MOODY'S
INVESTORS SERVICE

ISSUER IN-DEPTH
12 April 2017

Rate this Research

RATINGS

Ohio State University	Aa1 Stable

KEY METRICS:

	2014	2015	2016
Total Cash & Investments ($ billions)	$4.8	$5.3	$5.8
Operating Revenue ($ billions)	$5.1	$5.5	$5.9
Total FTE Enrollment	59,153	59,490	60,426

Source: Moody's Investors Service

Contacts

Edith Behr 212-553-0566
VP-Sr Credit Officer/ Manager
edith.behr@moodys.com

Susan I Fitzgerald 212-553-6832
Associate Managing Director
susan.fitzgerald@moodys.com

Erin V. Ortiz 212-553-4603
AVP-Analyst
erin.ortiz@moodys.com

Kendra M. Smith 212-553-4807
MD-Public Finance
kendra.smith@moodys.com

The Ohio State University, OH

Upfront Payment from Energy Management Initiative Enhances Ohio State's Competitive Position

On April 7, The Ohio State University's (Aa1 stable) Board of Trustees approved an over $1 billion concession and lease agreement with a private energy consortium — Ohio State Energy Partners (OSEP) — to operate and maintain the utilities system that powers, heats and cools the university's Columbus campus. The university will pay the consortium annual operating fees and continue to purchase power independently.

The Comprehensive Energy Management Project is the latest in a series of actions by the university to monetize existing business assets. In 2012, the university entered into a concession and lease agreement for its parking system with CampusParc in return for a $483 million upfront payment. These thoroughly planned partnerships, the magnitude of which sets Ohio State apart from its peers, contribute to a significant increase in financial reserves and greater revenue diversity, credit positives for one of the nation's 10 largest public universities.

» **Upfront payments increase university's financial reserves.** When the OSEP deal closes, Ohio State will receive a more than $1 billion upfront payment, which it will invest along side the endowment. The payment will increase the university's total cash and investments by nearly 18% to a pro-forma $6.9 billion. More robust reserves will reduce the university's reliance on constrained student fees, research funding and state support. They will also provide a cushion against unanticipated expenses.

» **The financial flexibility afforded by monetizing assets increases Ohio State's competitiveness by bolstering funds for core operations and strategic initiatives.** The utilities system concession and lease agreement, like the parking system transaction in 2012, offers a significant cash infusion to the university's cash and investments. The university plans to invest proceeds in the endowment, income from which will be used to address key strategic initiatives, including improving access and affordability for students, and recruiting and retaining high quality faculty.

» **Ohio State's thorough planning process largely mitigates project-related risks.** Ohio State undertook a three-phase project plan to examine the risks and identify the best partners for the project. However, there are inherent risks in any agreement that spans 50 years, including financial, performance, and reputational risks. The university projects that payments to the concessionaire, together with the cost of commodities used to run the system, will initially be equivalent to their current costs, about $115 million or a nominal 2% of the university's operating expenses.

In detail: The Ohio State Energy Partners deal

After three years of planning, Ohio State has entered into one of the largest monetization partnerships in the higher education sector with its $1.165 billion deal with Ohio State Energy Partners (OSEP), a private energy consortium comprised of French energy company ENGIE North America and Canadian investment firm Axium Infrastructure.

The concession and lease agreement shifts operation and maintenance of Ohio State's power, heating and cooling systems to the consortium for 50 years.

The concession and lease agreement includes three key benefits for the university:

» **An upfront payment of $1.015 billion**. The university will deposit the payment into its endowment. The university plans to use the endowment income for strategic initiatives, including: student financial aid, faculty recruitment and retainment, new classrooms and research labs, and a fund to enhance sustainability efforts.

» **A $150 million academic collaboration investment, a portion of which is upfront.** The $150 million will fund academic programs, including a new energy research and development center, additional student financial aid, internships, faculty positions and university philanthropy.

» **A commitment to improve energy efficiency by 25%.** OSEP has committed to meet the university's goal of improving energy efficiency by 25% within 10 years. This is expected to require approximately $250 million in capital investment in sustainability initiatives, for which OSEP will be compensated via the capital investment fee.

The university will pay OSEP an annual fee, comprised of three parts:

» **An operating fee,** which starts at $9.2 million based on a three-year average of university costs, adjusted throughout the concession based on actual costs of the operation, as approved through an annual budget process with the university.

» **A fixed fee** starting at $45 million, growing 1.5% per year

» **A capital investment fee** based on after-tax blended rate of 5.7% for the first 5 years

In addition to these costs, the university will continue to pay for all commodities, bringing all-in projected annual costs to roughly the same $115 million that the university currently pays for all energy needs on campus.

