

SPECIAL COMMENT

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Eye on the Ball: Big-Time Sports Pose Growing Risks for Universities

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Analyst Contacts:

NEW YORK +1.212.553.1653

Paul Corcoran +1.212.553.4418
Associate Analyst
paul.corcoran@moodys.com

Dennis M. Gephardt +1.212.553.7209
Vice President - Senior Analyst
dennis.gephardt@moodys.com

Kendra M. Smith +1.212.553.4807
Managing Director - Public Finance
kendra.smith@moodys.com

Karen Kedem +1.212.553.3614
Vice President - Senior Analyst
karen.kedem@moodys.com

Susan Fitzgerald +1.212.553.6832
Senior Vice President
susan.fitzgerald@moodys.com

Edie Behr +1.212.553.0566
Vice President - Senior Credit Officer/Manager
edith.behr@moodys.com

Summary

Universities pursue high-profile sports programs for the opportunity to increase brand recognition, student demand, and donor support. However, that upside comes with financial and reputational risks that require careful oversight. As the commercial success of big-time college sports has grown, so too have the potential benefits and risks to universities.

Benefits:

- » **Stronger Brand:** High-profile sports provide invaluable visibility for university brand, which can boost student demand and spur fundraising.
- » **Growing Media Revenue:** Television rights contracts for the five major conferences have grown exponentially, with no expected future deceleration.

Risks:

- » **Budgetary Strain:** 90% of athletic programs are not self-sustaining, requiring growing subsidies, which divert funding away from other university operations.¹
- » **Public Scrutiny:** Scandals cause reputational impact that is magnified by media attention and unwanted national focus.
- » **Debt Capacity:** Increasing capital investment for athletic facilities can deplete debt capacity in the absence of exceptional fundraising.
- » **Uncertain Future Costs:** Current cost structure does not incorporate potential impact of concussion treatment or movement away from amateur athlete model.

This report focuses on NCAA Division I universities. Athletic programs at NCAA Division II, III, and non-NCAA universities typically generate far less revenue and widespread brand recognition, but can contribute to the university's mission and market position. These programs still present financial and reputational risks, but not at the escalated level of more commercially successful franchises for Division I members.

¹ Division I public universities only. Data from Indiana University School of Journalism in conjunction with USA Today.

Athletic success typically enhances university brand

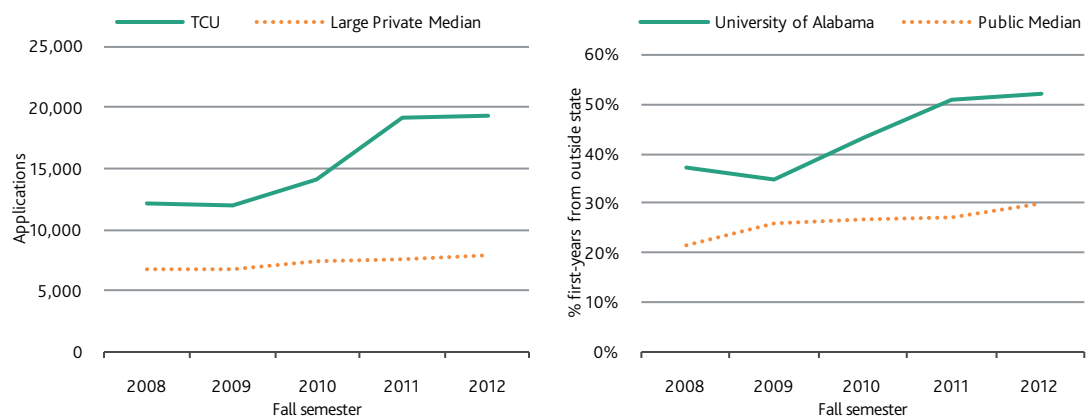
Although the direct financial impact of athletics is moderately negative for the majority of universities, the long term benefits go far beyond annual revenue generated directly from ticket sales, athletic fundraising, conference distributions, and licensing revenue. Successful football and basketball teams provide brand promotion that would otherwise be prohibitively expensive, and likely unobtainable, via traditional marketing. Less established programs that experience unexpected success like Wichita State University (Aa3 stable) and Florida Gulf Coast University (A1 stable) in the 2013 NCAA Men's Division I Basketball Championship garner national media attention, providing the universities the opportunity to quickly leverage increased visibility into elevated student demand and donor support.

