.2%
Tuition & fees, net, 74.9%


Current Year Expenses by Function
Auxiliary services 11.8%
Instruction 32.5%
Institutional support 27.8%
Academic support 13.0%
Student services 14.8%
Public service 0.1%

THE STATE OF PRIVATE HIGHER EDUCATION

Some Good News in 2015 but the Pressures Continue

In July 2015, Moody's Investor Services (Moody's) revised its four-year outlook for U.S. higher education to stable from negative, where it had been since January 2013. The upgrade is based upon the view that, "the fundamental business, financial and economic conditions for the higher education sector will neither erode significantly nor improve materially over the next 12 to 18 months". Moreover, also in July 2015, Moody's published an in-depth analysis of private universities, and noted that, "most private universities benefited from moderate net tuition revenue growth, strong investment returns and strengthening philanthropic support in fiscal year (FY) 2014". However, while stresses have moderated to a degree, concern continues to exist surrounding colleges and universities' abilities to maintain desired enrollment while continuing to grow net tuition revenue, anticipated weaker investment returns for FY 2015 and increased deferred maintenance for a material number of colleges and universities. Moody's suggests that while the outlook could change to positive with a significant acceleration in the rate of economic recovery, it also could turn negative if "aggregate revenue growth is projected to decline to below 3%, subject to changes in the inflationary environment".

The bottom line is that while there is some good news in 2015, small, private colleges and universities must continue to change to ensure financial sustainability.

What are the Major Pressures?

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 stay nimble enough to ride through the continuing economic pressures, institutions must remain in tune with several key issues of the day. In 2015, seven key issues demand emphasis, some of which are obviously carried over from prior years: 1) assessing effectiveness and value, 2) financial sustainability, 3) enrollment and net tuition trends, 4) student demographics, 5) increasing stress on governance, 6) continuation of the digital revolution in higher education and 7) other significant pressures such as addressing deferred maintenance and competing for gift revenue.

1. **Shifting from "Is College Worth It?" to Assessing Effectiveness** – Value always comes into question when consumers make large purchases, and looms even larger during any recession. This fundamental concept was extremely important during the Great Recession and continues today. A college education is a major purchase to most and, accordingly, policy makers, educational leaders, parents, and students themselves have become very interested in assessing the value, or the effectiveness of educational outcomes. In addition to the typical question *is college worth it*, constituents are asking more pointed questions, such as are institutions doing their job as effectively as possible? Stated another way, are consumers getting value commensurate to their cost and investment?

   Only 31.5 percent of adults say that college is worth the cost, according to Scott Jaschik's article *Mixed Views of Higher Ed* in the March 10, 2014, edition of Inside Higher Ed. However, specifically related to financial returns, the Brookings Institution's research reflects that the increases in student borrowing over the past two decades to earn their Bachelors' degrees resulted in increases in graduates' lifetime earnings, contrary to the stagnant level of wages in the broader economy. However, while such financial metrics are easy to measure, the public is asking for other evidence that college is worth it—they are asking to see proof that colleges and universities are performing effectively. The public, as well as policymakers and educational leaders are demanding evaluation of the questions listed above and expects to see demonstration of the related outcomes.

Some Good News in 2015 but the Pressures Continue (Continued)

What are the Major Pressures? (Continued)

Not only is the general public asking such questions – ***President Obama's college ratings system*** remains a priority for his administration. President Obama notes *we're creating a new college ratings system that will give parents and students the kind of clear, concise information [they] need to shop around for a school with the best value for a great education at a reasonable price*. Some uncertainty exists as to whether this ratings system will be produced. Officials have suggested that they will issue the first set of ratings by the beginning of the 2015-16 school year; however, Congress has not provided the $10 million requested to create the ratings, and some lawmakers continue to seek blocking the creation of the ratings system.

State governments also are scrutinizing higher education. In 2012, Virginia 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 the outcome of starting salary. ***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.

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.

In addition to answering outcome questions that the public is asking, ***institutions are demanding internal performance measurement***. Some industry experts suggest that, through institutional cost management models, institutions should be analyzing data from across internal systems to answer questions such as – Which programs and courses are unsustainable? Which courses/programs are running at a loss? What is the minimum number of students needed for a course/program to break even? What is the optimal class size? How much does it really cost to educate a student? How are institutional facilities being utilized? Does spare capacity exist? If so, where? On a course or program basis, what are the effects of changing student-to-staff ratios in support of learner-centered initiatives? What is the sustainable balance of the ratio of full-time to adjunct faculty, given effectiveness standards and accreditation requirements? What are the impacts of changes to academic offerings (courses and programs) on both faculty and staff support requirements, as well as overall university financial sustainability? Where can the institution grow to utilize its existing resources? Will the cost of expanding capacity be met by growth in revenue/margin?