Alternative revenue sources bolster university's financial reserves

In the last five years, Ohio State has successfully bolstered its balance sheet by monetizing the operation of key assets and selling non-core real estate. They have also entered into licensing agreements with private companies, providing alternative revenue streams. These credit-positive cash infusions allow the university to fund operations and capital improvements from investments while moderating tuition and reliance on state appropriations. By limiting tuition increases, Ohio State can remain competitive with its peers, while still serving the public education mission.

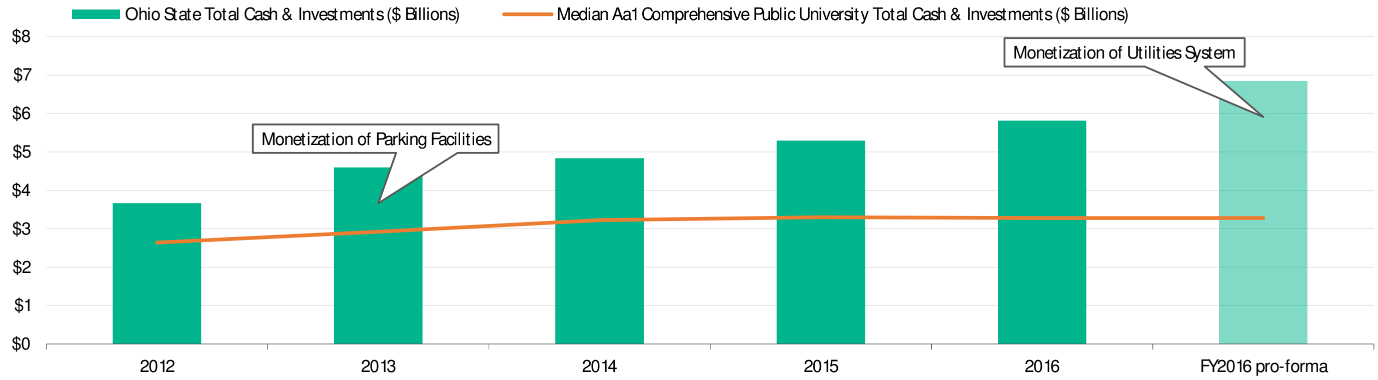
As a result of this recent utilities system deal, the university's total cash and investments will grow immediately by $1.069 billion ($1.015 billion upfront payment and $54 million of the $150 million academic collaboration investment) to a pro-forma nearly $6.9 billion upon closing the transaction (see blue box). The over $1 billion deposit represents almost 18% growth over fiscal year-end 2016 levels without considering additional growth from investment earnings, gifts or contributions from operations.

The OSEP payment compounds already strong cash and investment growth. Between FY 2012 and FY 2016, total cash and investments grew nearly 60%, double the median rate of increase for all Aa1-rated comprehensive public universities (see Exhibit 1). In 2012, Ohio

State agreed to a 50-year, $483 million deal to lease its parking operations. The upfront payment related to the parking system lease contributed to the strong growth of cash and investments.

Exhibit 1

University's Total Cash and Investments Have In Part Grown as a Result of Monetizations



Source: Ohio State University Audited Financial Statements, Moody's Investors Service

In addition to the two large concession and lease agreements, the university has successfully negotiated licensing and appearance agreements with a number of private companies. The largest of these agreements amount to over $500 million over roughly 15 years, including those with NIKE, Inc., Huntington National Bank, J. America/Fanatics, and Nationwide Insurance. The agreements with NIKE and J. America/Fanatics provide the private companies exclusive rights to use The Ohio State University name to market their products. The Huntington Bank and Nationwide Insurance agreements provide exclusive access to offer tailored services to the university's students, faculty, staff, and alumni, excluding credit cards and loans to students.

Exhibit 2

Company	Nature of Partnership	Total Value of Contract ($ millions)*
NIKE, Inc.	Licensing, equipment supply, appearances and consultation	252
Huntington National Bank	Exclusive access to directly offer tailored products and services to students, faculty, staff and alumni. Excludes credit cards and loans to students	125
J. America/Fanatics	Apparel production & distribution	97
Nationwide Insurance	Exclusive access to directly offer consumer insurance products and services to students, faculty, staff and alumni	17