Student demand has tended to increase at universities with athletic programs that have risen to national prominence. For example, Texas Christian University's (TCU, Aa3 stable) remarkable football seasons in 2009 and 2010 paved its way into the more prestigious and lucrative Big 12 conference. Undergraduate applications at the university increased by 60% from fall 2009 to fall 2011, with a much higher percentage coming from outside the state of Texas (Exhibit 1). With a newly renovated football stadium and a secure spot in one of the NCAA's (National Collegiate Athletic Association, Aa2 negative) five major conferences, we expect student demand at TCU will continue to benefit from its intercollegiate athletic program.

The University of Alabama (Aa2 stable), a flagship public university with an established national reputation, saw higher demand during its recent run of football national championships. The percentage of first-year students from outside the state grew to 52% from 35% in just three years (Exhibit 1). A higher proportion of students paying out-of-state tuition at public universities directly translates into increased tuition revenue and also reflects a broader geographic reach of university brand.

EXHIBIT 1

Athletic Success Fosters Strong Student Demand



Source: Moody's; Large Private Median includes those with over \$150m of revenue or over 3,000 total enrollment FTEs.

The potential boost to student demand from athletics is of growing importance because of heightened competition among universities amidst strains on enrollment. In fall 2012, the number of students attending four-year colleges declined for the first time in six years, highlighting the need to establish a strong brand in an increasingly competitive environment for students.² Even programs without winning records can generate interest from prospective students by offering a more complete campus experience, while also strengthening the relationship between a university and its local community.

² Moody's Sector Comment, [Enrollment Declines Are Credit Negative for Higher Education \(158110\)](#), September 9, 2013

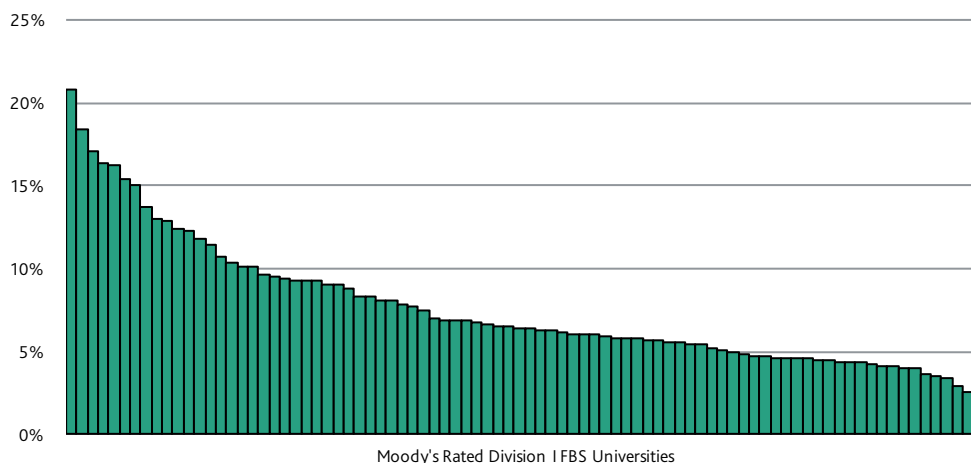
The financial model for athletics is changing, increasing the risk profile

Spending more on athletics can present a drain on overall operating performance and criticism because of the diversion of funds away from core academic and research initiatives. In most cases, athletic expenses are modest compared to the entire university budget, averaging 7.6% of total operating expenses³. However, athletic budgets have increased rapidly relative to other university expenses, a trend we expect to continue given the growing commercial success of Division I athletics. On an average basis, the athletic operating expenses of Division I universities have nearly doubled since 2004⁴ compared to growth of 58% for total expenses⁵. In fiscal year (FY) 2012, athletic budgets at more than 20% of Moody's rated Division I Football Bowl Subdivision (FBS) universities were greater than 10% of the total university budget (Exhibit 2).