Some Good News in 2015 but the Pressures Continue (Continued)

<u>What are the Major Pressures</u>? (Continued)

2. **Financial Sustainability** – Both *college and university management and governing boards list fiscal sustainability as the single most important area upon which they must focus currently. Institutions' chief financial officers believe that higher education currently is in a financial crisis, and according to a recent survey by Inside Higher Ed, less than 25 percent of business officers strongly express confidence in the sustainability of their institution's finances over the next five years.* Certainly recent college closings or the announcement of closings, especially close to home in Virginia (St. Paul's and Virginia Intermont) as well as the recent legal battle to keep Sweet Briar open after having previously announced a closing, have heightened awareness, if not concern, about the issues surrounding financial sustainability of small private higher education institutions. In April 2015, Moody's in-depth analysis of the higher education sector focused specifically on Sweet Briar College's announcement that it would close after the 2014-15 academic year and identified the key challenges facing Sweet Briar and other small private institutions:

   - <u>Small scale</u> – Colleges with low operating revenues have limited flexibility to adjust to either decreases in revenue sources, increases in cost structure, or emergency spending needs.

   - <u>Weakening demand</u> – Higher education institutions with relatively small enrollments, limited program offerings, a significant liberal arts orientation, and a rural location are especially vulnerable to decreasing demand. Even when applications might increase, weakening demand may become evident in reduced yield on accepted students, as well as low retention rates.

   - <u>Declining pricing flexibility</u> – Small scale and weakening demand only exacerbate the decline in pricing flexibility at colleges. Pricing flexibility is measured most clearly by net tuition revenue. For those institutions deriving a high percentage of their operating revenue from student-related charges, smaller enrollment typically means less revenue. To attempt to turn enrollment trends in a positive direction, institutions often find themselves having to offer increasing amounts of scholarships. Higher amounts of scholarships, if funded through the operating budget (that is, unfunded, rather than scholarships funded with gifts and/or endowment returns), means less net revenue per student. If the increased discounting does not generate enough incremental students to offset the increased tuition discount, institutions may find themselves in a vicious negative cycle of less and less net revenue and significantly diminished pricing flexibility.

Some Good News in 2015 but the Pressures Continue (Continued)

<u>What are the Major Pressures</u>? (Continued)

- <u>Insufficient endowment</u> – The two major sources of revenue for small private colleges are student-related charges (tuition, room, board, fees, and bookstore sales) and gifts. Gifts primarily include annual gifts, whether unrestricted or restricted for specific purposes, and endowment gifts. An endowment is critical to enhancing long-term financial stability, especially for those institutions dealing with one or more of the issues noted above (small scale, weakening demand, declining pricing flexibility). An endowment may allow an institution to release accumulated reserves and make extraordinary draws on occasion, to weather short-term financial stress. Without such a safety net, options for survival may be difficult to identify when too many performance indicators have turned negative.

In June 2015, the alumnae and supporters of Sweet Briar won a reprieve when a judge approved a deal in which alumnae pumped $5 million into the school to keep it open, with pledges for another $7 million to be delivered by early September. Additionally, $16 million (17% of the estimated $94 million endowment fund) will be released from the endowment to support operations. A new management team was hired, including a new President who stated in an interview that "targets for putting Sweet Briar on a solid footing are an enrollment of 800 students and limiting endowment drawdown to 5% a year". **To put this in perspective, current enrollment for the fall term is estimated at 300 students and the endowment draw for FY 2014 was 12%**.

3. **Enrollment and Net Tuition Trends** – Since it is key to institutional financial health, the focus has been on enrollment management issues. Moody's projects that the U.S. supply of students will level off over the next several years. Moody's estimates reflect that, while the South will see more high school graduates over the next several years, the Northeast, Midwest, and West will see little to no growth in the number of high school graduates – as a function of overall population demographics. The five-year enrollment trends support this projection as well. In the July 2015 in-depth analysis, Moody's highlights the divergence in enrollment pressures contributes to the net tuition revenue divergence. "Institutions that rely less on tuition revenue have been able to command more pricing power than the institutions that need it most. ***Baa-rated privates suffered a 1.4% decline in enrollment over the last five years***, while Aa-rated privates grew enrollment by 2.3%....Nearly 50% of privates in the Midwest and Northeast experienced enrollment declines over the last five years, compared to enrollment declines at approximately 30% of privates in the South and West." And, on the international front, the student market has become increasingly competitive as well.

The U.S. Department of Education's (USDE's) projections are consistent with those of Moody's regarding the supply of undergraduate students into the pipeline. The USDE projects only very slight growth in Bachelor's degrees conferred over the next six to eight years. Some positive news is the Department's projection in the number of Master's degrees conferred over the next eight years – a growth rate of over 20 percent. However, the USDE's National Center for Education Statistics, in the publication Projections of Education Statistics to 2021, notes that, while total enrollment increased 46 percent from 1996 to 2010, it is projected to increase only 15 percent from 2010 to 2021.

