MOODY'S
INVESTORS SERVICE

New Issue: MOODY'S ASSIGNS A2 RATING TO UNIVERSITY OF SAN DIEGO'S (CA) SERIES 2012A REFUNDING REVENUE BONDS; OUTLOOK IS POSITIVE

Global Credit Research - 25 Apr 2012

UNIVERSITY WILL HAVE $175 MILLION OF PRO-FORMA RATED DEBT, INCLUDING THE CURRENT OFFERING

CALIFORNIA MUNICIPAL FINANCE AUTHORITY
Private Colleges & Universities
CA

Moody's Rating

ISSUE	RATING
Refunding Revenue Bonds (University of San Diego), Series 2012A	A2
Sale Amount $11,000,000	
Expected Sale Date 05/30/12	
Rating Description Revenue: 501c3 Unsecured General Obligation	

Moody's Outlook POS

Opinion

NEW YORK, April 25, 2012 --Moody's Investors Service has assigned an A2 rating to the University of San Diego's approximately $11 million California Municipal Finance Authority ("CMFA") Series 2012A Refunding Revenue bonds. The rating outlook is positive.

SUMMARY RATING RATIONALE

The A2 rating reflects the University of San Diego's ("USD" or the university) stable enrollment growth, strong operating margins, growing balance sheet, and effective financial controls. The rating also incorporates the highly competitive student market, evidenced by a low and declining matriculation rate (17% for fall 2011); high dependence on student charges, and 51% of debt in variable rate mode.

STRENGTHS:

*Stable market position with diverse programs and improving selectivity at the undergraduate level. Full-time equivalent (FTE) enrollment was 7,748 in fall 2011, of which 71% was undergraduate. Freshman undergraduate selectivity was 47.5% in fall 2011, slightly stronger than the prior year at 51%. Management reports a 20% increase in freshmen applications for fall 2012 over last year.

*Robust operating performance, with a 23% operating cash flow margin in FY 2011, provided healthy debt service coverage of 4.9 times, and supported balance sheet growth since the university retained the majority of its surpluses.

*Growing financial resources provide healthy coverage of pro-forma debt and operations. Expendable financial resources grew a notable 57% last year to $250.4 million in FY 2011 due to a 19% endowment return, gift revenue and surplus reserves transferred to the quasi-endowment.

*Strong financial controls, conservative budgeting and long-term planning. In 2003, the board committed to growing the endowment to $500 million through investment returns, donations and tuition transfers to the quasi endowment by FY 2013.

CHALLENGES:

*High reliance on tuition and auxiliary revenue for 84% of total operating revenue as of FY 2011 per Moody's calculation. USD has seen variable net tuition revenue per student growth over the past five years, with a 2.3% increase in FY 2011 but recent declines of 5% and 0.3% in FY 2009 and FY 2010 respectively.

*USD operates in a very competitive environment, with lower-cost public institutions and many strong private universities in California, evidenced by a low matriculation rate that continues to decline and was 17.3% in fall 2011.

*Monthly liquidity of $147 million in FY 2011 provided adequate coverage of variable rate demand debt at 1.45 times, though below the FY 2010 median of 2.16 for A-rated private colleges and universities. Monthly liquidity provided satisfactory 225 days coverage of expenses in FY 2011, on a total expense base of $254 million.

*Potential for new debt issuance in the next 3 to 5 years.

DETAILED CREDIT DISCUSSION

USE OF PROCEEDS: The Series 2012A Refunding Revenue Bonds will be issued by the California Municipal Finance Authority and bond proceeds will be used to refund the Series 2002 Revenue bonds. The university will also provide up to $3.5 million of its own equity in addition to the bond proceeds to cover remaining refunding costs.

LEGAL SECURITY: The Series 2012A Refunding Revenue Bonds are an unsecured general obligation of the university.

Similar to the university's other outstanding debt, the university covenants that it will not issue any additional debt unless unrestricted and temporarily restricted net assets equals at least 200% of the university's debt outstanding. USD must also maintain its accreditation with the Western Association of Schools and Colleges and the American Bar Association, and not take any action that would impair the tax-exempt status of the bonds.

