

**District of Columbia
Howard University**

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Credit Profile

US\$286.900 mil rev bnds (Howard Univ) ser 2011A

Long Term Rating	A-/Stable	New
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US\$58.185 mil rev bnds (Howard Univ) ser 2011B

Long Term Rating	A-/Stable	New
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District of Columbia, District Of Columbia

Howard Univ, District Of Columbia

District of Columbia (Howard Univ) rev ref bnds ser 1998

District of Columbia (Howard University) (MBIA) (National) rev bnds ser 1998

Unenhanced Rating	A-(SPUR)/Stable	Downgraded
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Ratings Detail

Rationale

Standard & Poor's Ratings Services lowered its long-term rating and underlying rating (SPUR) to 'A-' from 'A' on the District of Columbia's series 1998, 2006A, and 2006B revenue bonds, issued for Howard University. We also assigned our 'A-' rating to the university's series 2011A and taxable series 2011B revenue bonds. The lowered rating is based on our view of the university's issuance of \$100 million of new debt, significant additional capital plans, and additional debt expected in several years. This rating action follows a downgrade to 'A' from A+' in October 2010.

The outlook is stable, reflecting our view of the significant improvement in operating performance achieved in fiscal 2010 by Howard's new management team, other strategic activity that we believe will bolster the university's long-term viability, and projected maintenance of positive operations into fiscals 2011 and 2012. Although we view fiscal 2010

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and projected fiscal 2011 operating performance positively, as well as this debt restructuring, the lower rating incorporates break-even operating margins in Howard's significant hospital operations, ongoing cash flow issues due to the timing of federal appropriations, significant long-term capital needs, additional debt plans, and still-pending strategic decisions relating to the hospital. These factors, in our view, leave management with less flexibility to execute its strategic plans.

The university has a liquidity provider for its series 2006B variable-rate demand bonds, which Standard & Poor's rates 'AAA/A-1' based on the application of our joint criteria methodology. The long-term component of the rating is based jointly (assuming low correlation) on the rating of the obligor, Howard University (A-) and the rating of the letter of credit provider (Bank of America N.A.). The short-term component of the rating is based solely on Bank of America N.A. Post-issuance, the university expects most of its outstanding bonds to be refunded, including the series 2006B bonds, and replaced with the serial fixed-rate series 2011A and 2011B bonds.

For the fiscal year ended June 30, 2010, Howard posted a \$4.2 million operating surplus (including both restricted and unrestricted revenues) based on generally accepted accounting principles (GAAP), which we consider an impressive feat by the new management team given the short period of time since the university posted significant operating deficits in fiscals 2009 and 2008. Management budgeted a \$30 million operating surplus in fiscal 2011, and reports that the budget is on track for another sizable surplus. The fiscal 2010 bottom-line change in unrestricted net assets (UNA) was negative \$57.2 million, which largely reflects pension and other postemployment benefit (OPEB) accruals. Resulting decreases in UNA — to \$191 million in 2010 from \$521 million at June 30, 2008 — led to a significant weakening in financial resource ratios for the rating category relative to both operating expenses and outstanding debt. When using cash and investments of \$490 million at the same time (some of which are restricted assets), however, we view resource ratios as more consistent with peer institutions. While we believe the new president and senior management team have made solid improvements in restoring balanced operating performance, significant challenges continue, including the university's aging facilities, bank liquidity requirements, and strategic hospital decisions. In our view, key drivers of the rating over the next few years will be management's success in achieving continued positive operating balances, restoring a healthy liquidity position without periodic reliance on lines of credit, resolving the long-term questions about the hospital, and implementing an extensive long-term facilities plan.

The 'A-' rating is supported by our view of Howard's:

- Unique niche as one of two federally chartered higher-education institutions and status as one of the most prestigious historic black higher-educational institutions in the U.S., as well as its impressive array of professional programs;
- Substantial and historically stable levels of federal operating support, which, at \$231 million in fiscal 2010 (and the current fiscal 2011), was 26% of adjusted fiscal 2010 operating revenues;
- Overall stable enrollment levels and good demand profile; and
- Manageable post-issuance debt burden for long-term debt of less than 4% of maximum annual debt service.