Some Good News in 2015 but the Pressures Continue (Continued)

<u>What are the Major Pressures</u>? (Continued)

As for pricing, Moody's reports that household balance sheets have improved, so families are more willing to invest in higher education than they have been in recent years. Household debt to personal disposable income has fallen from around 130 percent in 2007-08, to just above 100 percent in 2013-14. However, families are concerned to see tuition increases above inflationary increases – especially after students have invested in their first year or two of college. With society's having become more mobile and less loyal to brands, etc., families/students do not think twice before considering transferring from one institution to another – or even to dropping out of college for a time, if they become concerned about tuition increases.

Also, the competition from community colleges has become fierce. The National Center for Education Statistics reports that, as of fall 2012, community colleges enroll nearly 40 percent of undergraduates, and another one percent is enrolled at other two-year institutions. The rest of the mix for the over 18 million enrolled higher education students in fall 2012 is: 37 percent for four-year public institutions, 15 percent for four-year not-for-profit institutions, and 7 percent for four-year for-profit institutions. The U.S. Department of Education projects over 30 percent growth in the number of Associates degrees conferred over the next eight years.

As the supply of students to colleges and universities tightens, institutions continue to intensify their battle to woo students based on net cost—that is, providing prestigious scholarship packages. Moody's reported in its July 2015 in-depth analysis that while FY 2014 was the first year that median revenue growth exceeded median expense growth since FY 2011, "nearly 19% of rated private universities suffered a revenue decline in FY 2014, mostly A- and Baa- rated institutions".

In her June 2015 presentation at Brown Edwards Higher Education and Not-for-profit Conference, Patricia McGuire, President of Trinity Washington University remarked: *beware of "big fix" promises. Some of the most dangerous ideas out there urge institutions to drive up their discount rates as a means to build enrollment, believing that volume will level [or grow] the net tuition results; this is a dangerous strategy, not a well-considered risk! We can't buy our way out of the enrollment problem; we have to build the solutions through effective institutional change.*

4. **Student Demographics** – Student demographics continue to reflect a growing intensity in students' desire for institutions to be all things to all people – offer everything that a discerning student might want. So, while fundamental demand for a college education is high (as reported by Moody's), colleges see demand continuing to weaken for small, private, rural higher education institutions – especially those niche colleges, such as all female or all male institutions – simply because these colleges find keeping up with student desires too expensive to afford.

Some Good News in 2015 but the Pressures Continue (Continued)

What are the Major Pressures? (Continued)

Also, students continue to gradually move away from the onsite in-person delivery of education to the anytime online model. They desire the flexibility and portability that online education offers, regardless of the complexity that this mode brings to the institutional providers. The Babson Survey Research Group's 2014 survey of online learning, Grade Level: Tracking Online Education in the United States shows that the number of higher education students taking at least one distance education course in 2014 was up 3.7 percent from 2013. The study's co-author, Jeff Seaman, notes that *the study's findings point to a competitive marketplace, in which traditional institutions are gaining ground on the for-profits in online and distance education. While the rapid pace of online learning growth has moderated, it still accounts for nearly three-quarters of all U.S. higher education's enrollment increases last year.*

As mentioned earlier in this article, Moody's projects that the U.S. supply of students will level off over the next several years. However, the USDE's National Center for Education Statistics, in the publication Projections of Education Statistics to 2021, notes that ***certain races/ethnicities will increase rather significantly between 2010 and 2021 – enrollment of U.S. residents is projected to increase 25 percent for Black students, 42 percent for Hispanic students, and 20 percent for Asian/Pacific Islander students.***

Nontraditional students are comprising more and more of those earning higher education degrees. In the July 6, 2013, Wall Street Journal, in his article *Number of the Week: Nontraditional Students are Majority on College Campuses*, Ben Casselman reported that nontraditional students account for nearly 70 percent of all U.S. undergraduates. The traditional student generally earns an undergraduate degree in four years, lives on campus, and participates in campus-based extracurricular student activities. ***But now the nontraditional student is the new normal.*** These students come from a variety of backgrounds and experiences leading them to new models of higher education; they often already have some higher education experience; they cannot afford to pay for a four-year degree; they must work full- or part-time; and their extracurricular activities are life responsibilities, like raising a family.

