

CREDIT OPINION

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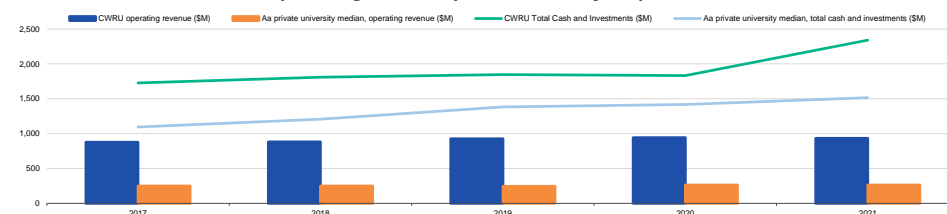
Case Western Reserve University, OH

Update to credit analysis

Summary

[Case Western Reserve University, OH's](#) (Aa3/stable) ("CWRU") strong credit quality is underpinned by its excellent brand and strategic position, evidenced by a solid student market and a sizable research enterprise with potential for further growth given partnerships and planned investments. Additionally supporting CWRU's credit strength is its substantial wealth, with total cash and investments totaling over \$2.3 billion in fiscal 2021. Proposed new debt will materially alter the university's debt profile, significantly increasing leverage and extending the maturity. Historically very good financial policy and management provide some ability to manage this degree of leverage and debt structure, though sustaining management credibility and track record of performance will become increasingly important to sustaining credit quality. Operating performance, which has historically lagged peers, improved in fiscal 2021 despite pandemic related operating challenges, with management providing forecasts that the improvement will continue through the near-term. Other credit factors considered include thinner liquidity compared with peers, solid expense management, a diverse revenue base, a modest pension liability, and a competitive operating environment for students and research awards.

Exhibit 1

CWRU's total wealth and operating size compares favorably to peers


Note: Fiscal 2021 median data reflects fiscal 2020 median data.

Source: Moody's Investors Service

Credit strengths

- » Considerable wealth with over \$2.3 billion in total cash and investments in fiscal 2021
- » Excellent strategic positioning, bolstered by strategic partnerships, supporting a strong student market and solid research enterprise
- » Sizable and diverse scope of operations with a large research profile and total operating revenue of about \$934 million
- » Strong philanthropic support with three-year average gift revenue of \$121 million

Credit challenges

- » Substantial increase in leverage leaves no additional room for borrowing at current credit quality
- » 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 is permanently restricted, somewhat limiting financial flexibility
- » Strategic plan to boost research funding elevates operating risks given new debt and historically slimmer margins for research

Rating outlook

The stable outlook reflects Moody's expectations of continued mid-double digit EBIDA with debt service coverage of over 2x. It also reflects our expectations that the university will not add additional debt beyond what is currently planned.

Factors that could lead to an upgrade

- » Substantial increase in wealth compared with peers
- » Significant improvement in EBIDA margins over multiple years
- » Further improvement in brand and strategic positioning, reflected in student demand, research, and philanthropy

Factors that could lead to a downgrade

- » Additional debt beyond what is currently planned given already high degree of leverage
- » Thinning of EBIDA margins below mid-double digits or reduction in debt service coverage below 2x
- » Deterioration of strategic partnerships with the Cleveland Clinic and/or University Hospitals

Key indicators

Exhibit 2

CASE WESTERN RESERVE UNIVERSITY, OH

	2017	2018	2019	2020	2021	Pro forma	Median: Aa Rated Private Universities
Total FTE Enrollment	10,917	11,073	11,072	10,891	11,233	11,233	3,483
Operating Revenue (\$000)	878,052	881,439	925,830	942,776	933,695	933,695	258,066
Annual Change in Operating Revenue (%)	5.0	0.4	5.0	1.8	-1.0	-1.0	-0.9
Total Cash & Investments (\$000)	1,726,918	1,808,068	1,847,534	1,831,838	2,340,508	2,340,508	2,340,508
Total Debt (\$000)	506,918	496,973	483,765	511,915	466,294	913,104	358,025
Total Cash & Investments to Total Adjusted Debt (x)	2.8	3.1	3.1	2.6	3.9	2.2	5.7
Total Cash & Investments to Operating Expenses (x)	2.0	2.1	2.0	2.0	2.7	2.7	6.4
Monthly Days Cash on Hand (x)	176	184	186	179	231	231	572
EBIDA Margin (%)	11.9	9.9	11.4	11.9	15.7	15.7	15.9
Total Debt to EBIDA (x)	4.9	5.7	4.6	4.6	3.2	6.2	5.7
Annual Debt Service Coverage (x)	3.0	2.3	2.9	3.1	4.2	4.2	3.4

Pro forma column include proposed century bonds and debt issued post fiscal year end of 2021.

Source: Moody's Investors Service

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Profile

Case Western Reserve University is the largest comprehensive private research university in Ohio, with sizable operations of over \$930 million and enrollment of over 11,000 FTE students. 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, sizable operations, and a solid student market

An excellent strategic position will continue, anchored by CWRU strong strategic partnerships and prominent STEM and healthcare programs, 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 2011, total enrollment is up an impressive 27% to 11,233 full-time equivalent (FTE) students in fall 2021. This growth occurred while many other institutions, particularly in the Midwest, suffered significant declines. Further, net tuition per student has increased annually since fiscal 2014, up a strong 7% in fiscal 2021.