DEBT STRUCTURE: The Series 2012A Revenue Bonds will be fixed-rate, 20-year tax-exempt debt with principal payments made from 2029 to 2032.

The university has $184.3 million in pro-forma direct debt based on FY 2011 financials, including $81.6 million of fixed rated debt and $93.4 million of Series 2005 variable rate bonds (51% of direct debt is in a variable rate mode). In addition, the college has $1.5 million of capital leases and a $7.8 million term loan with US Bank Equipment Finance for energy savings projects.

The university's variable rate Series 2005 is supported by a Letter of Credit (LOC) from Wells Fargo Bank, N.A. (Aa3/P-1 with a negative outlook). We note that the current debt structure adds additional risk since the bank could accelerate bond payments or terminate the LOC under certain circumstances. These circumstances include failure to maintain at least a Baa3 rating on rated debt or failure to meet certain financial covenants, including debt service coverage of at least 1.25 times and an unrestricted and temporarily restricted net assets ratio of at least 200% of pro-forma debt. According to the university's calculations as of the end of FY 2011, USD had significant headroom for these covenant requirements, with 3.5 times debt service coverage and 424% unrestricted and temporarily restricted net assets coverage of pro-forma debt. The university must also maintain its accreditation by the Western Association of Schools and Colleges at all times. The Letter of Credit expires on November 1, 2015.

USD has a $10 million line of credit with Wells Fargo for working capital; however the university has not drawn on this line of credit over the past ten years. The line of credit has a covenant that unrestricted net assets be 1.5 times the current portion of long-term debt; as of fiscal year end FY 2011, USD's coverage was an ample 4.2 times.

DEBT-RELATED DERIVATIVES: USD entered into a LIBOR-based swap agreement with Société Générale, New York branch (rated A1, rating under review for downgrade) in conjunction with its Series 2005 bonds. The counterparty may terminate the swap under certain conditions including the university's rating falling below Baa3 by Moody's or BBB by S&P. In addition, if the university's rating falls below Baa2 by Moody's or BBB by S&P, USD will have to post collateral ($0 threshold). As of March 30, 2012, the mark-to-market valuation for the agreements was a liability to USD of $26.18 million and no collateral has ever been posted. The swap termination date is October 1, 2045. Given USD's satisfactory liquidity and prudent management, Moody's believes the risks associated with this derivative structure are manageable at the current rating level.

MARKET POSITION/COMPETITIVE STRATEGY: STABLE ENROLLMENT AND DIVERSE PROGRAMS; COMPETITIVE STUDENT MARKET AND VARIABLE NET TUITION REVENUE PER STUDENT

The University of San Diego is an urban, Catholic university located in San Diego, CA that benefits from a diversity of undergraduate and graduate programs. As of fall 2011, 71% of students were undergraduates, and the university offers 33 master's degrees, three doctoral degrees, five masters of law degrees, and a Juris Doctorate.

We believe that the University of San Diego will continue to see stable enrollment given increased applications. Freshman applications were 13,867 in FY 2011, a 14% increase over fall 2010, and management expects a 20% increase for fall 2012. Many colleges across the country have seen an increase in applications, but particularly so for private colleges in California given enrollment caps at the state universities. In line with increased applications, the college has become more selective for freshmen, with a selective rate of 47.5% in fall 2011 down from 51.3% the prior year. Management anticipates a 40% acceptance rate for fall 2012, with 52% of students coming from outside California (up from 48% in fall 2011). Yield has also declined and was a low 17.3% for fall 2011, reflecting the increased applicant pool as well as the competitive student market.

Total FTE for undergraduates was 5,459 for fall 2011, a 2.6% increase over fall 2010. The college plans to keep the freshman class size at 1,100 to 1,150 students, but may explore increasing the class size in the longer-term. An increased size would require additional housing and parking. The university plans to redesign the college's core curriculum, which was a suggestion from the university's accreditation review process by the Western Association of Schools & Colleges. The core curriculum will aim to be more coherent, integrated and flexible; and some courses will be updated. In addition, the university will continue to prioritize undergraduate research opportunities, and is piloting a living learning community through which a cohort of freshmen study, live and engage in community service together.