5. **Additional Stresses on Governance** – Declining confidence by the public and financial pressures will place additional stresses on governing bodies as never before. The need for a strong internal governance structure at institutions has become critical. The governance structure, including from the Board to institutional administrative leadership to academic and programmatic hierarchies is being held accountable by constituents to evaluate all risks to the college or university – an enterprise risk management model. Constituents are expecting institutions to take visible action steps leading to measurable and sustainable institutional progress. The public demands that institutional governance structures prevent, mitigate, and/or respond to reputational threats such as sexual assault incidents; race, gender, sexual orientation, church relations, and other identity/mission issues; negative athletics images; child protection concerns; academic fraud/poor academic measures; and federal review results/news rankings.

Some Good News in 2015 but the Pressures Continue (Continued)

What are the Major Pressures? (Continued)

6. **Continuation of the Digital Revolution in Higher Education** – Changes in technology affecting higher education continue to occur, steadily and with much variety. Some advances of which to be aware and in which to participate include:

   - Data mining and analytics – Colleges and universities are storing and using data to measure student learning and progress more and more. They also are using data analysis to help predict whether prospective students will be successful. And, institutions are linking data from internal systems, such as general ledger, facilities, human resources, student records, and course schedules, to implement university cost management models (UCMMs), to better guide decisions that will enhance institutional financial performance.

   - Digital media education delivery – Varied technology-assisted methods exist for higher education institutions to use in teaching their students. These methods include online delivery of courses to a myriad of mobile devices (laptops, tablets, and even cellular phones), enhanced learning management systems, smart classrooms, and various digital collaboration tools allowing students and faculty to collaborate just about anywhere face-to-face – virtually.

   - New technology devices and software – The pace of developing new technology continues to be steady. Some recent innovations include data-feeding sensors, 3D printers, and smart buildings.

   - Automation of processes – Colleges and universities continue to identify ways to enhance operating efficiency by automating processes. Examples include online distribution of materials, reports, documents, etc.; electronic timekeeping for employees; digitized document storage; e-procurement/payment; and consolidation of technology (e.g., desktop printers). Additional technology efficiencies include outsourcing technology infrastructure (e.g., servers) and system hosting services (email service, software applications – 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.

   How all this activity translates into ongoing, future strategies for institutions isn't entirely clear now, but there is no doubt it will have some kind of significant impact.

Some Good News in 2015 but the Pressures Continue (Continued)

<u>What are the Major Pressures</u>? (Continued)

7. Other Significant Pressures

- ***Deferred Maintenance*** – Colleges and universities continue to worry about the deferred maintenance on their facilities. A report by *The Chronicle of Higher Education* notes that institutions have neglected facilities maintenance during the economic difficulties of the past five years. Sightlines 2014 annual report on facilities documents the growing backlog of deferred maintenance at colleges and universities. *We were moving in the right direction, especially in private colleges and universities, until about five years ago*, says Lander Medlin, executive vice president of APPA, the association serving educational facilities professionals. The periodical College Planning and Management reports that the deferred maintenance backlog on college campuses increased 15 percent from 2007 to 2012, as a result of both aging campus facilities and reduced spending on maintaining facilities.

  To fund deferred maintenance backlogs, institutions are taking various approaches, such as performance contracting, lease-purchase arrangements, maintenance tax note funding (public institutions), implementation of or increases in student building use fees or parking fees, and monetizing assets (e.g., selling valuable collections or real estate, if not prohibited by donor or other restrictions). To assist colleges and universities in prioritizing deferred maintenance projects, industry associations such as APPA have developed a benchmark, the Facility Condition Index (FCI), which is the ratio of deferred maintenance dollars to replacement dollars. That is, FCI is calculated by dividing the total estimated cost of deferred maintenance projects for a specific building by its estimated replacement value – the lower the FCI, the lower the need for remedial or renewal funding relative to the facility's value. And, institutional actions to address deferred maintenance include hiring third-party maintenance providers, implementing/utilizing computerized maintenance systems, standardizing materials/parts/tools, and obtaining appropriate training for maintenance crews.

Some Good News in 2015 but the Pressures Continue (Continued)

What are the Major Pressures? (Continued)

- ***Gift Revenue*** – Recent equity market returns have been stronger than several years back. While more positive returns bolster fundraising potential and generate investment returns, gift fundraising has become extremely competitive. The Giving USA Foundation reports that, in 2013 Americans donated a record amount to education, estimating that 60 percent of contributions to education went to higher education. This report, however, notes a couple of concerns relative to higher education donations. First, other charitable "industries" also are seeing increases in donations, competing strongly for donor dollars. These philanthropic organizations include those in the arts, those related to environmental causes, and health organizations – while food pantries and homeless shelters continue to hold their own in receiving donations. A second concern noted in The Giving USA Foundation report is that the Council for Aid to Education's Voluntary Support of Education Survey reflects that the fraction of alumni supporting their alma maters with contributions is at an historic low. Therefore, colleges and universities are relying more on a smaller number of wealthy donors. John Lippincott, president of the Council for Advancement and Support of Education, notes that the smaller number of alumni donors is a function of the growing income gap between the very wealthy and the middle and lower economic classes, adding that student debt discourages new alumni from donating to their alma maters. Moody's highlights another issue regarding contributions, of concern to smaller private institutions – that the wealthier universities are receiving a growing share of gifts. Specifically, Moody's data shows the following:

SOURCE: Moody's Investors Service

Endowment Ranges for Private Institutions	Percentage of Total Gift Revenue for Private Institutions 2003	2013
Endowment less than $100 million	3.1%	2.5%
Endowment between $100 million and $500 million	19.8%	16.6%
Endowment between $500 million and $1 billion	15.2%	13.9%
Endowment greater than $1 billion	61.8%	67.0%

Like almost all industries, higher education continues to be faced with a myriad of pressures. Each of these pressures is formidable and represents a considerable challenge. However, if you look at these challenges as "the glass is half full", they are also opportunities to adapt, improve overall institutional value, and even prosper. Financial sustainability and prosperity will mean continual change and adapting to the new realities of doing business.

Some Good News in 2015 but the Pressures Continue (Continued)

What Tactics Might Colleges Consider to Ensure Financial Sustainability?

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 continue to 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.

- **Provide facts to support the answers to questions about worthiness and effectiveness**, including indicators such as course completion rates, average time to degree completion, student transfer rates, number of degrees awarded, number of low-income and minority graduates, institutional cost per degree granted, student cost per degree earned, student debt ratios, job placement rate, career preparedness, average starting salary by degree, and student satisfaction.

- **Continue to stress the long-term value of postsecondary degrees** – especially higher income earning potential and lower unemployment rates. Bureau of Labor Statistics data reflects that, after increasing for several years, the unemployment rate for 25-34 year olds is declining. In this environment, stressing the value of postsecondary degrees is important:

Bureau of Labor Statistics, Current Population Survey (Rounded)

	Earnings			Unemployment Rate		
	2007	**2011**	**2014**	**2007**	**2011**	**2014**
High School	$31,000	$32,000	$35,000	4.5%	9.0%	6.0%
Bachelor's	$51,000	$55,000	$57,000	1.8%	4.6%	3.5%
Master's	$55,000	$65,000	$69,000	1.5%	3.8%	2.8%
Doctoral	$60,000	$80,000	$83,000	1.0%	2.8%	2.1%

Some Good News in 2015 but the Pressures Continue (Continued)

<u>What Tactics Might Colleges Consider to Ensure Financial Sustainability</u>? (Continued)

- **Focus on higher education's broad scope when seeking contributions, while evaluating and tweaking fundraising strategies.** By giving to colleges and universities, donors are investing in a myriad of good causes, including medical research, arts and culture, social mobility, economic development, and many other worthwhile opportunities. John Lippincott, president of the Council for Advancement and Support of Education, notes that, *as a sector there is this breadth of solutions that universities and colleges provide that can appeal to a very broad array of donors.* Some fundraising strategies to consider include 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.

- **Partner with other academic institutions – colleges/universities and high schools**. Shared services among colleges can bring economies of scale that individual institutions cannot achieve alone, reducing duplication of administrative functions and generating efficiencies. Recent efforts among colleges to share services show that non-academic services are those typically evaluated first to combine among institutions (e.g., financial, technology, facilities, human resources, purchasing, fundraising, and internal audit). Stony Brook University's Senate Administrative Review Committee in 2012 recommends that information dissemination and transparency are very helpful to the success of sharing services.

  When moving to share academic services, colleges and universities might consider financial incentives and work through the governance structure to focus on cooperative implementation (i.e., allow departmental control over the pace and scope of implementation). Benefits of sharing academic programs include leveraging the academic strengths of specific institutions and, of course, focusing scarce resources on areas of distinction at those campuses that have strong reputations in certain program areas. Another aspect of sharing academic programs is to co-locate – that is, perhaps have a community college and regional private college offer each other's programs at both campuses. Academic synergies may be developed jointly through such an arrangement that might involve dual enrollment programs and joint bachelor/master programs.

  Partnering with local high schools also can be beneficial to colleges and universities. 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.