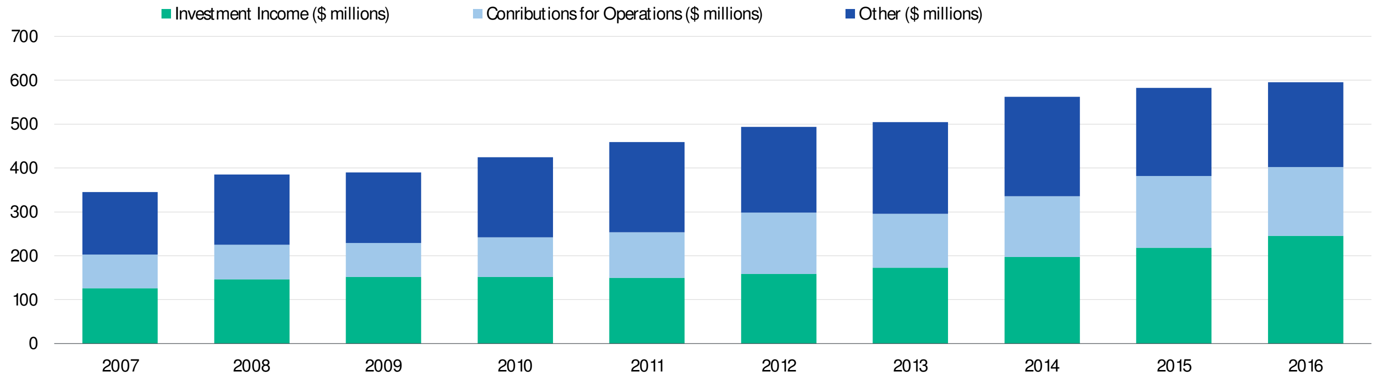
*Estimated by The Ohio State University since many payments are variable
Source: Moody's Investors Service

The university has also raised capital by selling non-core real estate that had been gifted to or acquired by the university over time. Since 2012, the university has sold 19 parcels of property all over Ohio (Aa1 stable), raising a total of $17.5 million.

In addition, in June 2016, the university approved the sale of 58 acres of undeveloped land in northwest Columbus. The land sale approval is the first of three parcels that the university is exploring selling outside the existing footprint of the Don Scott Airport. The sale of all three parcels is expected to yield $20 million – $30 million.

Exhibit 3

Alternative Revenue Now Exceeds One-Half Billion Dollars Annually



Source: Moody's Investors Service

Gift revenues and residual operating cash flow also bolster reserves

Above average gift revenue has also helped to grow Ohio State's endowment. During fiscal year 2016, the university concluded its "But for Ohio State" capital campaign with over $3.0 billion in gifts, exceeding its $2.5 billion goal. During the last five years, annual gift revenue grew 16% to $232 million in FY 2016 from $200 million in FY 2012, which is higher than the median for large comprehensive public universities. We expect these elevated levels of gift revenue to continue over the next few years as pledges are received.

Finally, a healthy operating cash flow margin of over 13% in recent years has been accretive to financial reserves, after repayment of debt and capital investments.

Financial flexibility afforded by monetizing assets increases competitiveness by bolstering funds for core operations and strategic initiatives

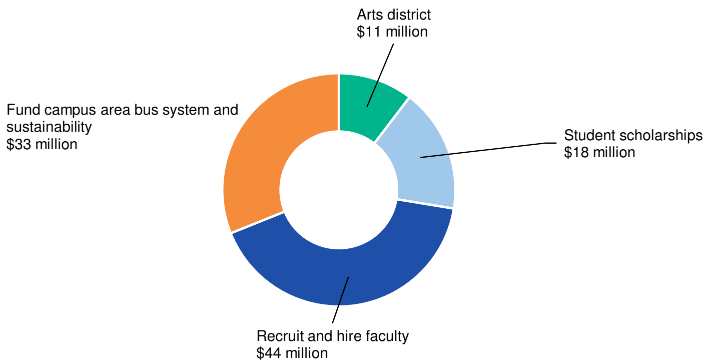
By building its cash and investments, the university improves its competitive position in the higher education, health care and research sectors. The upfront payment from the concession and lease agreements with private corporations and from the land sales, as well as investment earnings from the increased endowment, will fund core operations as well as strategic initiatives.

The university has a proven record of prudently using lump sum payments for long-term goals. From September 2012, when the university deposited $483 million parking facility lease upfront payment through January 2017, Ohio State has used $105 million in income for student scholarships, faculty recruitment in priority fields, capital investments and campus transportation (see Exhibit 4).

Exhibit 4

Endowment Income from Parking Lease Supports Four Priorities

$105 million distributed from September 2012 – January 2017



Source: The Ohio State University

Similar to uses of the earnings on the parking facility concession and lease agreement, Ohio State will deposit upfront payments from the current agreement into the university's endowment, using income generated to address affordability and access for students, to retain high quality faculty by enhancing compensation and to invest in new academic facilities.

The university also plans to use the proceeds to support the university's position as a major academic medical center with strengths in academics, health care and research. This alternative source of revenue is especially important to the university's ability to off-set any potential slow down in research and health care funding from the federal government. Proceeds also will be used for strategic initiatives to come out of an anticipated new Ohio State strategic plan and as a reserve for unanticipated costs associated with the concession and lease agreement.

