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Montclair State University (NJ)'s Public-Private Partnerships Exhibit Evolving Credit Impact

RATINGS

Montclair State University

Revenue Bonds	A1 Stable

Provident Group-Montclair Properties - MSU Student Housing Project

Revenue Bonds	Baa3 Stable

UMM Energy Partners

Energy Facility Revenue Bonds	Baa3 Stable

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Summary

Public-private partnerships (P3s) provided a significant portion of Montclair State University (MSU), NJ's (A1 stable) funding for two strategically important projects in student housing[1] and energy and heating infrastructure[2]. The impact of the two ventures developed in the last three years is currently credit neutral for the university. The projects' now established operating performances are counterbalanced by uncertainties posed in the long term as the projects' life cycles evolve.

The ventures are financed, owned and managed by private partners. Due to their strong linkages to university operations, we incorporate them in our credit analysis of the university's funding strategies even though we do not include them in direct debt. The lone exception is debt assumed from a university share of a dining facility lease.

» **The Heights student housing facility is core to the university's strategy to provide additional on-campus housing.** The project is beyond construction and lease-up risk and is now operational and meeting debt service requirements. Positive operations of the housing project are reimbursing the university for its subordinated expense contributions, mitigating the near-term need for direct financial support. Over the longer term, should the housing become less attractive or performance deteriorate, there is the risk that the university would have to either directly or indirectly support it.

» **The trigeneration plant and energy distribution system (the system) is core to the university's strategy to provide efficient utility services.** The system was completed on time in the fall of 2013 and is now providing campus energy infrastructure. The university is the primary customer of the system's output. The system's debt service is not directly paid by the university, but is paid from payments pursuant to the Energy Sales Agreement with the university. Over the life cycle of the system, MSU faces risks, such as a potential bankruptcy of the system owner/operator. The university has protections, though it would bear the burden of finding a new owner/operator if it chooses not to assume ownership.

1 Refer to "Moody's affirms Baa3 on $209.7M outstanding New Jersey Economic Development Authority's Revenue Bonds (Provident Group - Montclair Properties L.L.C. - Montclair State University Student Housing Project), Series 2010A; outlook is stable" (January 31, 2014) for more information.

2 Refer to "Moody's assigns initial Baa3 rating to UMM Energy Partners, LLC's $78.3 million Energy Facility Revenue Bonds issued through the New Jersey Economic Development Authority; Outlook is stable" (July 27, 2012) for more information.

Established Operating Performance of The Heights Student Housing Project Currently Mitigates Direct University Financial Support

Since inception, we have incorporated a portion of the debt related to MSU's privatized student housing, The Heights, as direct debt. We recently reduced this allocation because The Heights is fully occupied and generates good debt service coverage, reducing the likelihood the university will need to provide for certain subordinated operating expenses.

The Heights provides 1,978 beds, comprising a substantial 40% of MSU's housing stock. Located on what was once the northern edge of MSU's property, The Heights has quickly become a vibrant part of MSU's campus. All freshmen are assigned to The Heights until the project is fully occupied, but freshmen can choose to opt out. The Heights was funded by $211 million of New Jersey Economic Development Authority Series 2010A and 2010B bonds (Baa3 stable).

We initially included 30% of the principal outstanding on the housing project as direct debt of the university. This included a sublease for a dining facility directly paid by the university covering 7% of debt service. In addition, the university agreed to pay certain project expenses, such as residential life staff, utilities, marketing and landscaping. The project reimburses the university for these expenses should the project meet 1.1 times debt service coverage. The average combined allocation of the debt service related to the dining facility and the estimated subordinated expenses as a percent of total debt service averaged 30% over the 30-year life of the bonds, hence the 30% allocation. With the project further initially carrying construction risk given its scale and aggressive time to completion, the university faced a heightened probability of support in the early phases of the project.

Approach to Capital Funding Always Has Credit Impact

The choices of how a university finances its facilities will always have a credit impact, irrespective of whether such financing is counted as debt of the university. In the case of public private partnerships, the impact can be positive if a university is able to find a partner where short- and long-term strategic and financial interests are aligned, if the project is successful, and if it contributes to the competitive position of the university. On the other hand, the impact could be credit negative if the project results in a financial drain to the university, leads to management distraction as project issues are required to be addressed, or results in reputational harm to a university from a poorly managed project.

When determining the credit impact of a public-private partnership, we consider the strategic importance of a project to a university. We also assess the risk that the university would either need to financially support the project or find an alternative to the project under extenuating circumstances. The risk of future support for a project depends in part on the performance of the project owner and operator. During construction, the associated university could be exposed to project completion risk related to construction delays or cost overruns. Once completed, the university is exposed to the operator's ability to successfully manage the project in accordance with the contract and to ensure the project remains financially solvent.

Since opening in fall 2011, The Heights has been fully occupied and the project has reimbursed MSU each year for the subordinated expenses. As a result, we revised the fiscal year 2013 direct debt allocation of the bonds from 30%, or $62 million, to 7%, or $14.7 million. The risk of delayed construction has passed, demand for The Heights' housing is stable, and debt service coverage is reasonably projected to exceed 1.1 times (1.29 times in the most recent year). The 7% allocation accounts for MSU's direct lease expense associated with the dining facility. We could revise the full allocation upward again should performance weaken to the extent that the university would need to absorb subordinate operating expenses.

Trigeneration Plant Commenced Operations in Summer 2013; Energy Sales Agreement Payments Include Project Debt Service

The university's trigeneration plant and distribution system, an essential part of the campus infrastructure, was also recently replaced under a public-private partnership arrangement. Core to providing essential utility services (electricity, steam, and chilled water) to the university, the system has less immediate direct reputational risk for MSU as it is a backdrop to the day-to-day activities of students. While the university has alternatives for electricity, few alternatives exist for steam and chilled water if the project runs into difficulties.

The system, which began operating in late 2013, was financed and is owned by UMM Energy Partners LLC (UMM). UMM is a third-party special purpose entity formed and owned by Energenic (the developer). Energenic is jointly owned by DCO Energy and Marina Energy, a subsidiary of South Jersey Industries (A2, stable). The system was financed with $79.4 million in New Jersey Economic Development Agency Revenue Bonds (Baa3 stable), plus a roughly $20 million equity contribution by the developer.

MSU is the primary customer (offtaker) for the system's electricity, steam heating and chilled water pursuant to a 30-year Energy Sales Agreement (ESA) between UMM and the university. We have not counted the system financing in the university's direct debt because MSU is not legally responsible for debt service. However, we do capture the implicit cost of debt service in the university's expenses as it makes payments under the ESA.

A bankruptcy of one of the two system owners could lead to a change in control resulting in an event of default under the financing agreement. MSU can waive this event of default or could terminate the ESA but would be required to purchase the facility at a price sized to pay the outstanding debt. MSU's intention to finance the system improvements "off balance sheet" indicates that it would be incentivized to support the project on an annual cash flow basis instead of issuing debt to purchase the system outright. Thus, a university waiver of this event of default is likely in most circumstances. The provision providing for change of control in bankruptcy highlights: (1) MSU's counterparty exposure to the financial performance of the two system owners; (2) the possibility that MSU could redeem the debt in the future, at its choosing for convenience; (3) the risk that counterparties could change over time; and (4) the ongoing need to manage these relationships. As a result of these risks, we continue to monitor the system as a component of the university's capital structure.

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