Some Good News in 2015 but the Pressures Continue (Continued)

<u>What Tactics Might Colleges Consider to Ensure Financial Sustainability</u>? (Continued)

- **Partner with corporate entities for education delivery**. Industry and higher education continue to identify synergies in working together to develop the workforce necessary to ensure business competiveness and enhance economic development. While the focus of such partnerships tends to be on community colleges, private colleges and universities also are positioned to deliver education in a "real world" fashion, to provide the technical knowledge, business acumen, and creativity required of employees to add value to their organizations. Considering partnerships with corporate entities for education delivery becomes more important as the employment outlook for 25 to 34 year olds is slowly improving. From a recent high point of around 10 percent, the 2014 unemployment rate of 25 to 34 year olds has reduced to below 7 percent. Institutions may consider specific discounted tuition pricing for these arrangements, and the steady supply of students into the pipeline and the local/regional positive public relations often is worth the price break. In working with corporate entities to offer outcomes-based programs, colleges still can base the programs on a strong liberal arts foundation. Programs particularly relevant to the current demands of the corporate sector are: health professions, STEM programs, psychology and counseling, communications, criminal justice, and business.

  In looking at college partnerships with the private sector, Carrie B. Kisker and Rozanna Carducci note various success factors for the success of such partnerships:

  - Recognize a local/regional economic development challenge that calls for collaborative attention
  - Establish a shared mission and goals
  - Ensure that value is achieved for all partners (including students)
  - Have strong executive leadership from both the college and industry participants
  - Develop governance and accountability mechanisms.

- **Increase online offerings** – which might mean actually reducing investments in student services and capital facilities and reducing the cost of course delivery. While demand most likely will always exist for the traditional onsite model of higher education – even with the use of technology to complement the classroom experience, an online presence can minimize geographic campus constraints – in recruiting both students and faculty. Online market opportunities include specific distance learning programs, degree completion offerings, hybrid classes, fully online degrees, and Massive Online Open Courses (MOOCs). 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). Moving into or increasing online offerings can be challenging, particularly as it relates to faculty acceptance, student retention rates, and past stigma of online education (brand dilution, learning outcomes). However, as demand grows for online delivery, other institutions certainly are stepping up to the plate.

Some Good News in 2015 but the Pressures Continue (Continued)

What Tactics Might Colleges Consider to Ensure Financial Sustainability? (Continued)

- **Offer graduate degrees –** Projecting a flattening in the number of students pursuing Bachelor's degrees over the next eight years, the U.S. Department of Education projects significant growth in the Master's degree market **–** of over 20 percent. Moving into the graduate arena can be daunting and requires resources. However, if an institution can play to a few programs in which it already has a strong reputation, finding start-up donor support and then identifying a supply of students can be successful.

- **Offer competency-based degrees –** Competency-based learning is gaining some traction and is being addressed by accrediting agencies. Inside Higher Ed reports that Lipscomb University was the first Southern Association of Colleges and Schools Commission on Colleges (SACS COC) institution to apply for approval of a competency-based program. Belle Wheelan, president of SACS COC, notes that, since Lipscomb's program was approved, four additional SACS COC colleges have requested approval of competency-based learning programs. Meanwhile, SACS COC has developed a policy statement, **Direct Assessment [for] Competency-Based Educational Programs**. The policy statement introduces competency-based learning: *In recent years, some institutions have recognized the potential of innovative learning models and have developed creative programs that allow students the flexibility to learn at the pace that makes sense for them, both in career-technical and degree programs. Students progress in these programs by demonstrating their achievement of specific skills or knowledge. These programs, commonly called competency-based programs, fit into traditional learning models that measure progress in credit or clock hours, but increasing numbers do not. Direct assessment competency-based educational programs use the direct assessment of student learning in lieu of measuring student learning in credit or clock hours*. Accrediting agencies will evaluate competency-based programs in three primary areas (similar to those of traditional programs): methods of assessment, qualification and role of faculty, and student supports.

- **Ensure that students graduate in four years (or less!) – and that they are financially literate**. 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 expedite graduation is critical. 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.

- **Focus on financial sustainability enhancements**, which might include:

  - **Reevaluating the traditional higher education cost structure**, considering all areas, including faculty salaries, shared governance, classroom instruction, and student services. 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 and/or consolidation/integration of general education and overlapping courses across curricula.

Some Good News in 2015 but the Pressures Continue (Continued)

What Tactics Might Colleges Consider to Ensure Financial Sustainability? (Continued)

- **Evaluating 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.

- **Managing cash flow tightly**, including maintenance of cash reserves. Consider having a line of credit available, even it is never used – especially in light of potential delays in release of federal (and state) funds, not to mention slower payment by individuals.

- **Managing 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.

- **Commercializing intellectual property**, encouraging, and supporting faculty to be innovative in their research pursuits, even at the smaller colleges and universities.

- **Identifying 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).

- **Evaluate endowment policies**. As the investment markets have improved, 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.

Financial Outlook in Key Economic Areas

Various indicators specifically relevant to the overall economy are helpful to review as colleges and universities attempt to address the challenges before them. Much of this data has been sourced from Wells Fargo Securities Economics Group and Kiplinger. However, keep in mind economic data and expectations can change quickly and dramatically. A good example is what a difference a week makes – in the latter part of August, the financial markets were "whipsawed" with the equity markets dropping more than 10 percent in just four trading sessions. In the subsequent week, roughly half of those losses were recouped and the panic abated.