Partially offsetting credit factors include our view of:

- Financial resource ratios that we consider low for the rating category, with expendable resources (ER) of \$2.5 million as of June 30, 2010, that were equal to only 0.7% of pro forma debt and 0.3% of expenses. Cash and investments of \$490 million at the same time (which include restricted

investments but exclude accrued retirement liabilities) were stronger and more consistent with the rating category, equal to 55% of expenses and 129% of pro forma debt;

- Potentially significant capital needs and future debt plans, related to both the academic and medical operations; and
- Periodic liquidity stress, typically related to the timing of federal appropriation payments during federal budget continuing resolution cycles, resulting in the need of bank lines for liquidity.

Howard, founded in 1867, is a comprehensive private university located in Washington, D.C. and is one of the leading African-American higher-education institutions in the U.S. The university offers a broad range of undergraduate, graduate, and professional programs, including law, business, medicine, dentistry, pharmacy, engineering, and architecture. Howard also has a school of divinity. The university also owns and operates a teaching hospital, which in 2010 represented nearly 34% of consolidated operating revenues. Howard is unique as one of only two nonmilitary schools in the nation that are federally chartered (the other is Gallaudet University) and receive an ongoing direct appropriation from the federal government. As mandated by a 1928 congressional act, only an act of Congress can terminate Howard's annual appropriation. Howard also has a small research presence, and recorded \$34 million of research expenses in 2010.

The university's new president started in mid-2008 and has made significant management changes, including the installation of a new senior-level staff team. Initiatives include academic renewal and review as well as financial transparency with broader participation by all segments, and the university generated an operating surplus in fiscal 2010 and has budgeted for an even greater surplus in fiscal 2011, primarily from expense containments. The new chief financial officer (CFO), originally hired by the university as a consultant, now serves as CFO in a fiduciary role. Howard's board approved a strategic Academic Renewal Plan in January 2011, which over several years will close, reorganize, or restructure 71 existing academic programs. In the near term, the plan is not expected to contribute to expense reductions.

Proceeds of the fixed-rate series 2011A and 2011B revenue bonds will be used to refund or defease the 1998, 2006A, and 2006B bonds; provide \$100 million of new money for various capital projects; fund a debt service reserve fund; and pay the termination cost for one of the university's two swap contracts. The bonds essentially restructure Howard's outstanding debt.

Howard's outstanding debt at June 30, 2010, was \$222 million, including long-term debt, capital leases, and \$45 million of bank lines of credit. Post-issuance, debt is expected to total \$380 million, including various bank lines of credit. The university's various authorized bank lines of credit currently total \$65 million. The covenants on those bank lines (as well as on currently outstanding bonds) require the university to hold highly liquid investments, the amount of which will ramp up to \$50 million by Dec. 31, 2011. The university expects to restructure those lines over time, but management reports it has the liquidity to meet the covenants. The series 2011 debt restructuring is targeted at an annual debt service amount of \$30 million or less over time. The university is capitalizing a portion of interest to build liquidity and provide budget flexibility for the newly authorized academic initiative.

Outlook

The stable outlook reflects our expectation that over the next two years, the university will generate operating surpluses on a full-accrual basis and continue to receive fairly stable congressional operating appropriations. We also expect Howard to steadily increase liquidity and working capital levels, fund

critical capital improvements from internal cash flow, prudently manage its debt issuances, maintain stable enrollment, and over time rebuild financial resource ratios relative to both debt and expenses.

Credit factors that could lead to a negative rating action within the outlook period include operating cash stress, generation of operating deficits, a substantial debt issuance that results in a debt burden inconsistent with operating margins, or a decrease in net tuition revenue.

Consideration of a positive rating action during the outlook period is unlikely given the university's significant capital needs and plans. However, positive rating momentum outside the outlook period could be based on continued and measurable progress toward achieving operating stability (which began in fiscal 2010), significant improvement of financial resource ratios, and the articulation of a strategic plan for the hospital and funding for capital needs for the university as a whole.

