Moody's Investors Service

New Issue: Moody's assigns A1 to Case Western Reserve University, OH's $57M Ser. 2015A Rev. Bonds; outlook stable

Global Credit Research - 16 Jan 2015

$503M pro-forma rated debt, including full CP

CASE WESTERN RESERVE UNIVERSITY, OH
Private Colleges & Universities
OH

Moody's Rating

ISSUE	RATING
Higher Education Facility Revenue Bonds (Case Western Reserve University Project) Series 2015A	A1
Sale Amount $57,000,000	
Expected Sale Date 01/21/15	
Rating Description Revenue: 501c3 Unsecured General Obligation	

Moody's Outlook STA

NEW YORK, January 16, 2015 --Moody's Investors Service assigns an A1 rating to Case Western Reserve University's $57 million of 2015A Series Revenue Bonds issued through the Ohio Higher Educational Facility Commission. We also affirm all existing ratings. The rating outlook is stable.

SUMMARY RATING RATIONALE

The A1 rating and stable outlook reflect Case Western Reserve University's ("CWRU") national reputation as a large research university with prominent graduate and professional degree programs. Sizeable financial resources, good revenue diversity and strong fundraising also support the rating. Offsetting credit factors include a complex debt structure, thin operations, and high competition for students and federal research funding. CWRU has very limited unrestricted liquidity but adequate to support its debt structure.

The VMIG 1 ratings on Series 2001A and Series 2002A bonds reflect the presence of standby bond purchase agreements (SBPA) supporting the tender feature of those bonds.

The P-1 rating on CWRU's commercial paper (CP) program (authorized up to $90 million) reflects sufficient self-liquidity including two dedicated backup bank facilities.

STRENGTHS

*CWRU's sizeable total financial resources of $1.9 billion correspond to a strong history of philanthropic support. The three-year average annual gift revenue of $75 million in fiscal year (FY) 2014 helps build financial resources.

*Expendable financial resources of $942 million for FY 2014 adequately cushion total pro-forma debt (includes full $90 million CP authorization) at 1.5 times and a large expense base at 1.2 times.

*CWRU is successfully building on its established graduate and professional reputation as a private research university to grow its undergraduate population. Total enrollment is up 15% since fall 2011 to 10,130 full-time equivalent (FTE) students in fall 2014, notable growth compared to many other private colleges and universities.

*Operations improved in FY 2014 as the university carefully managed expense growth, with an 11.2% cash flow margin compared to 9.9% the prior year.

CHALLENGES

*A large portion of the university's net assets are permanently restricted, limiting financial flexibility. Unrestricted monthly liquidity of $379 million provides a modest 193 days cash on hand and includes $40 million drawn on operating lines of credit.

*CWRU's debt structure could result in unexpected liquidity calls, with 43% demand debt (including operating lines), 11% term mode bonds, an extensive swap portfolio and high level of capital calls.

*A highly competitive student market, as evidenced by a high 40.7% discount rate in FY 2014 despite the high graduate and professional enrollment, pressures net tuition per student growth, particularly as CWRU looks to elevates its undergraduate profile and compete with wealthier institutions.

*Significant exposure to federal research funding will continue to constrain grants and contracts revenue growth. Grants and contracts revenue of $322 million (excluding $83 million of Cleveland Clinic Lerner College of Medicine (CCLCM) revenue) comprise over 40% of total revenues, with 70% of that from federal sponsors.

DETAILED CREDIT DISCUSSION

USE OF PROCEEDS: The proceeds of the Series 2015A bonds will be used for costs associated with constructing a 290-bed student residence facility; refinancing the HUD-guaranteed loans associated with the Triangle Apartment Complex; and paying issuance costs.

LEGAL SECURITY: The bonds and commercial paper are an unsecured general obligation of the university.

DEBT STRUCTURE AND DEBT-RELATED DERIVATIVES: Following the Series 2015A issuance, CWRU's pro-forma debt will consist of 46% fixed rate, 43% demand debt (including $90 million commercial paper and $40 million drawn on operating lines), and 11% term-mode put bonds. Peak debt service of $51 million occurs in FY 2018.

CWRU has five floating-to-fixed interest rate swap agreements with one counterparty with a total notional amount of $176 million. CWRU is required to post collateral at its current rating level if the liability to the university exceeds $20 million. As of December 17, 2014, the university was posting $5.3 million of collateral.

The Series 2001A and 2002A bonds are supported by SBPAs from Wells Fargo Bank, NA with a scheduled expiration date of June 15, 2015. For more information on the SBPA terms, please refer to Moody's report dated May 25, 2012.