EXHIBIT 2

Size of Athletic Budget Varies Widely Relative to Total University Operations

Athletic expenses as a % of total operating expenses, FY 2012



Excludes large public university systems that operate multiple athletic programs at different campuses

Total operating expenses exclude research expense and patient care expense

Sources: Moody's Municipal Financial Ratio Analysis; US Department of Education NCES IPEDS Data Center; Indiana University School of Journalism in conjunction with USA Today;

The vast majority of athletic departments operate at a loss, requiring university subsidies, which have increased by a median of 25% from FY 2008 to FY 2012.⁶ This growth has sometimes created friction on campus, given that many units have been asked to reduce expenses. The operations of athletic systems can be volatile with upticks sometimes driven by outsized expenses such as paying penalties as a result of NCAA sanctions or paying a new high-profile head coach along with one who was dismissed, but is still paid in order to fulfill his or her contract. Although revenue from high-profile sports has grown significantly, expenses from less commercially prominent sports are still large enough such that most athletic departments generate negative net income each year.

³ Total operating expenses exclude research and patient care expense.

⁴ National Collegiate Athletic Association, "[Revenues & Expenses, 2004-2012](#)", April 2013

⁵ Average growth in total operating expenses at Moody's rated Division I universities.

⁶ Division I public universities only. Data from Indiana University School of Journalism in conjunction with USA Today.

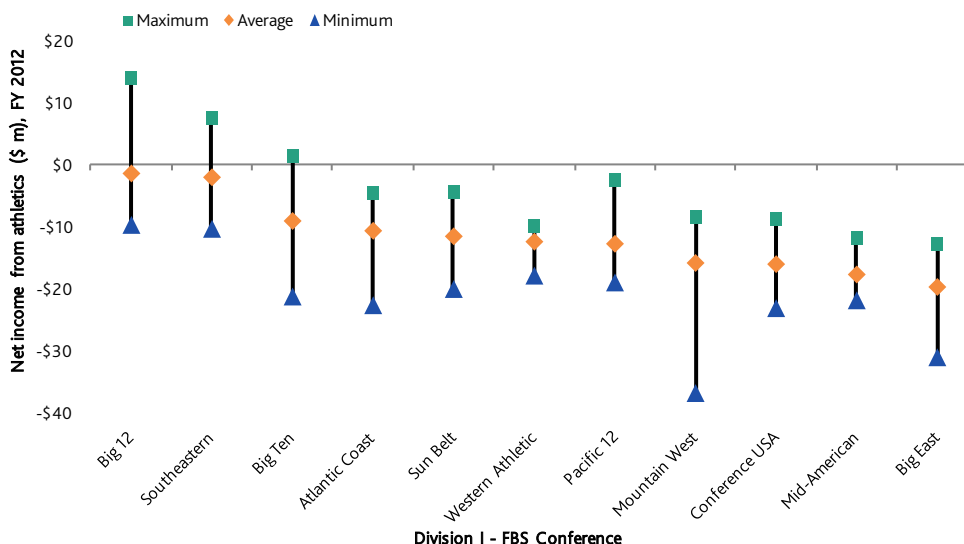
Concussion Risk and O'Bannon Lawsuit Highlight Uncertainty Around Potential Future Costs

While budgets for intercollegiate athletics already incorporate the costs of near-term injuries to student-athletes, the longer-term costs of injuries are uncertain. The August 2013 \$765 million settlement over concussion-related brain injuries between the National Football League and a group of its retired players highlights the costs of long-term cognitive decline and sets a precedent for player compensation.⁷ Changing standards around the treatment of football head injuries could increase the costs of college football programs. The NCAA is subject to litigation risk related to concussions sustained by former student-athletes with potential financial consequences for the association.

Athletic costs could also increase if the prevailing model of amateurism of student-athletes is successfully challenged. One challenge comes from the NCAA Student-Athletes Name & Likeness Licensing Litigation (also known as O'Bannon v. NCAA), initially filed in July 2009. The plaintiffs allege that the NCAA acts in violation of The Sherman Antitrust Act and improperly licenses the players' likenesses and violates the players' right of publicity.⁸ The timing of a ruling, appeal, or potential settlement remains uncertain. While the case initially involved only former players, the related credit risk to the NCAA and its members would increase if it were to incorporate current players as well as broaden claims on revenues related to the media and licensing revenue driven by student-athlete competition.

