University of San Diego, CA

Update - Moody’s Affirms University of San Diego’s (CA) A1; outlook stable

Summary Rating Rationale
Moody’s Investors Service has affirmed University of San Diego’s CA (USD) A1 underlying ratings on outstanding revenue bonds, reflecting very good strategic positioning as a Catholic university with diverse programming and an attractive campus in San Diego. The university’s well integrated long-term financial and strategic planning, strong cash flow and fundraising have contributed to solid cash and investment cushion relative to debt and operations, and denote future financial flexibility for strategic investments. These strengths help to offset an over 80% dependence on student charges, with low net tuition revenue growth and some enrollment challenges at the graduate schools. The remarketing and acceleration risk presented by USD’s over 50% of variable rate demand debt is manageable given strong monthly liquidity providing over three times coverage and exceptional headroom under covenants.

Credit Strengths
» Long-term trend of growing reserves with no debt issuance results in a very low leverage, with spendable cash to debt of 2.8 times and 1.6 times to operations

» Prudent fiscal management with careful expense management leads to robust 18% cash flow

» Attractive location and campus with healthy reinvestment and strong donor support of approximately $24 million in FY 2015

» Diverse programming and large size, with over 7,600 students, contribute to consistent net tuition per student growth

Credit Challenges
» High 82% dependence on student charges in an extremely competitive student market

» Commitment to affordability and some graduate enrollment pressure will result in low net tuition revenue growth

» Exposure to 55% variable rate demand debt and counterparty risk through direct placement and swap require careful liquidity management
Rating Outlook
The stable outlook reflects our expectation that the university will maintain favorable operating cash flow in the 15-20% range despite slow growing net tuition revenue in FYs 2016 and 2017.

Factors that Could Lead to an Upgrade
» Substantial growth of cash and investments outpacing that of peers
» Consistently stronger philanthropy to support growing financial aid

Factors that Could Lead to a Downgrade
» Trend of declining operating cash flow coupled with deteriorating liquidity
» Sustained enrollment or net tuition revenue pressure

Key Indicators

Recent Developments
Recent developments are incorporated in the Detailed Rating Rationale.

Detailed Rating Rationale
Market Profile: Excellent Location and Diversified Programming Balance Soft Enrollment and Net Tuition Revenue Growth
USD’s diverse programming and urban location in economically vibrant San Diego (county rated Aaa/STA and city rated Aa2/STA) will contribute to stable demand and help offset enrollment declines in any one program. Growth of net tuition revenue will remain constrained, at or about inflation, due both to high competition and enrollment challenges at some of the graduate schools, particularly law. Overall, however, we expect enrollment will remain relatively stable at approximately 7,600 students, with over 25% graduate enrollment.

The university’s strategic positioning is very good, with in depth and integrated strategic, capital and financial planning. Continual reinvestment in facilities and programming through a wide variety of funding sources bolsters its competitive position.

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Operating Performance: Continued Surpluses Through Conservative Budgeting and Careful Expense Management
USD will maintain excellent operating performance with surplus operations generating cash flow above 15% margins despite low net tuition growth through conservative budgeting and careful expense management. Operating cash flow margins are above 18% in the last several years and three year average debt service coverage was a high 5.2 times for FYs 2013-2015. Surpluses moderated slightly in FY 2015, with the university’s infusion of almost $3 million in additional resources to support academic and administrative initiatives. FY 2016 will moderate incrementally further by approximately $1.5 million, and then stabilize in FY 2017 and beyond, due to continued program investment. With student charges representing a high 82% of operating revenue and expectations for low net tuition revenue growth, USD’s demonstrated expense discipline and contingency budgeting are important credit strengths.

Wealth and Liquidity: Growing Cash and Investments Support Capital Program and Operations
Retained surpluses, cash flow and philanthropy will continue to build USD’s resource cushion to debt and operations. The university has an uncommonly strong capital reinvestment program, largely self-funded through operations, leaving some additional debt capacity at the A1 rating. Spendable cash and investments have risen steadily to $464 million, providing 1.6 times spendable cash and investments on par with A1 peers. The growth is expected to continue to grow with an ongoing comprehensive campaign. The university is completing its master plan, and has identified capital projects, an expanded business school and the renovation of a library and an academic/residence hall, for which fundraising is ongoing. Potential new debt issuance is manageable given USD’s reserve growth trajectory and scheduled principal repayment on existing debt.

LIQUIDITY
A concentrated effort to grow and retain a quasi-endowment since 2003 supported USD’s growing unrestricted reserves. As of June 30, 2015, USD had $292 million of monthly liquidity, which provides very good cushion for operations (383 days), any capital calls and its demand debt. USD also has a $10 million line of credit with Wells Fargo for working capital, though the university has not drawn on this line in over a decade.

Leverage
The combination of accumulating reserves, a multi-pronged funding approach to capital and low debt issuance create some debt capacity for USD at the A1 rating. With 60% growth of spendable cash and investments, the university now has a healthy 2.8 times cushion of debt. Debt affordability is very strong relative to peers, with FY 2015 debt to cash flow of below 3 times, compared to the FY 2014 A1 private university median of 5.4 times.

DEBT STRUCTURE
The university’s regularly amortizing and relatively level debt service provide operating and budgeting predictability. USD’s approximately $91 million outstanding of variable rate 2015 direct placement bonds with US Bank present very modest remarketing and acceleration risk, given excellent headroom to covenants and strong monthly liquidity. The bonds mature in October 2045, while the direct placement expires in July 2022. Events of default that could lead to immediate acceleration include failure to maintain at least a Baa3 rating on rated debt or failure to meet a debt service coverage covenant of at least 1.25 times (USD’s coverage measured 4.5 times at June 30, 2015). There is also an additional bonds test that requires unrestricted and temporarily restricted net assets to equal at least 200% of pro-forma debt to issue, which the university well exceeded at FYE 2015 with 603% coverage.

DEBT-RELATED DERIVATIVES
The university’s swap exposure is manageable. USD has a LIBOR-based swap agreement with Société Générale in conjunction with its Series 2005 variable rate bonds (now the 2015 Direct Placement) for a notional amount of $91 million. As of January 24, 2016, the mark-to-market was negative by almost $29 million. There are no collateral posting requirements at the current rating. The swap terminates on October 1, 2045, when the bonds mature.

PENSIONS AND OPEB
The university’s retirement plans present minimal credit risk, and are manageable within the scope of its operations. Combined annual expense for the defined contribution retirement plan and retirement healthcare program were just over $15 million, a moderate 4.5% of operating expenses.
Governance and Management: Strong Fiscal Stewardship; Excellent Planning
USD’s forward-looking and fiscally disciplined management team enhance its long term financial stability, bolster operating performance and contribute to very good strategic positioning. Prudent fiscal management practices include integrated strategic, financial and capital planning, annually budgeted capital and operating reserves, regular benchmarking and self-assessment, and conservative endowment spending and budgeting assumptions.

A new president joined USD in August 2015, and senior management and the board have begun a thorough strategic planning and master planning initiative.

Legal Security
USD’s revenue bonds are an unsecured general obligation of the university.

Use of Proceeds
Not applicable.

Obligor Profile
University of San Diego is a mid-sized private Catholic comprehensive university with over 7,600 students and $331 million in operating revenue.

Methodology
The principal methodology used in this rating was Global Higher Education published in November 2015. Please see the Ratings Methodologies page on www.moodys.com for a copy of this methodology.
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