The additional academic collaboration funding will be used to build an energy-related research and development facility, for philanthropy split between Ohio State-related organizations and faculty endowments, internships and scholarships, and for sustainability initiatives.

Utilities system lease has been in the works since 2011

The idea to partner with the private sector to upgrade and operate the utilities system first surfaced in 2011 when the university's president and the Office of Business and Finance were charged with identifying $2 billion of resources needed to support the university for the next 10 years.

Once the utilities were identified as an asset that might be monetized, the university conducted a pilot project, spending $7 million to implement energy conservation measures in five of its 485 buildings in Columbus. This pilot took three years to complete and the university decided that the approach was too slow to achieve its goals for service, sustainability, academic collaboration and financial considerations.

Representative stakeholders, including students, faculty and staff, have had a meaningful role in the three-year development of the Comprehensive Energy Management project and assessment of potential vendors. The university mapped out a three-phase approach to evaluating specific ideas and vendors:

- Phase I consisted of reaching out to 140 companies to gauge interest in the project and allowing the university to evaluate qualifications of potential bidders.
- Phase II allowed the university to collect more information from potential bidders about their qualifications and their ideas for how a partnership might work.
- Phase III consisted of soliciting bids on the university's detailed plan for the Comprehensive Energy Management Project.

Ohio State's thorough planning process largely mitigates project-related risk, but long-term performance could fail to meet the university's expectations

The university's careful planning of the parking concession lease, licensing agreements and land sales have all led to successful transactions. The success of these projects bode well for the success of the utilities system concession and lease agreement.

The university includes a variety of stakeholders in planning and evaluating any asset monetization. A steering committee for each type of asset, including university staff and faculty are appointed. In each case, the steering committee is comprised of financial and legal personnel and representatives of university departments who have related expertise or will be impacted by the proposed transaction. The committee is also responsible for outreach to potential corporate partners as well as to the city, state and university communities. Throughout the process, the Board of Trustees is apprised of the status of each project and ultimately, the Board of Trustees must approve.

For the utilities system monetization, the university undertook a three-phase project plan to examine the risks and identify the best partners for the project, which significantly lowered risks (see blue box). While the university will receive an upfront payment upon closing and the project will achieve many of the university's sustainability goals, there are risks inherent in any long-term agreement, including performance, financial, and reputational risk.

In terms of performance, the concession lease is for 50 years. While the university will enter into a detailed performance agreement, it is likely that not all issues arising over 50 years will be covered in the current agreement. The university has thoroughly vetted ENGIE and Axium; however, their ability to execute under the partnership could change over time. The contract with OSEP will reportedly have a number of key performance indicators (KPI) with significant financial penalties applied if not met.

It is likely that technology will change requiring further upgrades to the project prior to lease expiration--these upgrades will be jointly agreed to between the university and the partner, and paid for by the university through the capital investment fee.

Over the life-span of the project, it is possible that the university and the consortium will have differing priorities. The university plans to create an energy advisory committee for monitoring and managing the partnership, which will require an additional investment of time.

It is also possible that OSEP will not be able to produce the energy savings that the university is projecting. This is largely mitigated via financial penalties associated with failure to meet KPIs. However, it is possible that the university's carbon footprint would not be reduced to the extent expected by the university.

University payments are based on a set of cost/benefit assumptions. Agreed-upon fees are based on industry norms or indices that will change over time. Interest rates could increase resulting in a higher pass through cost of capital to the university upon the periodic reset of the capital investment fee. Tax treatment could also affect the rates incorporated in the capital investment fee. If one or more of these components differ from those used in the university's projections, the project could end up costing the university more than the university anticipated. It is also possible that earnings on the university's endowment will underperform projections, thereby providing less money for the strategic initiatives originally contemplated by the university.

Finally, the university has introduced new reputational risks should the project not perform as projected or should implementation and ongoing execution of the partnership prove more difficult than expected.

Moody's Related Research

Credit Opinion: The Ohio State University, Credit Opinion, February 19, 2016

Issuer Comment: Ohio State's Land Sale Would Be Credit Positive for University, Columbus and Columbus School District, June 9, 2016

REPORT NUMBER 1067250

Contacts

Christopher R McMahon 212-553-7409
Associate Analyst
christopher.mcmahon@moodys.com

Edith Behr 212-553-0566
VP-Sr Credit Officer/ Manager
edith.behr@moodys.com

CLIENT SERVICES

Americas	1-212-553-1653
Asia Pacific	852-3551-3077
Japan	81-3-5408-4100
EMEA	44-20-7772-5454

Moody's
INVESTORS SERVICE