

RatingsDirect®

Ohio Higher Education Facility Commission Case Western Reserve University; Private Coll/Univ - General Obligation

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Ohio Higher Education Facility Commission

Case Western Reserve University; Private Coll/Univ - General Obligation

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US\$36.06 mil rev bnds (Case Western Reserve Univ) ser 2019C dtd 12/02/2019 due 12/01/2034		
<i>Long Term Rating</i>	AA-/Stable	New
US\$29.805 mil rev bnds (Case Western Reserve Univ) ser 2019B dtd 12/02/2019 due 12/01/2040		
<i>Long Term Rating</i>	AA-/Stable	New
Ohio Higher Ed Fac Comm, Ohio		
Case Western Reserve Univ, Ohio		
Ohio Hgr Ed Fac Com (Case Western Reserve Univ) PCU-GO		
<i>Long Term Rating</i>	AA-/Stable	Affirmed
Case Western Reserve Univ		
<i>Unenhanced Rating</i>	AA-(SPUR)/Stable	Affirmed

Rationale

S&P Global Ratings assigned its 'AA-' long-term rating to the Ohio Higher Educational Facility Commission's \$29.8 million series 2019B bonds and \$36.06 million series 2019C bonds, issued for Case Western Reserve University (CWRU). At the same time, S&P Global Ratings affirmed its 'AA-' rating on the university's debt outstanding. The outlook is stable.

We assessed CWRU's enterprise profile as very strong, characterized by stable enrollment and a healthy demand profile, with improved selectivity, but mitigated by weak matriculation rates for the rating. We assessed CWRU's financial profile as strong, with consistently positive operations on a full-accrual basis and sufficient available resources for the rating, although somewhat weaker than category medians. Combined, we believe these credit factors lead to an indicative stand-alone credit profile of 'a+'. As our criteria indicate, the final rating can be within one notch of the indicative credit level. In our opinion, the 'AA-' rating on the university's bonds better reflects CWRU's position as a comprehensive research institution with available resources that, while somewhat weak, are consistent with those of its peers and have increased in recent years.

The rating reflects our assessment of CWRU's following strengths:

- Stable undergraduate and graduate enrollment due to the university's broad range of programs, research and community medical coalitions, and healthy demand metrics despite strong competition for CWRU's high-quality students;
- Consistently positive operating results on a full-accrual basis for the past several fiscal years;
- Sizable cash and investments of \$1.8 billion as of June 30, 2019; and

- A pro forma maximum annual debt service (MADS) burden of about 2.3% at fiscal 2019 year-end, which we consider low.

The rating reflects our assessment of the following weaknesses:

- Available resource ratios that, while adequate, are low for the 'AA' rating category; and
- Flat and still weak freshman matriculation rate of 17.2% in fall 2019 compared with that of peer research institutions, indicative of significant national competition for high-quality students.

The series 2019B bond proceeds will refund the university's series 2015A bonds and fund renovations of the Fribley dining hall and other facilities projects including academic, residence, athletic, and infrastructure. The Series 2019C bonds will fund renovations of the Maltz Performing Arts Center. Post issuance, CWRU will have approximately \$526 million of debt outstanding based on fiscal 2019 financial statements. There is potential for additional debt in fiscal 2022, however, these plans are preliminary with timing and size subject to change. Additional debt will be factored in when more specific information is available, but we understand that the project estimates are between \$90 million-\$100 million.

The university also has two bank lines of credit, totaling \$100 million, available for working capital. There is no balance on these lines at present.

CWRU, located in Cleveland, is Ohio's largest private university. It offers a wide range of undergraduate, graduate, and professional degree programs, including arts and sciences, law, business, medicine, engineering, nursing, social work, and dentistry. The university's research base is extensive, in our view. CWRU received approximately \$343 million in external research awards and indirect cost recovery revenue in fiscal 2019, principally related to health sciences and the medical school. The university received more when including revenue passed through to the Cleveland Clinic. CWRU's campus is one of the anchor institutions in University Circle, a 500-acre concentration of more than 40 educational, social, medical, cultural, and religious institutions at the eastern edge of Cleveland.

CWRU and the Cleveland Clinic have an agreement for development and operation of a new Health Education Campus which includes an academic building and dental clinic. Occupancy began in the spring of 2019 and we understand that the operations are as expected, with management reporting a solid working relationship and financial performance to date. We understand that the Cleveland Clinic is providing interim financing for construction and that the two organizations are jointly fundraising toward the project. If funds raised by 2020 are not sufficient to pay for the education campus, CWRU has agreed to pay up to \$50 million over a five-year period beginning in 2021. We understand that funds are reserved for this potential liability.