The Series 2008B bonds are supported by a letter of credit (LOC) agreement with PNC Bank, N.A., which expires on January 1, 2016. For more information on the LOC terms, please refer to Moody's report dated April 27, 2011.

CWRU converted the Series 2008B variable rate demand obligations to term mode bonds directly placed with Bank of New York Mellon. The $67.5 million of Series 2014A bonds have a mandatory tender of April 1, 2019 and each April 1 thereafter. Principal amortization begins in FY 2031. There are no financial covenants, but reduction of CWRU's rating to below Baa2/BBB is an event of default.

MARKET POSITION/COMPETITIVE STRATEGY: COMPREHENSIVE RESEARCH UNIVERSITY WITH STRONG GRADUATE PROGRAMS AND HIGHLY COMPETITIVE MARKET FOR UNDERGRADUATES

CWRU's market position will continue to strengthen as it leverages a nationally prominent research and graduate school profile to bolster its undergraduate reputation and expands academic partnerships and affiliations. CWRU successfully grew enrollment by parlaying its reputation in the sciences, technology, engineering, and math (STEM) graduate programs. Fall 2014 total FTE enrollment was 10,130 students, up nearly 15% since fall 2011, with the majority from undergraduate enrollment reflecting more aggressive recruiting outside of Ohio and investments in undergraduate programs. CWRU faces significant competition, reflected in the rising discount rate to nearly 41% in FY 2014 from 37% in FY 2012.

CWRU collaborates with nearby medical institutions for its educational programs. The medical school has affiliations with University Hospitals Health System Inc. ("UH") and the Cleveland Clinic Health System. The relationship with the Cleveland Clinic is poised to grow from plans to co-locate all health sciences education programs on one Health Education Campus. CWRU management reports that both organizations are fundraising for the large project, which is estimated at $400 million. Management also reported that this endeavor will not change existing agreements regarding its clinical and research programs.

CWRU's large research profile has significant federally sponsored research that exposes it to the weak federal research environment. In addition, federal award revenue is concentrated, with CWRU receiving 87% of federal research revenue, on average from FY 2010-FY 2014, from the National Institutes of Health. Other sponsors include the National Science Foundation, Department of Defense and the Department of Energy. In FY 2014, research expenses (excluding CCLCM) were $249 million, representing a significant 32% of operating expenses. Management projects level research activity for FY 2015.

OPERATING PERFORMANCE: GRADUALLY IMPROVING OPERATING PERFORMANCE

We expect that CWRU will generate balanced operating margins with annual cash flow comfortably covering debt service. Over the past three years (FY 2012-2014), CWRU's operating margin averaged 0.2%, showing gradual improvement over the past five years. The FY 2014 11.2% operating cash flow margin covered three-year average debt service a solid 2.6 times. The improved performance has been achieved through a combination of deliberate expense containment and net tuition revenue growth.

CWRU's large $785 million operating revenue base (Moody's adjusted) relies heavily on grant and contract revenue (41%) and student charges (37%), but is relatively diverse with investment income at 10%, other revenues at 7%, and gifts at 5%.

BALANCE SHEET/CAPITAL: SIGNIFICANT FINANCIAL RESOURCES AND STRONG DONOR SUPPORT OFFSET BY THIN UNRESTRICTED RESERVES

CWRU maintains solid financial resources with total financial resources of $1.9 billion in FY 2014. Unrestricted financial resources are depressed by $78 million of pension and swap liabilities, resulting in negative unrestricted financial resources. However, expendable financial resources, including temporarily restricted net assets, of $942 million resources cushion pro-forma debt and operations a solid 1.5 times and 1.2 times, respectively.

Despite the considerable wealth, unrestricted resources are thin, with monthly liquidity only 22% of total cash and investments. Monthly liquidity of $379 million translates into 193 monthly days cash on hand in FY 2014, lower than comparably rated institutions. With its relatively low investments not subject to restrictions and its resulting investment strategy, CWRU actively uses operating lines of credit to enhance liquidity.

We expect that the university will continue to benefit from fundraising success, but that we anticipate overall financial resource growth will be more measured compared to prior years. Last fall, having attained the $1 billion goal, the university increased the goal to $1.5 billion with a scheduled conclusion in 2018. Gift revenues continue to increase, averaging $85 million in gifts per annum from FY 2012-FY 2014. As of November 30, 2014, 71% of the $1.04 billion in gifts were received in cash, 28% in pledges, and only 1% from deferred giving.

Additional capital plans include construction of a health education building with the Cleveland Clinic. CWRU does not intend to proceed with this project unless philanthropic commitments for the full amount of the building are in place. Other projects include renovation of existing buildings into a performance arts center. Management indicates no additional debt will be issued but it will continue to draw the full $90 million of its CP program to bridge finance CWRU campus projects.