Stable Federal Support Levels And Improved Financial Operations

Howard's operations improved significantly for the fiscal year ended June 30, 2010. The change in unrestricted operating results was a small deficit of \$0.58 million, which is a marked improvement from the larger operating deficits of \$57 million in fiscal 2009 and \$42 million in fiscal 2008. Including net temporarily restricted operating revenues of \$1.7 million and net permanently restricted revenues of \$3 million, the total GAAP surplus was a positive \$4.2 million in fiscal 2010. On a consolidated basis, including unrestricted, temporarily restricted, and permanently restricted revenues, operating results were positive \$4.2 million. These results include depreciation expense of \$49.6 million, resulting in even stronger results on a cash flow basis. Management projects results for fiscal 2011 to be substantially stronger, and is targeting a \$30 million operating surplus. Included in the university's results is the wholly owned Howard University Hospital (HUH), an acute-care facility that produced break-even results in both fiscals 2009 and 2010 on a full-accrual basis, when including internal allocations of federal operating appropriations. Management projects operating results for the hospital operations in the current fiscal 2011 to again be at or slightly above break-even.

Management reported that on an overall institutional basis in fiscal 2010 — and continuing into the current fiscal 2011 — it has improved operations by making program cuts, decreasing staff positions through select employee layoffs and attrition, lowering costs of outside services, and achieving higher revenues and overall expense reductions. We believe significant strategic challenges remain for both the university and its hospital. Challenges for the hospital include an aging facility, a low case mix index, and a small admissions base. The university faces some of the same challenges, including needed renovations and improved productivity from both financial and educational aspects.

Howard ran into liquidity issues during fiscal 2010 due to the late budget passage by Congress, which, in turn, delayed the university's federal appropriation. Similar liquidity issues are recurring in fiscal 2011, and the university is currently operating under a federal "continuing resolution" from fiscal 2010. In response, management focused on segment accountability and negotiated new bank credit lines, which eased the liquidity issues but exposed Howard to higher bank-imposed liquidity requirements that, in our view, could limit management's ability to cash-fund strategic capital improvements. Howard currently has \$65 million of operating bank lines, and reports that to date in fiscal 2011 it has drawn a peak of \$49 million, and as of March 21, 2011, has about \$25 million outstanding.

The bottom-line change in fiscal 2010 UNA was negative \$58 million, largely due to pension accruals and OPEB liabilities; however, improvement in endowment market values helped to mitigate

the negative result. This was an improvement over the negative \$272 million change in fiscal 2009 UNA, which also was negatively impacted by pension and OPEB accruals, but was hurt even more significantly by endowment market value losses.

The university's revenue mix remains a credit strength, in our opinion. Audited fiscal 2010 consolidated operating revenues included 26% federal appropriations, most of which was unrestricted; 28% tuition, fees, and student charges; 33% hospital and patient income; and 6.8% grants and gifts. Howard has a sustainable endowment spending draw of 5% of the rolling-three-year average of market value, and the university held to this level in the fiscal 2010 and 2011 operating budgets. The university's federal appropriation amount has been very stable in recent years, which we consider a significant credit strength; in fiscal 2010, it was \$231 million for the third year in a row. At this time, university management expects the fiscal 2011 appropriation to again be flat, and at this time expects modest reductions in fiscals 2012 and 2013 and a modest increase in fiscal 2014. Roughly \$29 million of the federal appropriation is internally designated for the hospital. We consider Howard's institutional tuition discount rate moderate at 30%, although the undergraduate discount rate is higher. Management expects the discount rate for fiscal 2012 (fall 2011 enrollment) to be held to the current 30% rate.

Howard University Hospital: A Key Strategic Challenge

HUH is an acute-care facility that provides health care services in the Washington, D.C. area. It is also a teaching and research facility that serves the entire D.C. metropolitan area. There are 482 licensed beds, of which 274 are in service. The hospital serves as the principal clinical teaching site for Howard's colleges of medicine and dentistry. Most of the hospital's facilities are located in a six-story structure that opened in 1975. HUH management reports significant capital needs, which are currently being studied. The hospital is relatively small for an academic medical center with about 13,000 admissions, and acuity is low as demonstrated by a 1.14 overall case mix. We consider the payor mix constrained, with Medicaid representing 55% of total hospital revenues.

