New Issue: University of South Carolina, SC

MOODY’S ASSIGNS Aa2 RATING TO THE UNIVERSITY OF SOUTH CAROLINA’S $30 MILLION HIGHER EDUCATION REVENUE BONDS, SERIES 2010; OUTLOOK IS STABLE FOR HIGHER EDUCATION REVENUE BOND RATING

Aa2 RATINGS AFFIRMED ON EXISTING DEBT; UNIVERSITY HAS A TOTAL OF $392 MILLION PRO FORMA RATED DEBT OUTSTANDING

Higher Education
SC

Moody’s Rating

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Moody’s Outlook  Stable(m)

Opinion

NEW YORK, May 14, 2010 -- Moody's Investors Service has assigned a Aa2 rating to the University of South Carolina's $30 million Higher Education Revenue Bonds, Series 2010. The rating outlook on the Higher Education Revenue Bonds is stable. We have revised the rating outlook on the Athletic Facilities Revenue Bonds Aa2 rating to negative from stable, reflecting planned issuance of additional debt secured by this relatively narrow revenue pledge. At this time, Moody's has also affirmed the Aa2 ratings on the University's outstanding Revenue Bonds and Athletic Facilities Revenue Bonds. Moody's also maintains Aaa ratings on the outstanding State Institution Bonds, issued by the State for projects at USC and secured by the State's general obligation pledge. For a list of rated debt, please see detailed section at the end of this report.

USE OF PROCEEDS: Proceeds will be used to fund the costs of renovation of the student residence facilities on the Columbia Campus and to pay costs of issuance.

LEGAL SECURITY: The Revenue Bonds are secured by a pledge of net revenues of the parking and housing systems of the University, as well as a broad basket of legally available Additional Funds totaling $604 million in FY 2009. Additional funds include the University's unrestricted revenues less the parking revenues, housing revenues and state appropriations. Other features include a sum sufficient net revenues rate maintenance covenant and additional bonds test.

The Athletic Facilities bonds are secured by a pledge of the net revenues of the University's Athletic Department, a mandatory student fee, and admission ticket surcharges at the University's football stadium and basketball arena, which totaled $17.1 million in FY 2009. There is a debt service reserve requirement and 110% rate maintenance covenant.

DEBT-RELATED INTEREST RATE DERIVATIVES: The University itself has not entered into any debt related interest rate derivative contracts. The University of South Carolina Upstate Foundation, a component unit of the University, has entered into two swap agreements to hedge its variable interest rate exposure associated with its Series 2002 South Carolina Job Economic Development Authority Bonds and Series 2008 South Carolina Job Economic Development Authority Bonds with a total notional amount of approximately $32 million. The fair value of the two agreements to the Upstate Foundation at June 30, 2009 was a liability of $1.5 million. A subsidiary of the University of South Carolina Development Foundation has entered into an interest rate swap agreement with a notional amount of $10.7 million as against a variable rate note payable. The liability to the Foundation at June 30, 2009 was $807,122.

STRENGTHS
Growing enrollment trends with almost 38,000 full-time equivalent students and improving student qualifications at vibrant flagship University for the Aaa-rated State of South Carolina.

Consistently positive operating performance with three-year average operating margin of 4.2% supporting debt service coverage of 3.1 times.

With total financial resources of $647 million at the end of FY 2009, the University maintains a good cushion relative to debt with expendable financial resources to pro-forma direct debt of 0.7 times. Expendable financial resources cover annual operations by 0.5 times. Unrestricted liquidity is sound with monthly liquidity of $312 million at FYE 2009 equating to 130 days cash on hand and more than 3 times demand debt at the University and its affiliated foundations. The University and its foundations have a relatively conservative debt structure, with 17% or $101 million of demand debt at June 30, 2009.

Increasing sponsored research awards ($108 million in research expenditures in FY 2009) bolstered by ongoing strategic investments including a new research park named Innovista.

CHALLENGES

Continued period of dramatic cuts in state operating support which has declined as a portion of operating revenue from 25% in 2005 to 18% in 2009, with additional declines expected. State appropriations fell 7% to $161 million in FY 2010 from the prior year and the University is preparing for further reductions in FY2011. Along with other management actions, USC has made relatively aggressive tuition price increases to offset reductions, leaving it with somewhat reduced pricing power relative to its peers. However, the University has seen a strong and sustained increase in applications indicating continued healthy market demand.

Research programs, while benefiting from healthy sponsor diversity, are likely to experience heightened competition for federal funding which constitutes approximately two-thirds of awards.

MARKET/COMPETITIVE POSITION: IMPROVING MARKET POSITION REFLECTS VIBRANT REGIONAL DEMOGRAPHIC TRENDS AND STEPPED-UP SPONSORED RESEARCH ACTIVITY

Moody’s expects that the University of South Carolina’s established reputation as the State’s flagship and a leading research institution, as well as its location in the demographically vibrant Southeast, will result in moderately growing student enrollment in the near future.