Educational programs and research are bolstered by collaborated efforts with nearby medical institutions, the [Cleveland Clinic](#) (Aa2/stable) and [University Hospitals](#) (A2/stable). In summer 2019, CWRU and Cleveland Clinic opened the jointly owned Health Education Campus, a sprawling academic and research focused campus. Importantly, CWRU recently signed a ten-year affiliation agreement with University Hospitals, extending its primary teaching hospital agreement.

CWRU has a sizable scope of operations and maintains a large research profile with significant federally sponsored research, supporting an excellent operating environment. The university reported total operating revenue of over \$930 million and grants and contracts of \$329 million in fiscal 2021. Grants and contracts contracted in fiscal 2020 and fiscal 2021, with management reporting a decline in activity because of the pandemic. Favorably, management is projecting growth in future research activity in the near-term. Longer-term, material capital and human capital investments are planned to support growth of the university's research profile, which will continue supporting the university's strong brand and operating environment, but could erode operating performance.

Overall, revenue comes from a variety of sources, with the largest component, tuition, fees and auxiliaries, representing 39% of total revenue.

Operating performance: expense reduction efforts during the height of the pandemic improved operating performance

CWRU's improved operating performance will continue with moderate revenue growth and manageable expense growth. Historically, CWRU's operating performance lagged peers, with EBIDA margins consistently around 10-12%. During the pandemic, management took swift expense containment measures, including hiring and salary freezes, resulting in a solid 15.7% EBIDA. Though merit increases and hiring have resumed, management is maintaining other cost containment efforts and is projecting a stronger operating surplus for fiscal 2022 while maintaining a 4.7% endowment spend. An inability to maintain mid-double digit EBIDA margins could lead to credit pressure.

Revenue grew modestly in fiscal 2021 despite a significant reduction of on-campus activities. Favorably, management is projecting an over 5% growth in revenue for fiscal 2022, driven by a return to near normalized operations on-campus and continued growth in net tuition revenue. CWRU, unlike a majority of Midwest privates, has witnessed favorable net tuition per student growth trends over the past five years, averaging nearly 4% growth per year. Management is projecting continued net tuition revenue growth in fiscal 2023 given strong student demand and strategic tuition discounting.

Management reduced expenses in fiscal 2021, down 5.4% compared to 2020, in response to operating challenges brought on by the pandemic. Prior to the pandemic, management demonstrated a track record of maintaining manageable expense growth of just over 3% annual from fiscal 2015 through fiscal 2019. Management is projecting for expense growth of 5% for fiscal 2022, above historical levels, but below estimated revenue growth. Longer-term expense growth containment could prove difficult given planned strategic investments in research.

Wealth and liquidity: substantial wealth increased materially in fiscal 2021 because of investment returns; future growth will be driven primarily by philanthropy

Prospects for continued long-term wealth accretion are strong given the university's sound philanthropic base. Total cash and investments surged to over \$2.3 billion at the end of fiscal 2021, driven by a robust investment return of nearly 32%. Despite a substantial wealth, coverage of operating expenses of 2.7x is weaker than peers, which is primarily due to the university's large research enterprise. Although overall wealth is robust, a large portion of the university's wealth is restricted, with spendable cash and investments totaling approximately \$1.3 billion. Favorably, despite significant market volatility, management is reporting a modest overall decline in wealth compared with end of fiscal 2021.

Three-year average gift revenue is strong at \$121 million (fiscal 2019 through 2021). The university is not currently in a fundraising campaign, but its prior campaign was highly successful, raising over \$1.8 billion compared with an initial goal of \$1 billion.

Liquidity

CWRU's liquidity will remain adequate given its overall wealth. Monthly liquidity at the end of fiscal 2021 was \$510 million, translating to 231 monthly days cash on hand. Supplementing liquidity is \$150 million of available lines of credit for working capital and a \$50 million line of credit for short-term liquidity for its investment pool. CWRU currently has \$0 drawn from its various lines

Leverage: material increase in leverage with no additional debt capacity at current credit quality

With the proposed new debt, CWRU's leverage will materially weaken leaving it with no additional debt capacity at its current credit quality. Pro forma total adjusted debt to revenue, including the proposed century bonds and a planned private placement, will weaken coverage to 2.2x from 3.9x. Total adjusted debt to fiscal 2021 EBIDA will worsen to 6.2x from 3.2x, materially worse than peers of similar credit quality. Annual debt service coverage is also projected to erode given new debt, despite the proposed century bond in interest only mode, with 2.5x coverage estimated given fiscal 2021 cash flow. Favorably, the university's current outstanding debt is amortizing, with approximately \$16 million of principal pay down annually over the past five years.

