

CREDIT OPINION

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Case Western Reserve University, OH

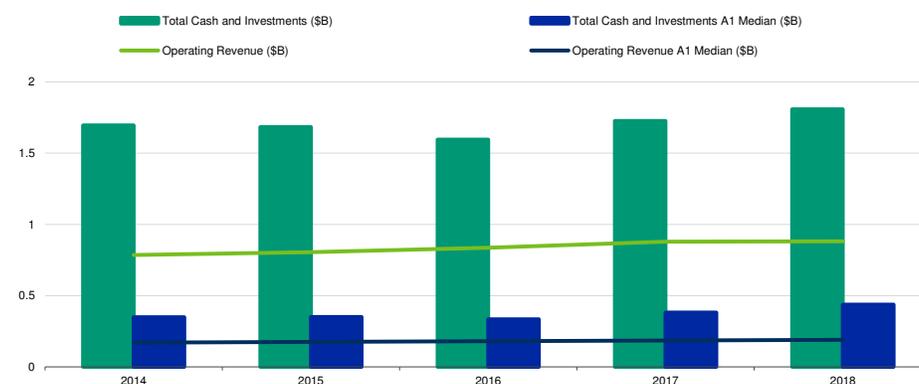
Update following revision of outlook to positive

Summary

[Case Western Reserve University's](#) (A1 positive, "CWRU") very good credit quality reflects its significant wealth and large and diverse scope of operations, supported by strong philanthropy and a sizable research enterprise. The scale and diversity of revenues provides protection against weakness in a single revenue stream. Nationally renowned health and science programs continue to drive strong student demand at both the undergraduate and graduate levels, reflected in continued growth in net tuition revenue. Further, strong relationships with the [Cleveland Clinic Health System Oblig. Group](#) (Aa2 stable, "Cleveland Clinic") and [University Hospitals Health System Inc.](#) (A2 positive, "UH") boosts the university's strategic and market position. Offsetting considerations include more constrained liquidity because of higher proportion of permanently restricted assets, moderate operating performance, recent weakening of revenue growth, and a competitive operating environment for students and research awards.

On March 1, 2019 Moody's revised Case Western Reserve University, OH's outlook to positive, from stable.

Exhibit 1

CWRU's total cash and investments and operating revenue far exceed the A1 median


Fiscal 2018 A1 median numbers are estimated.

Source: Moody's Investors Service

Credit strengths

- » Considerable wealth of over \$1.8 billion in total cash and investments in fiscal 2018
- » Strong donor support, averaging \$99 million in gift revenue from fiscal 2016 through fiscal 2018
- » Sizable and diverse scope of operations with a large research profile and total operating revenue of over \$880 million

Credit challenges

- » Highly competitive student market and significant competition for federal research funding, which are the university's two key revenue streams
- » A large portion of CWRU's wealth permanently restricted, somewhat limiting financial flexibility
- » Thin operating performance relative to peers

Rating outlook

The positive outlook reflects the potential for enhanced credit quality should the university's strategic position be further bolstered by the successful launch of the university's Health Education Campus, strengthening the university's market position and research profile. Further, the positive outlook reflects expectations of continued growth in wealth and scope of operations, driven primarily by strong fundraising and higher net tuition revenue.

Factors that could lead to an upgrade

- » Successful launch of the Health Education Campus with the Cleveland Clinic
- » Improved operating performance with operating cash flow margins sustainable in the low-to-mid double digits
- » Continued strengthening of student demand resulting in further net tuition revenue growth and enhanced competitiveness of the research enterprise
- » Further growth in liquid financial reserves improving coverage of expenses

Factors that could lead to a downgrade

- » Material decline in available liquid reserves weakening leverage and coverage of expenses
- » Multiyear weakening of operating performance reducing debt service coverage below 1.5x
- » Deterioration of strategic partnerships with the Cleveland Clinic and University Hospitals