The investment portfolio achieved a 16% positive return in FY 2014, in line with other institutions. Through December 31, 2014, the portfolio had a 0.8% return. The investment portfolio is highly diversified among funds and managers, with the largest exposure of 3% to one manager across different asset classes in the portfolio. The university reported $149 million in unfunded commitments at June 30, 2014.

MANAGEMENT AND GOVERNANCE: FINANCIAL MANAGEMENT TEAM FOCUSED ON IMPROVING OPERATING PERFORMANCE AND INCREASING LIQUIDITY

The financial leadership team continues to focus on improving operations and growing liquidity. Management's primary focus for improved operations is on expense monitoring and containment, a key driver for the improved FY 2014 results. The university is also reviewing its defined benefit pension plan, which remains open to new employees. It also looks to increase revenue through addition or enhancement of higher net revenue graduate programs.

To manage the university's large investment portfolio, CWRU has an in-house investment office with an investment staff of six people with deep expertise to manage its diverse portfolio. The university does not utilize a consultant to select it managers and the board's investment committee remains active in overseeing the function.

SELF-LIQUIDITY: PRESENCE OF DEDICATED BANK LINES IS IMPORTANT GIVEN OTHER POTENTIAL CALLS ON LIQUIDITY

Case Western Reserve has a commercial paper program sized at $90 million. The commercial paper documents do not have any limitations on maturities and the full $90 million of CP could mature on one day. Of the $90 million, $63 million is part of the university's long-term debt portfolio and $27 million is dedicated to bridge financing purposes. The university expects to pay for any CP which is not rolled over from a combination of its internal liquidity and liquidity facilities provided by JPMorgan of $60 million and Northern Trust of $30 million. The liquidity facilities are dedicated to the purchase of CP and cannot be used for other purposes. The termination date for both facilities is February 25, 2017.

As of September 30, 2014, the university had $191 million in discounted daily investments, including $120 million in demand accounts in P-1 rated banks and $62 million across multiple 2a-7 compliant money market funds meeting Moody's criteria for a Aaa-mf rating. The coverage of the fully drawn $90 million of the CP program is good at 3.1 times with and 2.1 times without the bank facilities Coverage remains good when excluding the largest money market fund at 2.8 times and 1.8 times without the bank facilities.

OUTLOOK

The stable outlook reflects our expectation that the university will maintain at least balanced operating performance, no significant deterioration in unrestricted liquidity and no additional debt in the near-term.

WHAT COULD CHANGE THE RATING UP

The university's rating could be upgraded with substantial growth in unrestricted liquidity and strengthening of operating cash flow.

WHAT COULD CHANGE THE RATING DOWN

The rating could be downgraded with weakening of liquidity, significant additional borrowing, or a return to larger operating deficits.

KEY INDICATORS (FY 2014 financial data and 2014 fall enrollment)

Total Full-Time Equivalent Enrollment: 10,130 students

Total Cash and Investments: $1.7 billion

Total Pro-Forma Direct Debt: $625 million (includes Series 2015A bonds, full $90 million CP program, and $40 million drawn on operating lines)

Total Operating Revenue: $785 million

Reliance on Grants and Contracts (% of Moody's Adjusted Operating Revenue): 41%

Reliance on Tuition and Auxiliaries (% of Moody's Adjusted Operating Revenue): 37%

Monthly Days Cash on Hand: 193 days

Monthly Liquidity to Pro-Forma Demand Debt: 114% (demand debt includes VRDOs, term loans, lines of credit, and full amount of authorized CP)

Operating Cash Flow Margin: 11.2%

Three Year Average Debt Service Coverage: 2.6 times

RATING METHODOLOGY

The principal methodology used in this rating was U.S. Not-for-Profit Private and Public Higher Education published in August 2011. An additional methodology used in the short term rating of the Series 2001A and 2002A bonds was Variable Rate Instruments Supported by Conditional Liquidity Facilities published in May 2013. The principal methodology used in rating the Commercial Paper Notes was Rating Methodology for Municipal Bonds and Commercial Paper Supported by a Borrower's Self-Liquidity published in January 2012. Please see the Credit Policy page on www.moodys.com for a copy of these methodologies.

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Analysts

Erin V. Ortiz
Lead Analyst
Public Finance Group
Moody's Investors Service

Diane F. Viacava
Backup Analyst
Public Finance Group
Moody's Investors Service

Susan Fitzgerald
Additional Contact
Public Finance Group
Moody's Investors Service

Contacts

Journalists: (212) 553-0376
Research Clients: (212) 553-1653

Moody's Investors Service, Inc.
250 Greenwich Street
New York, NY 10007
USA

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