In the past two years, a new management team has been installed at the hospital, and significant improvements have been made in patient flow, admissions, and revenue cycle. As a result, the hospital posted operating surpluses of \$1 million and \$3 million in fiscals 2009 and 2010, respectively, following a \$14 million operating loss in fiscal 2008. Management has budgeted a \$5.0 million operating surplus for the current fiscal 2011 but expects that results may be lower than that, although still stronger than break-even. The hospital's operating results include an internal budget allocation of \$29 million of federal operating appropriations in each of fiscals 2008, 2009, and 2010. Still, we believe a key challenge for hospital and university management will be developing a long-term plan for the hospital facility, given its size and age, while maintaining the teaching programs of the health sciences departments.

Overall Stable Enrollment Levels And Good Demand Profile

Enrollment has been fairly stable in recent years, with a total headcount of 10,670 in fall 2010. Approximately two-thirds of Howard's students are undergraduates, with about 96% attending on a full-time basis. Freshman demand, as measured by the number of applications received, fell for the second straight year by 4.5% to 8,794 in fall 2010, after declining by 5.5% in fall 2009. This followed an historical high of 9,750 applicants in fall 2008, which was a 38% increase from fall 2003 levels.

Management attributed the fall 2008 application increase to marketing efforts, the ease of its updated online application process, and the university's strong reputation. For fall 2011 admissions, management reports that enrollment is expected to be at or slightly above fall 2010 levels. The university reports that the number of students impacted negatively by the recently announced Academic Renewal Plan is fairly small, and the plan is not expected to negatively affect enrollment.

We consider freshman selectivity good, with 55% of applicants accepted in fall 2010. The matriculation rate has remained fairly stable, which we believe reflects Howard's historic niche and reputation, with between 31% and 32% of accepted freshman students choosing to attend the university. Student quality is above average, with an incoming freshman average SAT score of 1067 in fall 2010, which, in our view, compares very favorably to peer historically black colleges and universities and is above the national average (about 1017). Student tuition of \$17,100 for the 2010-2011 academic year (\$26,619 including room and board) was well below that of other private institutions in the D.C. metropolitan area, which we believe could provide Howard with future flexibility to increase tuition levels and net tuition income. Management reports plans to increase tuition for both fall 2011 and fall 2012, and at the same time shift the tuition discount to a more need-based focus.

Howard draws students primarily from Maryland, New York, and New Jersey; the next largest group comes from Georgia, Virginia, and California. Management reports that it competes primarily with the large public institutions in those states, as well as the other historically black colleges and universities.

Management reports that certain graduate and professional programs are experiencing softer demand, including business, engineering, and other graduate programs, as demonstrated by decreasing application and enrollment levels. Given the volatile demand history and current economic stresses on students and their families, it is uncertain whether the softer demand is representative of a longer-term trend.

Low Financial Resource Ratios For The Rating Category

The university's UNA decreased to \$191 million in fiscal 2010 from \$249 million in 2009, primarily due to accruals of more than \$100 million of pension and OPEB liabilities. In 2009, there were \$120 million of pension and OPEB accruals, as well as an \$89 million endowment market value decrease. Reclassifications of net assets under the Uniform Prudent Management of Institutional Funds Act from UNA to temporarily restricted net assets also contributed to the decrease in UNA. As a result, we view the appropriate financial resources measure to be ER, which is a calculation based on audited UNA adjusted for temporarily restricted net assets, long-term debt, and net plant and equipment.

ER for Howard on June 30, 2010, was \$2.5 million, equal to less than 1% of operating expenses and a little more than 1% of then-outstanding debt. On a projected basis, using pro forma outstanding debt of \$380 million, the ER ratio to debt remains low, in our opinion, at 0.7%. Much of the decline in Howard's ER ratios in recent years is related to pension and OPEB expense accruals, as well as fluctuation in the investment markets. Using cash and investments at the end of fiscal 2010 of \$490.6 million (which includes restricted investments but excludes benefit liabilities), ratios are more comparable to peer institutions — cash and investments were equal to 55% of expenses and 129% of pro forma debt. We consider these ratios low for the 'A' rating category.

Howard's endowment had a market value of about \$400 million as of June 30, 2010, equal to what we consider a slim \$41,296 per full-time-equivalent student. Endowment market value was estimated at \$442 million as of Dec. 31, 2010. The asset allocation mix on June 30, 2010, was what we consider a conventional mix, with 38% in equity, 24% in fixed income, and 38% in alternative investments — mainly hedge funds and venture capital. Howard had what we consider a manageable \$52 million in remaining capital commitments to private equity investments, which management reports is about \$44 million in March 2011.