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Key indicators

Exhibit 2

CASE WESTERN RESERVE UNIVERSITY, OH

| | 2014 | 2015 | 2016 | 2017 | 2018 | Pro Forma | Median: A Rated Private Universities |
|--|-----------|-----------|-----------|-----------|-----------|-----------|--|
| Total FTE Enrollment | 10,130 | 10,586 | 10,820 | 10,917 | 11,073 | 11,073 | 4,604 |
| Operating Revenue (\$000) | 785,208 | 805,129 | 836,428 | 878,052 | 881,439 | 881,439 | 185,094 |
| Annual Change in Operating Revenue (%) | 2.3 | 2.5 | 3.9 | 5.0 | 0.4 | 0.4 | 2.6 |
| Total Cash & Investments (\$000) | 1,694,480 | 1,683,882 | 1,595,496 | 1,726,918 | 1,808,068 | 1,808,068 | 382,221 |
| Total Debt (\$000) | 565,243 | 564,856 | 560,603 | 506,918 | 496,973 | 497,613 | 144,757 |
| Spendable Cash & Investments to Total Debt (x) | 1.9 | 1.8 | 1.7 | 2.0 | 2.2 | 2.2 | 1.8 |
| Spendable Cash & Investments to Operating Expenses (x) | 1.4 | 1.3 | 1.1 | 1.2 | 1.3 | 1.3 | 1.4 |
| Monthly Days Cash on Hand (x) | 191 | 180 | 177 | 176 | 184 | 184 | 355 |
| Operating Cash Flow Margin (%) | 11.2 | 11.8 | 12.2 | 11.8 | 9.8 | 9.8 | 14.1 |
| Total Debt to Cash Flow (x) | 6.4 | 6.0 | 5.5 | 4.9 | 5.7 | 5.7 | 4.9 |
| Annual Debt Service Coverage (x) | 2.9 | 2.9 | 2.8 | 3.0 | 2.3 | 2.3 | 2.7 |

Pro forma column includes proposed Series 2019 A bonds.

Source: Moody's Investors Service

Profile

Case Western Reserve University is the largest comprehensive private research university in Ohio, with sizable operations of over \$880 million and enrollment of over 11,000 FTEs. The university is located in University Circle, a 550-acre concentration of more than 50 educational, medical, cultural, religious, and social service institutions at the eastern edge of Cleveland.

Detailed credit considerations

Market profile: comprehensive research university with strong partnerships and sizable operations

CWRU's excellent strategic position will continue to be anchored by its strong strategic partnerships and prominent graduate reputation, bolstering its research and academic profile nationally. Favorable student demand at both the undergraduate and graduate levels continues, driven by the university's strong reputation in the sciences, technology, engineering, and math (STEM). Since fall 2010, total enrollment is up an impressive 24% to 11,073 FTEs in fall 2018. This growth occurred while many other institutions, particularly in the Midwest, suffered significant declines. Enrollment growth is likely to taper slightly, as CWRU has met its undergraduate class size goal. However, its prominent graduate and professional degree programs will remain a solid growth market, particularly given continued high demand for STEM programs.

CWRU bolsters its educational programs and research by collaborating with nearby medical institutions, the [Cleveland Clinic Health System Oblig. Group](#) (Aa2 stable "Cleveland Clinic") and [University Hospitals Health System Inc.](#) (A2 positive "UH"). The relationship with Cleveland Clinic will continue strengthening, as the two agreed on constructing a jointly owned Health Education Campus that is expected to open in the summer of 2019. The campus will include two buildings and will house multiple health science education programs. Both organizations are fundraising jointly for the project, which is estimated at \$515 million, with over \$275 million raised by both to date.

CWRU has a sizable scope of operations and maintains a large research profile with significant federally sponsored research. The university reported total operating revenue of over \$880 million and research expenditures of \$262 million in fiscal 2018. Overall, revenue comes from a variety of sources, with the largest component, tuition, fees and auxiliaries, representing 43% of total revenue.

Operating performance: operating performance will remain thin compared to peers, but debt service coverage remains sound

CWRU's steady operating performance will continue despite moderating revenue growth. Operating performance dipped in fiscal 2018, with a 9.8% operating cash flow margin in fiscal 2018, compared to 11.8% in fiscal 2017. Operating performance has historically lagged

peers, due in part to a significant research program which does not generate significant surplus operating cash flow. Despite thinner operating performance, operating cash flow covered debt service 2.3x in fiscal 2018.

Revenue growth in fiscal 2018 was very modest, at 0.4%, after averaging 3.4% annually during the prior four years, driven by fewer assets released for operations. Favorably, the university grew net tuition revenue by a solid 4.0% in fiscal 2018, after growing 8.9% the prior year. Management is budgeting for an uptick in revenue growth in fiscal 2019, primarily from the net tuition revenue growth.

Expense growth in fiscal 2018 moderated to 2.3%, down from 4.7% in the prior year. Overall, annual expense growth has averaged 2.6% over the past five years, primarily driven by research and salary expense growth. Salary and benefits expense growth pressures will continue into fiscal 2019. Sound budgeting and expense allocation will be important in maintaining or improving operating performance.