Enrollment at the graduate and professional level has increased, except for the law school. Total FTE for the graduate school (including the paralegal program) was 1,291 in fall 2011, a 2.8% increase from fall 2010. The fall 2011 entering law school class size declined 9.4% from fall 2010, though FTE for the entire law school remained stable over last year. Though applications have increased for other graduate programs, the law school's applications for fall 2011 fell a significant 17% from fall 2010, above the approximately 11% decline for law schools nationally according to the American Bar Association journal.

OPERATING PERFORMANCE: STRONG OPERATING MARGINS LEADING TO ENDOWMENT GROWTH; VARIABLE NET TUITION REVENUE GROWTH PAST FEW YEARS

Moody's expects that USD will continue to see high operating margins in the future given conservative budgeting and expense control measures, as well as tuition increases with plans to keep the discount rate flat. The university's operating cash flow margin was a strong 22.7% in FY 2011 due to a 7% increase in net tuition revenue as well as grants and contracts and gift revenue growth. Management also reports expense cuts from reduced utilities costs, lower non-instructional labor costs, and debt service reductions through debt refundings. USD's strong operating performance provided healthy debt service coverage of 4.87 times in FY 2011, above the median of 3.03 times for private universities in the A rating category.

For FY 2012, the university expects similar or better operating performance relative to FY 2011, through under-budgeting enrollment and lower expenses due to reduced utilities and a flat discount rate (accomplished by reducing the number of students who receive merit scholarships). For FY 2012, management anticipates an operating surplus of $14 million (similar to FY 2011's surplus), a large portion of which will be invested in the long-term pool.

USD is heavily dependent on tuition and auxiliary revenue, representing 84.5% of total operating revenues in FY 2011 per Moody's calculation. In FY 2009 and FY 2010, USD saw declining net tuition per student, with 4.9% and 0.3% declines respectively, due to an increasing discount rate. As of FY 2011 the college experienced 2.3% net tuition per student growth. While growing net tuition will be challenging given the competitive student market, we expect modest increases moving forward given plans to increase tuition moderately (3.5% for undergraduates in fall 2012) while holding the discount rate flat. The discount rate was 29% in fall 2011 per Moody's calculation.

BALANCE SHEET POSITION: SIGNIFICANT GROWTH IN FINANCIAL RESOURCES PROVIDED INCREASED COVERAGE FOR DEBT AND OPERATIONS AT RATING LEVEL

USD experienced a significant 57% increase in expendable financial resources last year, and we expect the university will continue to see endowment growth due to retained operating surplus, future fundraising efforts and tight budget controls. Expendable financial resources were $250.4 million in FY 2011, providing good coverage of pro-forma debt and operations at 1.36 and 0.99 times, respectively. The board of trustees is focused on growing the university's endowment and in 2003 began an ambitious ten-year plan to grow the endowment to $500 million.

The university is growing its endowment through market performance, gifts and $13 million of operating surplus per year transferred to the quasi endowment. As of FY 2011, the endowment was $327 million (up from $97 million in FY 2003), of which over $100 million represented the unrestricted, quasi endowment. Even though only two years remain to reach the goal, senior management indicated that the board of trustees is committed to growing the endowment and will likely extend the timeframe.

Per Moody's calculation, investment income represented 6% of total operating revenue in FY 2011. As of February 29, 2012, endowment return year-to-date was 0%, with no concentration of fund managers. The endowment return was 19% in FY 2011 and 14% in FY 2010 As of fiscal-year end 2011, the endowment was invested 37.2% in equities, 15.9% in fixed income, 22.2% in hedge funds, 10.3% in private equity, 13.4% in commodities and alternatives, and 1% in cash. Cambridge Associates is the university's investment advisor, though the investment committee of the board makes the final investment decisions and may also meet with managers.

Total gift revenue increased to $24 million in FY 2011 (up from $18 million in FY 2010), but despite this growth the university's average gifts per student remain relatively week at $2,331 as of FY 2011, below the FY 2010 $3,703 median for A-rated private colleges and universities. Management reports that fundraising is hampered by the university's young age - it was founded in 1956 - resulting in fewer alumni, but as time passes, we expect gift revenue to increase. USD's various schools are responsible for individual fundraising and many have seen large gifts recently. In addition, gifts recently fully funded a new baseball field ($14 million project cost), and is in the preliminary stages of planning the next campaign.