In fall 2009 the University enrolled over 37,965 students on a full-time equivalent basis, approximately 75% of whom are state residents. Selectivity at the University’s main campus in Columbia for the fall of 2009 was 63.6%, showing a trend of continued increases in demand volume. USC has been able to improve the academic qualifications of its incoming class while also increasing the size of the undergraduate entering class which has risen from just under 3,500 in 2003 to over 3,900 in 2009. The University also operates smaller campuses in Aiken, Beaufort, Upstate and other regional sites in the state. The University expects another strong enrollment year in fall 2010 with an increase in the academic quality of its incoming freshmen class at the Columbia campus. With Columbia tuition and fees for in-state undergraduate students at $9,156 per year for the current academic year, USC has a relatively high price for the region, but is not the most expensive within the state and state merit scholarship programs have made the increase more politically palatable. Management plans on further increases in the coming years but in the 5% range per year. Non-resident tuition has become an increasingly important source of net tuition revenue and the Columbia campus has been successful in driving demand from out of state as last fall 43% of freshman students were from outside the state. Graduate and professional enrollment system wide increased 3% in the fall of 2009 on an FTE basis.

Sponsored research funding at USC increased 2% in fiscal year 2009 from the prior year to $206 million reflecting recent momentum and management’s strategic investments in research activities. While approximately two-thirds of the awards came from the federal government, USC enjoys a relatively high degree of funding diversity and is not overly reliant on any one federal agency. We expect the University’s ongoing investment in research facilities will enhance its competitive profile and industry partnerships.

OPERATING PERFORMANCE: HEALTHY ANNUAL OPERATING PERFORMANCE DESPITE MATERIAL REDUCTIONS IN STATE FUNDING

Moody’s expects that the University will continue to produce positive operating margins despite a highly challenging state funding environment. Appropriations from the Aaa-rated State of South Carolina, which accounted for 18% of the University’s operating budget in 2009, were down from 36% in 2002. The funding outlook from the state is weak, with the University already absorbing a 7% cut in FY 2010 with an additional reduction expected next year. The State of South Carolina was given a special exemption from the maintenance of effort requirement for the receipt of stimulus funds from the American Recovery and Reinvestment Act State Fiscal Stabilization Fund. USC has managed to reduce various expenditures and offset the losses to some degree with increases in student fees through both enrollment growth and rate increases. USC management is using the stimulus funds for non-recurring items and prudently planning around a lasting reduction in state support. Despite the cuts, the University has a three-year average
The State's Aaa rating is based primarily on conservative fiscal management, which has been particularly important in the economic downturn that began at the end of 2007. In addition to various established statutory and fiscal policy requirements designed to safeguard financial stability, the state historically has taken quick action to address projected budget gaps and has enacted legislation in recent years to eliminate a cumulative operating deficit, restore reserves, control expenditures, and develop a formal process for long-term financial planning. For more information about the state's rating please see our report dated March 19, 2010.

To offset the effects of the reduction in state support over the past several years, the University has increased tuition, which has continued to exhibit healthy growth in overall net tuition revenue. Despite the increases in tuition ($9,156 for resident undergraduates at USC Columbia in the current academic year), costs of attendance will remain lower than at Clemson University (rated Aa2 with a stable outlook), the University's main competitor. However, the University is now the highest priced institution for a resident student in the Southeastern Conference. Student interest, as measured by application volume, however, continues to increase indicating favorable market demand. Concerns about affordability and access, heightened by recessionary declines in household wealth and income levels, will likely temper future price increases, especially at the system's regional campuses.

The net revenues of the housing and parking systems continue to provide comfortable debt service coverage of the Revenue Bonds with 2.1 times coverage in FY 2009, not including the pledge of Additional Funds which totaled $604 million. Given consistently strong student demand for the auxiliary system's offerings, Moody's expects this performance to continue. The housing system has enjoyed fall occupancy in the 90 to 100% range in the fall of 2008 and 2009 and the parking system continues to have untapped pricing power for its structured and surface parking permits.

The Athletic Facilities Revenue Bonds are secured by a pledge of the net revenues of the University's Athletics Department, a mandatory student fee, and admission ticket surcharges at the University's football stadium and basketball arena. Debt service coverage in FY 2009 was 4.7 times, which includes interest expense on $19.6 million of Bond Anticipation Notes. Funds available for debt service increased 28% in FY 2009. The mandatory student fee portion of the pledge comprised $1.4 million of the $17.6 million in funds available for debt service in FY 2009. Net revenues of the Athletic Department were $13.2 million in FY 2009, and while more volatile, have demonstrated increases. The University plans to issue about $60 million of Athletic Facilities Bonds in 2010, a portion of which will refund $17.6 million in BANs, and an additional approximately $38 million in spring 2011.