The university's fundraising history has been solid, in our opinion. Howard reported raising between \$12 million and \$15 million in its fiscal 2010 annual fund. Management reports that plans for a comprehensive capital campaign are under development.

Debt: Potentially Significant Capital Needs

Howard's outstanding debt at June 30, 2010, was \$222 million, including long-term debt, capital leases, and \$45 million of bank lines of credit. As of Dec. 31, 2010, it was \$242 million (unaudited), including \$47 million of bank lines for working capital. Post-issuance debt is estimated at \$380 million, including about \$50 million of recurring bank line draws. The series 2011 debt restructuring is targeted at an annual debt service amount of \$30 million or less over time. As a result, post-issuance debt service, when excluding repayment of working cash lines, remains less than 4% of fiscal 2010 operating expenses, a level we consider moderate.

The university's various authorized bank lines of credit currently total \$65 million. The covenants on those bank lines (as well as on currently outstanding bonds) require the university to hold highly liquid investments, the amount of which will ramp up to \$50 million by Dec. 31, 2011. The university expects to restructure those lines over time, but management reports it has the liquidity to meet the covenants. The university is capitalizing a portion of interest in the series 2011 bonds to build liquidity and provide some budget flexibility in fiscals 2011 through 2013.

Howard's 10-year campus master plan calls for about \$750 million of facilities improvements. At this time, the university expects about a third of that to be funded from direct university debt, one-third from future fundraising, and one-third from internal cash flow and third-party nonrecourse financing. Funding details are evolving. After issuance of these series 2011A and 2011B bonds, which will provide \$100 million of new money, offering documents indicate that another \$100 million to \$125 million could be borrowed by fiscal 2013. In addition, the university may have to navigate through more stringent bank leverage covenants to access future debt.

Management reports that future capital plans will include facility improvements for HUH. A few years ago, Howard and the District of Columbia were working together on a plan to share the costs of a replacement hospital but the district backed away from that plan in 2006. Since then, operating losses and management changes at the hospital have delayed long-term capital planning for the facility. However, now that the hospital's operating performance has stabilized and new management is in place, long-term planning remains on the university's near-term agenda.

Pensions

Substantially all full-time university employees participated in a noncontributory, defined benefit retirement plan. Effective July 1, 2010, however, the plan was closed to new employees, and was frozen in relation to accruing defined benefit pension benefits. Existing employees began participating in a

defined contribution plan. The defined benefit plan had been significantly underfunded as of June 30, 2010.

Debt Derivative Profile

Howard has two interest rate swap agreements with a total notional amount of \$42.7 million with Goldman Sachs Mitsui Marine Derivative Products L.P. and Bank of America. Both are floating-to-fixed rate swaps; Howard receives a percent of the LIBOR index and pays a fixed rate. Post-issuance, the university expects to terminate one of the swap contracts.

Standard & Poor's assigned Howard a Debt Derivative Profile (DDP) overall score of '1.5' on a 4-point scale, with '1' representing the lowest risk. The overall score reflects Standard & Poor's view that Howard's swaps reflect a very low risk to the overall credit profile at this time. We will review the university's DDP score once the refinancing is completed and one of the swap contracts terminated.

Related Criteria And Research

- USPF Criteria: Higher Education, June 19, 2007
- USPF Criteria: Debt Derivative Profile Scores, March 27, 2006

Ratings Detail (As Of 24-Mar-2011)

District of Columbia, District Of Columbia

Howard Univ, District Of Columbia

District of Columbia (Howard University) rev bnds ser 2006A

District of Columbia (Howard University) (AMBAC & BHAC) (SEC MKT) ser 2006A

Unenhanced Rating	A-(SPUR)/Stable	Downgraded
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District of Columbia (Howard Univ) rev bnds ser 2006A

District of Columbia (Howard University) (AMBAC) ser 2006A

Unenhanced Rating	A-(SPUR)/Stable	Downgraded
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District of Columbia (Howard Univ) VRDB rev bnds ser 2006B

District of Columbia (Howard University) ed VRDO ser 2006B

Unenhanced Rating	A-(SPUR)/Stable	Downgraded
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Long Term Rating	AAA/A-1	Affirmed
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Many issues are enhanced by bond insurance.

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