Despite weak first half 2015 reports, many economists are predicting that the outlook for the U.S. economy for the remainder of 2015 is more positive – but that markets may be a bit unstable. Kiplinger's August 2015 Economic Outlooks presents the following:

GDP Up to 3% - 3.5% in the second-half 2015; 2.5% for the calendar year	**Unemployment** Falling to 5.1% by end 2015
Interest rates By end '15, 10-year T-notes at 2.3%; mortgages, 4.1%	**Inflation** 1.4% for calendar '15, up from 0.8% in 2014
Business spending Increasing by 4% in calendar 2015, vs. 5% in 2014	**Energy** Crude oil trading from $40 to $45/bbl. by December
Housing Single-family starts rising 12% in second half of 2015	**Retail sales** Up 4.5% calendar 2015, excluding gasoline sales
Trade deficit Widening by 5% in calendar 2015	

- Fears that China's economy (the second largest in the world) is continuing to slow and is much weaker than previously reported rattled the financial markets; however, economic data released continues to show that the U.S. economy is on solid footing. Big questions are a) will the market volatility impact the overall economy and b) will the volatility impact the Federal Reserve's decision to raise rates later this year.

- The new reality appears to be that 2 percent economic growth, a pace that used to be thought of as weak, is now considered strong enough to remove excess slack in the labor market. Expectations must be recalibrated since data indicates that the real GDP has averaged just 2.1 percent since the Great Recession ended six years ago.

- GDP will increase at a rate of up to 2.5 percent for the calendar year 2015, fueled by strong consumer spending along with a ramping up of construction activity, including home building. Kiplinger noted the biggest drag on growth going forward is exports which will continue to be hampered by the strong U.S. dollar.

- Continuing job gains, growth in consumer incomes, and lower gasoline prices will encourage the purchase of homes, cars, and other products and services.

- Wage pressure is building slowly, but 2016 should show a more noticeable pickup.

Financial Outlook in Key Economic Areas (Continued)

- **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 3.7 percent in the second quarter of 2015 and is expected to be strong in the remaining quarters of 2015, to result in total GDP growth for calendar 2015 of up to 2.5 percent and slightly higher than that for 2016.

- **Inflation** – Economists note that inflation appears to be fairly stable. Overall inflation for the 12-month period ended June 30, 2015, (as measured by the Consumer Price Index for All Urban Consumers – CPI-U) was 0.1 percent before seasonal adjustment. Economists forecast that inflation will remain low for 2015, at less than 1.0 percent. Current key factors predicted to continue to keep inflation low are oil prices, the strong U.S. dollar, and a continuation of only moderate wage increases. The greatest risks of higher prices currently are predicted to be in medical services, shelter/housing, and college tuition. Some volatility may occur in food and energy costs.

- **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 2014 was 6.2 percent. The outlook is that the unemployment rate will drop as low as 5.0 percent by the end of calendar year 2015 and will remain there at the end of 2016.

- **Consumer Income/Spending Growth –** The consumer is the most critical driver of U.S. economic growth, accounting for approximately 68 percent of gross domestic product (GDP), and currently is the bright spot in the economic data. Continued gains in jobs over the past two years have resulted in a falling unemployment rate. Stronger job and income growth along with rising home prices and higher equity prices have boosted household finances. As noted in Kiplinger, the housing market is in for a good year and will become a more important driver in the coming quarters. Home sales and new home construction provide support not only to manufacturers of building products and furnishings, but also to a whole host of services ranging from mortgages and insurance to lawn care and pest control.

- **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. 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. An index of 90 indicates a healthy economy.

  The Conference Board Consumer Confidence Index, declined sharply in July to 90.9 (1985=100), following a gain to 99.8 in June but then rebounded to 101.5 in August. Consumers continue to assess current conditions favorably due to an optimistic outlook for the labor market. However, it is important to note that the August index was taken before the recent equity market volatility. *Overall, the Index remains at levels associated with an expanding economy and a relatively confident consumer*.

Financial Outlook in Key Economic Areas (Continued)

- **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 sixty-year low, 3.25 percent, since January 2009, having begun its current descent from 8.25 percent in September 2007. (Prior to this, 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 July 2015 meeting, the Federal Open Market Committee (FOMC) held short-term interest rates at their current levels and stated that, *the Committee anticipates that it will be appropriate to raise the target range for the federal funds rate when it has seen some further improvement in the labor market and is reasonably confident that inflation will move back to its 2 percent objective over the medium term*. Predictions are that the prime rate may increase to 3.5 percent in September 2015, creeping up to perhaps 3.75 percent by December 2015 – but similar predictions have been made for the past couple of years as well, with no movement. Also as previously noted, it is not known what the recent equity market volatility will have on any decisions to begin the interest rate increases.