Wealth and liquidity: substantial wealth driven by strong fundraising success, although relatively modest unrestricted resources for its size

The university's considerable wealth is a key credit strength, with further growth likely over the coming years from excellent fundraising. Total cash and investments in fiscal 2018 surpassed \$1.8 billion, well above A1-rated peers. Three-year average gift revenue (fiscal 2016 through fiscal 2018) was an impressive \$99 million. A recently completed capital campaign was extremely successful, raising over \$1.8 billion, compared to an initial goal of \$1.0 billion. The campaign focused on four areas for fundraising: programmatic support; capital support; faculty support; and student financial aid.

Despite its significant wealth, spendable cash to expenses is weak compared to peers, since a large portion of CWRU's wealth is restricted and research costs elevate overall expenses. Fiscal 2018 spendable cash and investments covered operating expenses 1.3x compared to the A1-private university median of 1.8x in fiscal 2017.

To manage the university's large investment portfolio, CWRU has an in-house investment office staffed with five people. The university does not use a consultant to select its managers and the board's investment committee remains active in overseeing the function. At the end of fiscal 2018, the university reported a 9.2% investment gain, comparable to returns for other similarly-sized endowments.

Liquidity

CWRU's liquidity will remain relatively thin compared to peers, as the university's high proportion of restricted assets and allocation to alternative investments (including hedge funds and private equity) will continue to place limitations on liquidity growth. In fiscal 2018, the university reported available monthly liquidity of \$410 million, translating to 184 days of cash on hand. (In fiscal 2017, the A1-median for private colleges and universities was 397 days of cash on hand.)

Supplementing internal liquidity are two unsecured external bank lines with two counterparties totaling \$100 million. At the end of fiscal 2018, the university had drawn \$36 million, up from \$14 million at the end of fiscal 2018.

Leverage: affordable and manageable debt burden

Financial leverage will remain manageable, as the university continues to build its wealth and amortize debt. Debt has decreased by approximately 13% since fiscal 2014, with an additional \$15 million principal pay down scheduled for this fiscal year. Spendable cash and investments of \$1.1 billion buffered debt in fiscal 2018 by a solid 2.2x. Debt affordability, despite slightly weaker operating performance in fiscal 2018, is solid, with debt to cash flow of 5.7x.

Debt structure

Over recent years, university management has made a concerted effort to revise its debt structure, lessening credit risk. After refunding the Series 2014A private placement with proceeds of the Series 2019 A bonds, the university will have no outstanding private placement debt. Overall, most the university's pro forma debt will be fixed rate and amortizing, with only the Series 2019A bonds in a floating rate mode. Additionally, the floating rate payment will be offset by the floating rate receipts on CWRU's interest rate swaps, resulting in a synthetic fixed rate. (If CWRU issues the Series 2019A as a long-term rate put bond, the university would only have fixed rate bonds.) The university does have several medium-term bullets, which it plans to refinance before maturity.

Debt-related derivatives

CWRU currently has four floating-to-fixed interest rate swap agreements with a total notional amount of \$73 million. At its current rating level, the university posts collateral if the liability to CWRU exceeds \$20 million. As of June 30, 2018 the liability was \$11 million, well below the collateral posting threshold, and down moderately from the fiscal 2017 liability of \$15 million.

Pensions and OPEB

The university contributes to both a defined benefit plan (DB) and defined contribution plan (DC). The DB plan stopped being offered to employees hired after July 1, 2015. Total expenses for both plans in fiscal 2018 totaled \$37 million, a manageable 4% of overall expenses. Overall, the liabilities associated with the DB plan surpass assets held for the plan by \$90 million, down from \$102 million in fiscal 2017.

Favorably, the university does not have other post-employment benefits (OPEB) expenses.

Governance and management: successfully growing reputation and strategic partnerships while producing consistent operations and lowering debt structure and liquidity risks

CWRU's strong management team has led the university through a period of strengthening reputation and strategic positioning, consistent operating performance, and enhancement of important partnerships. Through successful marketing of its nationally known graduate STEM programs, the CWRU has increased its undergraduate reputation markedly. Though operating performance lags peers, management has consistently achieved fairly steady performance, driven by sound budgeting practices. Additionally, the university's financial team has made a concerted effort to lower debt structure and liquidity risks through strategic refinancings, lowering overall credit risk.

In spring 2019, the HEC will open for occupancy, a joint partnership between CWRU and the Cleveland Clinic. The HEC is an 11 acre campus that is adjacent to the Cleveland Clinic's main campus and is jointly controlled by CWRU and the Clinic. The HEC is a key factor to strengthening CWRU's already strong market and strategic position, as it could drive additional research and student demand.

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