Only about 10% of athletic programs generate positive net income. All these programs are in one of the three top conferences: the Big 12, Southeastern, or Big Ten (Exhibit 3). Universities without strong athletic reputations that fund increasing annual athletic expenses sacrifice potentially stronger university-wide operating performance for a chance at generating the same national name recognition as their peers. Given slowed revenue growth at both public and private universities in FY 2012 (medians of 1.7% and 3.0%, respectively), management of athletic budgets requires heightened fiscal discipline, especially at universities where athletics fail to meaningfully promote the brand to justify increasing the investment.

EXHIBIT 3
Most Division I Athletic Programs Are Not Self-Sustaining



Data reflect public universities only; Net Income excludes university subsidy and mandatory student fees
 Source: Indiana University School of Journalism in conjunction with USA Today

⁷ National Football League, “[NFL, ex-players agree to \\$765M settlement in concussions suit](#)”, August 29, 2013.

⁸ Moody’s Issuer Research, [Moody’s revises NCAA \(IN\)’s outlook to negative; Aa2 affirmed, June 2013](#)

Many universities have undertaken costly improvements to their athletic facilities as they join new conferences. The improvements are financed by fundraising or by debt issuance. Universities that are unable to generate exceptional fundraising have financed athletic capital projects through issuing bonds. Oftentimes these projects generate incremental revenues, but the issuance of debt for athletics reduces debt capacity available for other university priorities.

The two newest members of the Southeastern Conference, Texas A&M University System (Texas A&M, Aaa stable) and University of Missouri System (Aa1 stable), will over the next few years begin constructing \$450 million and \$72 million athletics-related projects, respectively. Texas A&M recently announced that it had raised a university record \$740 million of gifts in FY 2013, driven in part by the university's conference change and massive stadium project.⁹ Likewise, TCU joined the Big 12 conference in fall 2012 after renovating its stadium, primarily with funding from a capital campaign that far exceeded its original goal.

Switching conferences to capture brand benefits and grow revenue

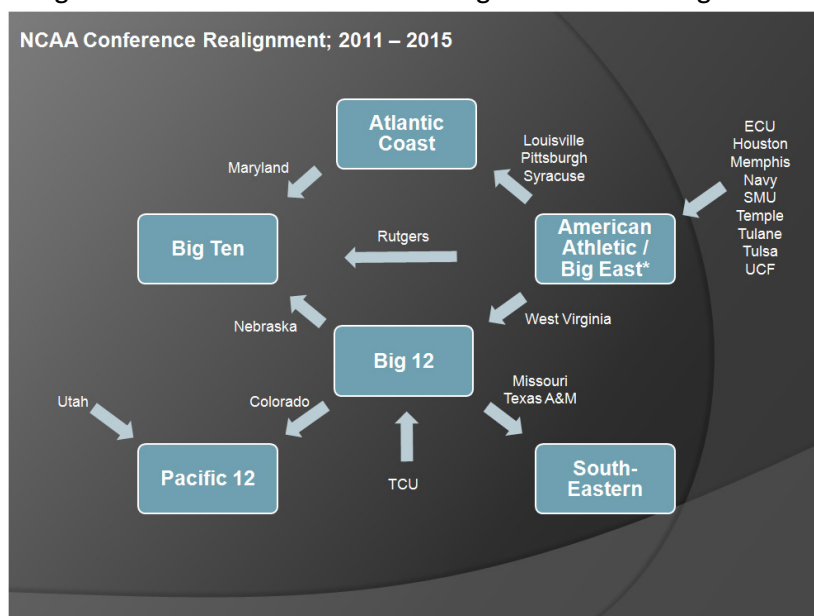
Entry into a new conference can be an opportunity to achieve greater national visibility in order to recruit more students from a wider geographic area, and eventually, attract more donor support. Since 2011, there has been considerable realignment within the five major football conferences, with universities forsaking regional and traditional affiliations for the chance to strategically realign their brands with a more prestigious conference. For example, the three former members of the Big East Conference that will join the Atlantic Coast Conference can eventually expect greater brand exposure to the Southeastern region of the country where high school student demographics are more favorable (Exhibit 4). In addition to the branding considerations, the conferences form a natural peer group that is useful in administrative benchmarking and some have a record of fostering academic collaboration.