Outlook

The stable outlook reflects our expectation that CWRU will maintain relatively stable enrollment and demand, continue to produce positive operations on a generally accepted accounting principles basis and, at minimum, maintain stable-to-improving available resources in the next two years.

Upside scenario

We could consider a positive rating action if the university's available resources increase materially such that measures were more in line with those of a higher rating, and more robust full-accrual surpluses as well as improvement in enterprise-profile characteristics such as matriculation to be more in line with those of a higher rating.

Downside scenario

We could consider a negative rating action in the next two years if enrollment declines materially, the university incurs full-accrual deficits, or if additional debt plans yield balance-sheet ratios that are no longer commensurate with the current rating.

Enterprise Profile

Industry risk

Industry risk addresses the higher education sector's overall cyclical and competitive risk and growth by applying various stress scenarios and evaluating barriers to entry, levels and trends of profitability, substitution risk, and growth trends observed in the industry. We believe the higher education sector represents a low credit risk when compared with other industries and sectors.

Economic fundamentals

In our view, the university has good geographic diversity, with only about 30% of students coming from Ohio. Therefore, our assessment of CWRU's economic fundamentals is anchored by the national GDP per capita.

Market position and demand

Enrollment growth has moderated in the past few years, but remains positive. Total headcount reached 11,874 (11,076 full-time equivalent [FTE] students) in fall 2019, which was in line with the previous year's results. As a comprehensive research institution, CWRU has a larger proportion of graduate and professional students (approximately 52% of FTEs) than many of its peers. Management reports that a concerted focus on recruitment and improved retention and student quality have supported enrollment growth. It also reports that it anticipates maintaining incoming freshman class sizes at current levels at about 1,350.

Applications for fall 2019 rose 8.2% over the past year. The solid demand profile is characterized by increasing applications and selectivity offset by weak matriculation. With the recent addition of an application fee, management reports that matriculation has improved and it expects matriculation could continue to see modest increases. The university is notably selective, accepting a low of 27.4% of undergraduate freshman applicants compared with more than 50% in fall 2012. Matriculation is still limited in our view at 17.2% for fall 2019, reflecting, in our view, a highly competitive market environment.

Student quality is also very high as measured by average freshmen ACT and SAT scores. Retention and graduation rates have improved as well, reaching 93% and 84%, respectively. In our view, CWRU's enrollment and demand profile is healthy with no material changes expected in the near term.

CWRU announced a \$1 billion comprehensive campaign in 2011. After meeting its original goal early and increasing it to \$1.5 billion, the campaign successfully closed on Dec. 31, 2018 with \$1.8 billion raised. The campaign will benefit

funding for programmatic support, scholarships, capital projects, faculty chairs, and the annual fund.

Management and governance

CWRU's regulations and bylaws do not provide for a maximum size for its board of trustees; there are 43 regular (voting) members, including the president, who is an ex officio member, and 89 member emeriti. Members are generally limited to four-consecutive, four-year terms, and may move to emeritus status, once their term ends. Most board members are also alumni. We understand that board turnover has been routine. The full board meets formally three times a year and has a committee system.

There have not been any significant management changes at the organization since the last review and we are not aware of any planned in the near term.

Financial Profile

Financial policies

In October 2018 the university adopted a formal debt policy, which did not exist previously. In addition, the university budgets for debt service and an operating contingency, but not depreciation, which we consider a best practice. In our view, the university has good financial practices and manages proactively.

It operates according to a five-year strategic plan, and has an informal reserve liquidity policy. The university meets standard annual disclosure requirements. The financial policies assessment is neutral, reflecting our opinion that, while there may be some areas of risk, the organization's overall financial policies are not likely to negatively affect its future ability to pay debt service. Our analysis of financial policies includes a review of the organization's financial reporting and disclosure, investment allocation and liquidity, debt profile, contingent liabilities, and legal structure, and a comparison of these policies with peer universities.

Financial performance

CWRU typically produces small operating surpluses on a full-accrual basis, with margins ranging from 1%-3% in recent years. Operating results on a full-accrual basis were \$32.6 million (a 2.7% operating margin) for the fiscal year ended June 30, 2019, which was similar to the previous year. The surpluses continue to reflect above-budgeted enrollment and increased research revenue. Management projects fiscal 2020 operations will be positive and include a full year of operations at the new health education campus. We expect the margin to be similar to fiscal 2019 results.