A portion of the planned new century bond debt (\$180 million) will go toward financing a \$300 million interdisciplinary science and engineering building on campus which will accommodate research for engineering and arts and sciences. The remaining amount (\$170 million) will go toward creating an internal central bank to fund strategic capital investments across campus, an interest reserve fund, and a corpus for future principal payment. (The corpus for repayment is \$3 million, which management assumes a 5% investment return over 100 years will pay off the expected future value of the final principal and interest payment.) The internal bank will have several policies in place to govern it, which will include a policy to provide annual performance reports to the board of trustees.

In addition to the proposed century bond, the university is negotiating a private placement with an estimated par amount of approximately \$116 million. Proceeds from the private placement will go toward funding new student housing on campus, which management projects net revenue from the new housing will cover future debt service costs. Combined with the century bond, future capital expenditures should alleviate the university's elevated age of plant, which surpassed 18 years in fiscal 2021.

Legal security

Proposed and outstanding bonds are all general unsecured obligations of the university.

Debt structure

The proposed century bond will add additional maturity risk to CWRU's debt structure, but a strong management team and sizable liquidity limits risk. Most of the university's current debt is in fixed rate mode with only the Series 2021B bonds will be in variable rate mode. (Series 2021B bonds also have a proposed mandatory tender in December 2026.) Interest rate risk is mitigated by floating receipts on CWRU's outstanding interest rate swap, resulting in a synthetic fixed rate.) CWRU'S debt does have a number of bullet payments, with the proposed new century bond adding an additional, large bullet payment. Management anticipates refinancing other bullet payments before maturity.

Included in the university's outstanding total adjusted debt is a \$40 million obligation (originally \$50 million) to cover its remaining share of the costs associated with the HEC. This amount will be paid for over the next four years. The university has established an internal reserve to cover this obligation.

Debt-related derivatives

CWRU had four floating-to-fixed interest rate swap agreements with a total notional amount of approximately \$71 million at the end of fiscal 2021. At its current rating level, the university posts collateral if the liability to CWRU exceeds \$20 million. As of June 30, 2021 the liability was \$13 million, well below the collateral posting threshold. Three of the swaps are set to expire in 2022 with one remaining thereafter that hedges the rate risk of the Series 2021B bonds.

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 totaled \$23 million, down from the prior year due to a reduction in defined contribution expenses stemming from CWRU's pandemic expense response.

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

ESG considerations**Environmental**

Environmental considerations are not material to CWRU's credit profile at this time.

Social

CWRU's ability to attract students from outside of the State of Ohio (Aa1/stable) and Midwest region mitigates social risk from state and regional population growth challenges. Students from the State of Ohio makeup approximately 17% of enrolled undergraduate students, down from 27% in fiscal 2012, yet overall enrollment and net tuition per student has increased significantly during that period. The university has also fared well compared to most peers regarding international student enrollment which has remained relatively flat over recent years, making up just over 13% of enrolled students.

Governance

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, CWRU has increased its undergraduate reputation markedly. Strong management credibility was demonstrated during the height of the pandemic, as CWRU made strategic expense reductions that led to improved operating performance in a difficult environment, while increasing net tuition per student and overall net tuition revenue.

Though operating performance lags peers, management has consistently achieved fairly steady performance, driven by sound budgeting practices. Planned continuation of improved margins is reasonable given the university's historic track record, but could prove difficult given research growth plans and inflationary pressures. The proposed new debt issuance was not previously laid out by management and indicates some heightened risk appetite and uncertainty around the predictability of capital planning.

The university has strengthened its partnership with the Cleveland Clinic through its joint ownership of the Health Education Campus and reaffirmed its partnership with University Hospitals for the next decade. CWRU's ability to manage these partnerships are important to the university's excellent brand and strategic positioning.

Rating methodology and scorecard factors

The principal methodology used in this rating was [Higher Education Methodology](#) published in August 2021. The Higher Education Methodology includes a scorecard that summarizes the factors that are generally most important to higher education credit profiles. Because the scorecard is a summary and may not include every consideration in the credit analysis for a specific issuer, a scorecard indicated outcome may or may not match an assigned rating. We assess brand and strategic positioning, financial policy and strategy, and operating environment on a qualitative basis.

Exhibit 3

Case Western Reserve University, OH

Scorecard Factors and Sub-factors	Value	Score
Factor 1: Scale (15%)		
Adjusted Operating Revenue (USD Million)	934	Aa
Factor 2: Market Profile (20%)		
Brand and Strategic Positioning	Aa	Aa
Operating Environment	Aa	Aa
Factor 3: Operating Performance (10%)		
EBIDA Margin	16%	A
Factor 4: Financial Resources and Liquidity (25%)		
Total Cash and Investments (USD Million)	2,341	Aa
Total Cash and Investments to Operating Expenses	2.7	A
Factor 5: Leverage and coverage (20%)		
Total Cash and Investment to Total Adjusted Debt	2.2	A
Annual Debt Service Coverage	4.2	Aa
Factor 6: Financial Policy and Strategy (10%)		
Financial Policy and Strategy	A	A
Scorecard-Indicated Outcome		Aa3
Assigned Rating		Aa3

Data is based on most recent fiscal year available. Debt may include pro forma data for new debt issued or proposed to be issued after the close of the fiscal year.

For non-US issuers, nominal figures are in US dollars consistent with the Higher Education Methodology.

Source: Moody's Investors Service

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