Strategic conference realignment is also motivated by the potential for revenue growth because conferences with stronger national brand recognition also command the highest broadcast revenue distributions. Universities have shown willingness to incur steep conference exit fees for the opportunity to join new conferences, reasoning that increased future revenue growth will cover the one-time payment. For example, West Virginia University (Aa3 stable) paid \$20 million to the Big East Conference to exit in 2012 (Exhibit 4). In joining the Big 12 Conference, the university will receive an annual media rights revenue distribution of approximately \$20 million, which is significantly higher than the annual payout to universities in the Big East Conference.

⁹ Texas A&M University, "[Texas A&M posts a record year for fundraising](#)," September 16, 2013

EXHIBIT 4

Universities Strengthen Brand and Grow Revenue Through Conference Realignment



Source: Individual athletic conferences; Moody's

*The Big East became a non-football conference starting in 2013. The six Big East universities that had football teams left the conference to form the American Athletic Conference, which will add eight new universities by 2015.

See Appendix for full university names and additional details.

Larger media rights contracts for members of the five major conferences have provided additional motivation to develop major athletic programs. We expect the competition for establishing nationally recognized programs will intensify as the broadcast and cable networks' demand for media rights strengthens, continuing to increase payouts to universities. Live college sports are highly coveted programs for broadcast and cable networks due to their dependably strong ratings and desirable viewer demographics. As a result, advertisers are willing to pay a premium for air time during live sporting events. In FY 2013, annual conference revenue from media rights contracts was over \$17 million for each university within the five major conferences (Exhibit 5). By contrast, the next largest annual conference payout is less than \$5 million per university.

EXHIBIT 5

A New Era of Television Contracts Makes Pursuit of Big-Time Athletics More Attractive

Conference	Est. Previous Contract (\$ m)	Current Contract (\$ m)	TV Revenue per University (\$ m)*
Big Ten	\$62	\$250	\$23
Pacific 12	\$57	\$250	\$21
Big 12	\$80	\$200	\$20
Atlantic Coast	\$70	\$240	\$17
Southeastern	\$57	**\$205	\$17

*Per university figures are approximate. Details for exact distributions among universities in each conference are not disclosed.

**The Southeastern Conference recently signed a contract anticipated to be worth more than that of any prior contract.

Source: SportsBusiness Journal Factbook; Forbes

Heightened risks require careful oversight and management

As college sports become a greater focus of both universities and the national media, strong governance is required to prevent negative financial and reputational impact. Establishing proper controls and procedures that reflect institutional integrity while laying the groundwork for the university to produce competitive teams remains a difficult, but crucial, objective of a university's governing policies. High-profile coaches, major donors, and booster clubs are sometimes motivated to promote and develop strong programs through strategies that can compromise institutional integrity. Control over these potential influences and clear definitions of where accountability and decision-making responsibilities lie are paramount for effective governance and risk mitigation.

A breach of institutional integrity related to intercollegiate sports can produce a major public relations challenge due to the propensity for media to fixate on athletics scandals. High-profile sports garner disproportionately large media attention relative to their place within the realm of university activities. Such visibility is positive for brands during periods of athletic success, but detrimental during scandals. Negative public focus stemming from athletics can cause a distraction for management and damage the reputation of a university. Sound governance structure is a credit positive because it can minimize both the likelihood and the effect of scandals by establishing clear policies regarding decision-making, accountability, reporting, and handling of misconduct.

Pennsylvania State University (Penn State, Aa2 stable), incurred a \$60 million penalty from the NCAA plus future potential costs of litigation settlements following the criminal conviction of former assistant football coach, Jerry Sandusky. Penn State has recently employed stronger governance practices to more appropriately assess and not overlook emerging enterprise risks.¹⁰ The NCAA recently acknowledged the strengthening of Penn State's governance by allowing it to restore scholarships slots at a faster pace than outlined in July 2012 sanctions. Athletic scandals can also lead to management distraction and contribute to turnover as was the case at the University of North Carolina at Chapel Hill (Aaa stable) and at Rutgers, the State University of New Jersey (Aa3 negative)¹¹. The reputational impact can last multiple years, distracting management, negatively affecting donor support and, in extreme cases, enrollment.