As of fiscal 2018, the university's endowment spending policy is based on a formula of 50% on an inflation index and 50% on 4.5% of the three-year average market value of long-term investments, resulting in an anticipated endowment draw of less than 5%. In addition, the board has approved another draw amount in support of the comprehensive campaign. According to management, an additional \$6 million went toward supporting the campaign in fiscal 2018, \$6 million in fiscal 2019, and the university expects to draw a similar amount in future years to support its development campaign. Beginning in fiscal 2019, CWRU adopted a new endowment payout policy, which compares the 10-year average of actual endowment activity and will adjust the annual distribution based on the comparison.

Operating revenue streams are relatively diverse compared with peers, however, CWRU is primarily dependent on student-related charges to fund operations. In fiscal 2019, gross tuition and student fees represented 46% of total

revenue. The university receives a concentration of National Institutes of Health funding; we understand that management has concentrated efforts on remaining competitive for federal grants and is exploring efforts to bolster foundation and industry awards. In our opinion, management is positioned to adjust its research enterprise as project funding lessens, if necessary.

Available resources

CWRU's financial resource ratios are improving and sufficient for the rating, in our view, although they remain lower than 'AA' category medians. We calculate expendable resources as unrestricted plus temporarily restricted net assets minus net property, plant, and equipment plus long-term debt. As of June 30, 2019, expendable resources totaled approximately \$1.05 billion; equal to 88% annual adjusted operating expenses and 200% of total pro forma debt. Total cash and investments, which includes restricted assets, were approximately \$1.85 billion as of fiscal year-end 2019 (June 30), excluding funds held by trusts, which the university does not manage, but are shown as assets on the financial statements. Cash and investments were equal to 154.3% of annual adjusted expenses and 350.9% of total pro forma debt. We believe that a significant growth in additional debt without commensurate growth in financial resources could pressure the rating.

The university's private equity, real assets, and private credit investments have mandatory capital calls related to future investments. As of Sept. 30, 2019, unfunded calls totaled approximately \$217.1 million; (about 14% of the investment pool value). The university reports that approximately 39% (\$715 million) of long-term investments could be liquidated in less than 30 days; it is our view that the university's liquidity profile mitigates its unfunded calls.

Debt and contingent liabilities

CWRU had approximately \$484 million of debt including line of credit as of fiscal year-end 2019 (excluding premium and unamortized bond issuance costs). The debt includes:

- Approximately \$379 million in fixed-rate debt;
- \$68.2 million in floating rate notes; and
- \$37 million line of credit.

The university's commercial paper program was closed May 2018. The direct purchase agreement was terminated following the issuance of the series 2019A public floating rate note bonds.

The series 2019B and 2019C will refund about \$22 million of series 2015A bonds and go toward capital projects.

The debt profile of the university is uneven, in our opinion. We calculate MADS as the total debt service averaged over the remaining 26 years, resulting in a smoothed MADS of about \$27 million. Approximately 12% of CWRU's debt is variable rate. Management notes that the variable rate exposure is offset by CWRU's interest-rate swaps resulting in a synthetic fixed rate.

The university has four interest-rate swap contracts with a total notional amount of \$71.5 million. Three of the four contracts terminate in 2022 and the fourth in 2034. The contracts are floating-to-fixed rate and all have Morgan Stanley as counterparty. The mark-to-market value was negative \$15.4 million as of Oct. 24, 2019. The university reports that its collateral threshold is \$20 million. In our view, CWRU's swap portfolio reflects low credit risk at this

time due to counterparty credit quality, the average economic viability of the swap portfolio over stressful economic cycles, and sound debt and swap management internal procedures.

The university offers both a defined-contribution retirement plan to employees (which, by definition, is fully funded), and a defined-benefit (DB) plan. According to management, the DB plan is now closed to new entrants. It had a funded status of negative \$104.2 million at the end of fiscal 2019 and is about 63% funded. DB contributions are made annually according to actuarial valuations. The university offers a retiree health care plan but reports no related liability on the university's balance sheet, because the cost is paid entirely by retirees.