- **Equity and Fixed Income Markets** – The bull market continued in 2014, although volatility increased in late 2014. Market analysts predict that volatility will continue and most likely increase in 2015 (as it did in late August). Prophetically, predictions have indicated that 2015 would be the year of market adjustment, where the market will move less as a whole as sectors and stocks move in their own directions. Kiplinger suggests that *returns will depend on selecting the right companies in the right markets, rather than relying on a broad-based approach*. Gary Pzegeo, of Atlantic Trust Private Wealth Management, predicts *a lower return trajectory, a bumpier ride, and a narrower advance, with more companies getting left behind*.

- **Global Economy, Specifically Greece, China, and Iran –** Uncertainty is never a good ingredient for economic growth and while the Greek problem has been serious, it appears to be over for now. However, Greece is not the only, or even the most concerning uncertainty that exists. Slowing growth in China's economy, the recent collapse of the Chinese stock market, and the efforts from the Chinese government to stabilize the market are causing more significant concern. Furthermore, the pending nuclear deal with Iran is increasing speculation surrounding the future price of oil already at about $40 per barrel. The global economy will welcome any reduction in uncertainty in any of these arenas.

Financial Outlook in Key Economic Areas (Continued)

Below are some well-known market indices for the **one-year and three-year periods ended June 30, 2015**:

	Annualized Returns	
	One-Year	**Three-Year**
Domestic Equities		
S&P 500	7.4%	17.3%
Russell 1000 *(Large Cap)*	7.4%	17.7%
Russell Midcap	6.6%	19.3%
Russell 2000 *(Small Cap)*	6.5%	17.8%
Russell 3000 *(All Cap)*	7.3%	17.7%
Dow Jones Industrials	7.2%	13.8%
NASDAQ Composite	14.4%	20.9%
International & Emerging Markets Equities		
MSCI EAFE International Index	-4.2%	12.0%
MSCI Emerging Markets Index	-4.8%	4.1%
Fixed Income		
Barclays U.S. Aggregate Bond Index	1.9%	1.8%
Citigroup World Govt Bond Index	-9.0%	-2.4%
Barclays Capital U.S. TIPS Index	-1.7%	-0.8%
Bank of America Merrill Lynch 91-Day T-Bills	0.0%	0.1%
Alternatives		
HFRI Fund of Funds Composite Index	3.9%	6.2%
FTSE NAREIT Equity REIT	11.1%	11.2%
Traditional Benchmarks		
60% S&P 500/40% Barclays Aggregate Bond Index	5.2%	11.1%
70% S&P 500/30% Barclays Aggregate Bond Index	5.8%	12.7%

Financial Outlook in Key Economic Areas (Continued)

- **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). Commonfund also calculates HEPI 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 Forecast FY 2015	Official FY 2014	Official FY 2013	Official FY 2012	Official FY 2011
Faculty salaries	35%	2.2%	2.2%	1.7%	1.8%	1.4%
Administrative salaries	11%	4.2%	1.1%	2.9%	2.7%	1.7%
Clerical salaries	18%	2.1%	1.9%	1.9%	1.7%	2.0%
Service employee salaries	8%	2.6%	1.1%	1.6%	1.1%	1.4%
Fringe benefits	13%	5.6%	4.8%	2.9%	1.8%	3.7%
Miscellaneous services	2%	2.1%	1.8%	1.8%	1.7%	1.8%
Supplies and materials	6%	-4.7%	11.2%	-11.7%	5.2%	8.2%
Utilities	7%	-12.6%	8.1%	2.0%	-4.9%	4.1%
HEPI (all institutions)	100%	**2.2%**	3.0%	1.6%	1.7%	2.3%
HEPI (private baccalaureate)		not yet avlbl	3.4%	2.2%	1.6%	1.9%
HEPI (private master's)		not yet avlbl	2.3%	2.3%	1.4%	1.8%
HEPI (South Atlantic)		not yet avlbl	5.1%	0.2%	1.2%	1.5%
		FYE (6/30/15)				
CPI (Consumer Price Index) - ***Official***		**0.1%**	2.1%	1.8%	1.7%	3.6%

(United States Department of Labor – Bureau of Labor Statistics)

Note:
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Other resources:

Various periodicals (particularly those related to higher education), including, in some cases, Internet links to articles and related research reports.

Various reports from Moody's Investors Services.

Various investment market, economic, and news websites, including those of Bureau of Labor Statistics, Bureau of Economic Analysis, The Conference Board, Commonfund, and various investment managers (with benchmark index returns).