Rawlings Panel Report: A Proposal for Athletics Oversight

On August 29, 2013, the Rawlings Panel on Intercollegiate Athletics at the University of North Carolina at Chapel Hill released a report making recommendations that included suggestions for universities nationwide to consider, including a framework for governing athletics.¹² The report advocates for policies that establish institutional control and minimize the potential for reputation damaging scandals. The framework is centered on defining responsibility and accountability of the university's board as well as its chief executive officer. The report suggests proper governance should be implemented so that decision making power of the president and board is impervious to undue influence from booster clubs or other athletic stakeholders. The report also acknowledges the difficulty of meaningful reform in the face of the desire to mount competitive teams. It cites several prior concerted efforts of intercollegiate reforms that did not stem the tide of escalating challenges.

¹⁰ Moody's Issuer Research, [Pennsylvania State University Makes Credit Positive Changes to Board and Oversight Policies, May 2013 \(153998\)](#)

¹¹ Moody's Issuer Research, [Basketball Controversy is Credit Negative for Rutgers, a University in Transition, April 2013 \(152255\)](#)

¹² University of North Carolina, "[Rawlings Panel on Intercollegiate Athletics at University of North Carolina at Chapel Hill](#)", August 9, 2013

Binghamton University (State University of New York, Aa2 stable) is another example of a university that faced negative consequences from lack of appropriate oversight of its athletics program. Hoping to heighten the visibility of its basketball program, the university joined Division I in 2001 and opened a new \$33 million Events Center in 2004. Following a period of increasingly negative publicity in 2009, the SUNY Board of Trustees requested an independent investigation conducted by Judith S. Kaye of Skadden, Arps, Slate, Meagher & Flom. The resulting Kaye report¹³ found that under a new coach the university “had suddenly multiplied the pool of student-athletes requiring extensive academic... services” and the “President took no corrective action... when faced with growing concerns ... regarding the direction of BU’s men’s basketball program.” The fallout from the publicized events ultimately resulted in resignation or dismissal of the head coach and athletic director. In addition to cases of violation of the university’s protocol involving communication between coaching staff and admissions personnel, the Kaye report also concluded that the coaching staff reacted to allegations of basketball player misconduct in a manner “in which damage control was emphasized at the expense of constructive discipline.”

¹³ State University of New York, “[Kaye Report to Board of Trustees of State University of New York](#)”, February 11, 2010

Appendix: NCAA Conference Realignment, 2011-2015

Abbreviation	Full Name of University	First Year in New Conference	Previous Conference	New Conference
Colorado	University of Colorado	2011	Big 12	Pacific 12
Utah	University of Utah	2011	Mountain West	Pacific 12
Nebraska	University of Nebraska	2011	Big 12	Big Ten
West Virginia	West Virginia University	2012	Big East*	Big 12
Missouri	University of Missouri	2012	Big 12	Southeastern
Texas A&M	Texas A&M University	2012	Big 12	Southeastern
TCU	Texas Christian University	2012	Mountain West	Big 12
Houston	University of Houston	2013	Conference USA	American Athletic*
Memphis	University of Memphis	2013	Conference USA	American Athletic*
SMU	Southern Methodist University	2013	Conference USA	American Athletic*
Temple	Temple University	2013	Mid-American	American Athletic*
UCF	University of Central Florida	2013	Conference USA	American Athletic*
Pittsburgh	University of Pittsburgh	2013	Big East*	Atlantic Coast
Syracuse	Syracuse University	2013	Big East*	Atlantic Coast
ECU	Eastern Carolina University	2014	Conference USA	American Athletic*
Tulane	Tulane University	2014	Conference USA	American Athletic*
Tulsa	University of Tulsa	2014	Conference USA	American Athletic*
Rutgers	Rutgers, the State University of New Jersey	2014	Big East*	Big Ten
Maryland	University of Maryland	2014	Atlantic Coast	Big Ten
Louisville	University of Louisville	2014	Big East*	Atlantic Coast
Navy	United States Naval Academy	2015	Independent	American Athletic*

Source: Individual athletic conferences; Moody's

*The Big East became a non-football conference starting in 2013. The six Big East universities that had football teams left the conference to form the American Athletic Conference, which will add eight new universities by 2015.

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Authors
 Paul Corcoran
 Dennis M. Gephardt

Editors
 Susan Fitzgerald
 Edie Behr

Production Associate
 Eri Watanabe

Associate Analyst
 Gopal Narsimhamurthy

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