Case Western Reserve University, Ohio--Enterprise And Financial Statistics						
	--Fiscal year ended June 30--					--Medians reported for 'AA' rated private colleges and universities--
	2020	2019	2018	2017	2016	2018
Enrollment and demand						
Headcount	11,874	11,891	11,824	11,664	11,340	MNR
Full-time equivalent	11,076	11,072	10,917	10,820	10,587	6,429
Freshman acceptance rate (%)	27.4	29.3	33.1	35.4	36.3	22.2
Freshman matriculation rate (%)	17.2	17.9	15.6	15.4	15.2	MNR
Undergraduates as a % of total enrollment (%)	45.3	44.3	43.6	44.2	45.2	67.8
Freshman retention (%)	93.2	94.4	92.5	91.6	93.9	95.0
Graduation rates (six years) (%)	84.4	84.9	82.6	82.1	80.6	MNR
Income statement						
Adjusted operating revenue (\$000s)	N.A.	1,230,105	1,195,955	1,153,524	1,098,470	MNR
Adjusted operating expense (\$000s)	N.A.	1,197,534	1,163,479	1,132,070	1,086,463	MNR
Net operating income (\$000s)	N.A.	32,571	32,476	21,454	12,007	MNR
Net operating margin (%)	N.A.	2.72	2.79	1.90	1.11	2.30
Change in unrestricted net assets (\$000s)	N.A.	29,798	22,859	53,169	(49,296)	MNR
Tuition discount (%)	N.A.	38.8	38.6	38.4	40.1	37.9
Tuition dependence (%)	N.A.	39.9	39.4	39.2	38.8	MNR
Student dependence (%)	N.A.	46.1	45.4	45.4	45.2	58.3
Health care operations dependence (%)	N.A.	0.0	0.0	0.0	0.0	MNR
Research dependence (%)	N.A.	21.5	21.8	22.0	22.1	MNR
Endowment and investment income dependence (%)	N.A.	6.7	7.0	7.1	6.6	MNR
Debt						
Outstanding debt (\$000s)	N.A.	483,765	496,973	506,918	560,603	386,585
Proposed debt (\$000s)	N.A.	64,790	N.A.	N.A.	N.A.	MNR
Total pro forma debt (\$000s)	N.A.	526,555	N.A.	N.A.	N.A.	MNR

Case Western Reserve University, Ohio--Enterprise And Financial Statistics (cont.)

	--Fiscal year ended June 30--					--Medians reported for 'AA' rated private colleges and universities--
	2020	2019	2018	2017	2016	2018
Pro forma MADS	N.A.	26,954	N.A.	N.A.	N.A.	MNR
Current debt service burden (%)	N.A.	2.84	3.03	2.92	2.67	MNR
Current MADS burden (%)	N.A.	2.06	2.20	2.16	2.25	4.10
Pro forma MADS burden (%)	N.A.	2.25	N.A.	N.A.	N.A.	MNR
Financial resource ratios						
Endowment market value (\$000s)	N.A.	1,568,311	1,539,302	1,461,237	1,350,104	1,603,114
Cash and investments (\$000s)	N.A.	1,847,534	1,808,068	1,726,942	1,598,047	MNR
Unrestricted net assets (\$000s)	N.A.	258,483	228,685	205,826	152,657	MNR
Expendable resources (\$000s)	N.A.	1,053,313	1,050,654	968,498	853,128	MNR
Cash and investments to operations (%)	N.A.	154.3	155.4	152.5	147.1	333.1
Cash and investments to debt (%)	N.A.	381.9	363.8	340.7	285.1	505.9
Cash and investments to pro forma debt (%)	N.A.	350.9	N.A.	N.A.	N.A.	MNR
Expendable resources to operations (%)	N.A.	88.0	90.3	85.6	78.5	228.6
Expendable resources to debt (%)	N.A.	217.7	211.4	191.1	152.2	320.2
Expendable resources to pro forma debt (%)	N.A.	200.0	N.A.	N.A.	N.A.	MNR
Average age of plant (years)	N.A.	17.2	15.9	14.9	14.2	13.9

MADS--Maximum annual debt service. Total adjusted operating revenue equals unrestricted revenue less realized and unrealized gains/losses and financial aid. Total adjusted operating expense equals unrestricted expense plus financial aid expense. Net operating margin equals 100 times (net adjusted operating income/adjusted operating expense). Student dependence equals 100 times (gross tuition revenue plus auxiliary revenue) / adjusted operating revenue. Current debt service burden equals 100 times (current debt service expense/adjusted operating expenses). Current MADS burden equals 100 times (MADS expense/adjusted operating expenses). Cash and investments equals cash plus short-term and long-term investments. Expendable resources equals unrestricted net assets plus temporary restricted net assets minus (net propoerty, plant, and equipment minus outstanding debt). Average age of plant equals accumulated depreciation/depreciation and amortization expense. N.A.--Not available. MNR--Median not reported.

Ratings Detail (As Of November 12, 2019)

Ohio Higher Ed Fac Comm, Ohio

Case Western Reserve Univ, Ohio

Ohio Hgr Ed Fac Com (Case Western Reserve Univ) PCU-GO

Long Term Rating AA-/Stable Affirmed

Case Western Reserve Univ

Long Term Rating AA-/Stable Affirmed

Many issues are enhanced by bond insurance.

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