According to management, the university would consider issuing additional debt in the next three to five years. However, USD hopes to fund most of their future capital projects with private donations. USD hopes to build a new business school facility with private funding, and will aim to minimize potential debt issuance. Management may also start a school of engineering, and would use private gifts to renovate existing spaces. In addition, the master plan also includes additional athletic facilities, which would be built if there is sufficient private funding, and there is a housing study currently underway to support a potential requirement for sophomores to live on campus, increased undergraduate enrollment, and the relocation of certain student residences to create additional classroom and office space.

As of FY 2011, USD's monthly liquidity was $147 million, providing adequate coverage of the $93.4 million Series 2005 variable rate debt at 1.45 times, though below the FY 2010 2.12 median for A rated private universities. In addition to variable rate debt, as of fiscal-year end 2011, the university had $24.2 million in unfunded investment commitments. Monthly liquidity also provides satisfactory 225 days coverage of expenses.

GOVERNANCE AND MANAGEMENT

The experienced, competent management staff at the University of San Diego is a credit positive. USD has prudent budget measures and, along with the board, is focused on growing the endowment through operating surplus transfers. The university budgets conservatively such that enrollment always meets or exceeds the budget.

Management implemented additional checks and instituted new policies after learning lessons during the economic decline of 2009. For example, the university made several changes after certain auction rate securities became temporarily illiquid and their cash reserves hit a low point in summer 2009. The university has since eliminated its investment in auction rate securities and plans to nearly double cash held in short and medium term government bonds. The university also created a construction funding policy, which states that USD cannot build without 50-75% of gifts in hand and the remainder to be collected within 5 years of the start of construction. In addition, USD amended its debt policy, which now only allows debt for mission-critical needs.

USD's board of trustees includes two members of the Diocese of San Diego and two members of the Religious of the Sacred Heart. The other board members are lay, have diverse professional backgrounds and many attended USD. The university has a conflict of interest policy for its board of trustees.

The university benchmarks itself against ten other comparable schools, as well as public and private colleges in California.

Outlook

The positive outlook reflects Moody's expectation that the University of San Diego will continue to experience financial resource growth, strong operating surpluses and increased net tuition and gift revenue.

WHAT COULD CHANGE THE RATING UP

Improved market position, with improved or stable matriculation rates and net tuition per student growth; continued upward trend in financial resource growth providing stronger coverage of debt, particularly given potential plans for additional debt issuance in the future; increased revenue diversity.

WHAT COULD CHANGE THE RATING DOWN

Weakened student market, including further declines in the matriculation rate; stagnant or negative net tuition per student revenue; significant additional debt without commensurate financial resource growth.

KEY INDICATORS (Fall 2011 enrollment data and FY 2011 financial data):

Total Full-Time Equivalent (FTE) Enrollment: 7,748 students

Net Tuition per Student: $27,040

Educational Expenses per Student: $26,099

Average Gifts per Student: $2,331

Total Cash and Investments: $438.3 million

Total Pro-forma Direct Debt: $184.3 million

Total Comprehensive Debt: $184.3 million

Expendable Financial Resources-to-Direct Debt: 1.36 times

Expendable Financial Resources-to-Operations: 0.99 times

Monthly Days Cash on Hand: 225 days

Total Operating Revenue: $296 million

Operating Cash Flow Margin: 22.7%

Three-Year Average Debt Service Coverage: 4.37 times

Reliance on Student Charges (Tuition, Fees and Auxiliaries): 84.5%

RATED DEBT

Series 1999 Capital Appreciation Bonds: A2

Series 2002 Revenue Bonds: A2 (to be refunded)

Series 2005 VRDO Revenue Bonds: A2

CEFA Series 2011: A2

CMFA Series 2011A&B: A2

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PRINCIPAL RATING METHODOLOGY

The principal methodology used in this rating was U.S. Not-for-Profit Private and Public Higher Education published in August 2011. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

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