BALANCE SHEET PROFILE: SOLID RESOURCE LEVELS DESPITE FY 2009 INVESTMENT LOSSES AND MANAGEABLE BORROWING PLANS

Moody's believes that the University's financial position remains sound and consistent with the long-term Aa2 rating despite recent investment losses. Total financial resources at the University and several affiliated foundations were $647 million at FYE 2009, down from $712 million at FYE 2008. At the end of FY 2009, expendable financial resources covered pro-forma debt 0.7 times and annual operating expenses by 0.5 times. Unrestricted financial resources of $270 at FYE 2009 point to favorable reserve levels. Monthly liquidity of $312 million at FYE 2009 equates to 130 days cash on hand and more than 3 times demand debt at the University and its affiliated foundations.

USC's pooled endowment had a negative 22% return in FY 2009 with a large allocation to equities, which also supported stronger than typical performance for the first three quarters of FY 2010 with a 23.6% return. The asset allocation as of March 31, 2010 was 50% US equities, 14% international equities, 19% fixed income, 3% private equity and 14% hedge funds. USC had total gift revenue of $107.5 million in FY 2009 and management is actively planning a new campaign which will emphasize scholarship funding and long-term resource growth.

Future capital needs of the University are manageable and expected to be supported by a variety of funding sources, although state capital support has been diminished compared both from prior eras in South Carolina and with neighboring states. In addition to the $83 million athletic bonds planned ($17.6 million will refund BANs), the University is planning to debt finance a portion of the Darla Moore School of Business building ($90 million project cost), Health Science Renovation ($18 million estimated project cost), approximately $28 million ($37 million estimated project cost) debt for a Student Health Center and a portion of a new Law School facility over the next several years. With pro-forma direct debt-to-total revenues of 0.7 times, we believe the University maintains additional debt capacity at the Aa2 level.

Outlook

The stable outlook on the Higher Education Revenue Bond ratings reflects Moody's expectation of anticipated moderate enrollment growth, sound operating performance, healthy debt service coverage from pledge revenues, manageable additional borrowings and maintenance of a healthy level of unrestricted resources at the University. The negative outlook on the Athletic Facilities ratings is based on expectations that the mandatory student fee portion of the pledged revenues will cover a diminishing portion of debt.
service with the likely increase in debt, combined with possibility for additional volatility from the net revenues of the athletic system. The negative outlook reflects the possibility that the rating on the Athletic Facilities bonds could move to one notch below the Higher Education Revenue Bond rating.

What Could Change the Rating UP

Significant growth in financial resource base; further improvements in scope of research activities and student market position.

What Could Change the Rating DOWN

Marked decline in operating performance; significant reductions in public support; decline in coverage by pledged revenues or material increase in debt under the Athletic Facilities pledge.

KEY INDICATORS (Fiscal year 2009 financial data and Fall 2009 enrollment data):

FTE enrollment: 37,965 students

Columbia campus freshman selectivity: 63.6%

Columbia campus freshman yield: 34.8%

Total financial resources: $647 million--including affiliated foundations

Total pro forma debt: $631 million--including affiliated foundations

Expendable financial resources to pro forma debt: 0.7 times

Expendable financial resources to operations: 0.5 times

Monthly Liquidity: $312 million

Monthly Days Cash on Hand (unrestricted funds available within 1 month divided by operating expenses excluding depreciation, divided by 365 days): 130 days

State appropriation per student: $4,764

Average operating margin: 4.2%

State general obligations rating: Aaa with stable outlook

Operating reliance on state support: 18%

RATED DEBT


Series 2005 Refunding Series A Revenue Bonds: rated Aa2; insured by National Public Finance Guarantee Corp. (current financial strength rating of Baa1 with a developing outlook)

Series 1999A, 2004A Revenue Bonds: rated Aa2; Ambac insured (current financial strength rating of Caa2 on review for potential upgrade)

Series 2002 Athletic Revenue Bonds: rated Aa2; Ambac insured

Series 2000A Revenue Bonds: rated Aa2; FGIC insured

Series 2005A and 2006A Revenue Bonds: rated Aa2; XLCA insured (current financial strength rating of Ca with a developing outlook)

Series 2003B and 2009A Revenue Bonds: rated Aa2

Series 2008A Revenue Bonds: rated Aa2; FSA insured (current financial strength rating of Aa3 with a
Series 2008A and 2008B Athletic Revenue Bonds: rated Aa2

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METHODOLOGY

The rating assigned to the University of South Carolina was issued on Moody's global rating scale. Market participants should not view the recalibration of municipal ratings as rating upgrades, but rather as a recalibration of the ratings to a different rating scale. This recalibration does not reflect an improvement in credit quality or a change in our credit opinion for rated municipal debt issuers. For further details regarding the recalibration of Moody's U.S. municipal ratings to its global scale please visit www.moodys.com/gsr.

The principal methodology used in rating the University of South Carolina was Moody's Rating Methodology for Public Colleges and Universities published in November 2006 and available on www.moodys.com in the Rating Methodologies sub-directory under the Research & Ratings tab. Other methodologies and factors that may have been considered in the process of rating this issuer can also be found in the Rating Methodologies sub-directory on Moody's website.

The last rating action was on February 12, 2009 when the Aa2 ratings and stable outlook of the University of South Carolina were affirmed.

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