New Issue: Moody's assigns A1 to George Washington University (DC) $350M Series 2015; outlook stable

Global Credit Research - 20 Jun 2015

$1.6B pro forma rated debt

GEORGE WASHINGTON UNIVERSITY, DC
Private Colleges & Universities
DC

Moody's Rating

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Sale Amount $350,000,000
Expected Sale Date 06/24/15
Rating Description Revenue: 501c3 Unsecured General Obligation

Moody's Outlook STA

NEW YORK, June 20, 2015 -- Moody's Investors Service assigns an A1 rating to George Washington University's Taxable Bonds, Series 2015. The proposed Series 2015 bonds will have a final maturity in 2045. The A1 ratings on the university's prior bonds are also affirmed. The outlook is stable.

SUMMARY RATING RATIONALE

The A1 assignment in conjunction with the new sale incorporates expectations that the university will use the proceeds to retire $330 million of prior debt.

The A1 rating reflects George Washington University's favorable market position with growing net tuition revenue, diverse academic programs for research university with $1.1 billion in operating revenue and considerable financial strength.

Offsetting factors include a weaker operating performance in fiscal 2014 and high debt to operating revenue burden, with pro forma debt to operating revenue of 1.4 times.

OUTLOOK

The stable outlook is predicated on expected improvement in operating cash flow performance with an operating cash flow margin in the 9% range for FY 2015, up from 7% in FY 2014. The stable outlook also assumes the university will be able to generate revenue growth and manage expense increases more closely than in the last half decade as expense growth has outpaced revenue growth.

WHAT COULD MAKE THE RATING GO UP

- Sustained improvement in operating cash flow performance
- Reduction in financial leverage
- Material growth in financial resources and sustained philanthropic support

WHAT COULD MAKE THE RATING GO DOWN

- Inability to generate stronger operating cash flow margins
-Reduction in prospects for ongoing revenue growth
-Contraction of liquidity
-Increase in financial leverage

STRENGTHS

-Ongoing revenue growth prospects for comprehensive university with solid undergraduate demand
-Large financial resource base with total cash and investments of $2 billion
-Healthy liquidity with $530 million of monthly liquidity in fiscal 2014
-Improving prospects for donor support with $142 million raised in fiscal 2014

CHALLENGES

-Soft operating performance in fiscal 2014 as expense growth outpaced revenue growth
-Considerable debt relative to operating revenue and cash flow, underscoring the importance of cash flow improvement to maintain credit quality
-Financial resources include relatively concentrated commercial real estate holdings near campus
-Bullet maturity debt structure increases reliance on market access and treasury management

RECENT DEVELOPMENTS

Recent developments are incorporated in the Detailed Rating Rationale.

DETAILED RATING RATIONALE

MARKET POSITION: GROWING COMPREHENSIVE UNIVERSITY

George Washington University (GWU) remains well poised to translate its market position and favorable location into net tuition revenue gains. Net tuition per student was at $27,962 in FY 2014 up 3% from the prior year.

GWU continues to enjoy strong and geographically diverse student demand for its residential undergraduate degree offerings from eight colleges and schools. While demand for graduate and professional programs proves generally strong, some programs, including law and business continue to weather enrollment declines. Over half of enrollment is at the graduate level. Implementation of strengthened and more centralized graduate program recruitment is expected to offset recent weakness.

Sponsored research awards have recently been a source of revenue growth as the university bucks sector trends. Fueled by university investments in faculty, facilities and programs sponsored awards increased to $190 million in FY 2014, up from $149 million in FY 2012. In FY 2014, federal agencies made up 77% of awards, with the Department of Health and Human Services comprising 82% of federal awards.

The university's ability to invest in programs will continue to be aided by its growing donor support. Total gift revenue increased to $142 million in FY 2014 as the university makes gains toward its $1 billion comprehensive campaign goal.

OPERATING PERFORMANCE, BALANCE SHEET, AND CAPITAL PLANS: CASH FLOW EXPECTED TO IMPROVE OVER FY 2014 SOFTNESS

Since FY 2009 the university has increased investments in programs, faculty, and financial aid at the expense of operating performance. In FY 2014 expenses grew 6.5% while revenue increased only 2.2% pushing the operating cash flow margin to a thin 6.5%. Management projects a moderate improvement in operating cash flow in FY 2015, with an estimated rebound to a 9% range operating cash flow margin. In addition, new expense control measures including a round of staff reductions in late FY 2015 should aid future operating health.

GWU remains reliant on student charges, with tuition and auxiliary revenue comprising 61% of operating revenue in FY 2014. Other components of operating revenue include grants and contracts (18%), investment income (11%) and patient care/medical education agreements (5%).
Through a number of strategic changes between 1997 and 2002, the university greatly reduced its exposure to the patient care revenue, although its School of Medicine relies on affiliations with a faculty practice plan and hospital. The university maintains a 20% stake in District Hospital Partners, L.P. which owns and operates the 371 bed GWU Hospital and provides support to the university’s School of Medicine and Health Sciences. The university’s partner is Universal Health Services, Inc. (Ba1 stable). Under agreements with its partner the university is reimbursed for providing personnel and other services and also receives a share of the DHP profits. GWU also has an affiliation agreement with its faculty practice plan group, Medical Faculty Associates, Inc. (MFA). In FY 2014 the university recorded revenue of $11 million from MFA.

GWU will continue to benefit from a large pool of financial assets. The university’s total financial resources were $1.8 billion as of June 30, 2014.

The Investment Committee of the Board of Trustees is responsible for the oversight of the endowment. In December 2014 the university moved to an outsourced chief investment officer. The GWU assets will continue to held in the university name. The university’s endowment had a 18% return in fiscal year 2014, including the appreciation of the direct real estate investments.

Of the March 31, 2015 total endowment investments of $1.5 billion, 40% was investment real estate. The majority of the real estate investments are associated with the two commercial office buildings and the rental payments GWU expects to receive from Boston Properties, Inc. for the long-term ground lease of the university’s Square 54 site. Because of the concentration in the Foggy Bottom area, the university’s financial strength is sensitive to changes in that particular market.

With $1.6 billion of pro forma debt including the expected refunding of bullet maturities we expect debt to remain elevated relative to operating revenue. Pro forma debt is at 1.4 times FY 2014 operating revenue, double the median for A-rated private universities. The considerable debt also underscores the importance of stronger cash flow from operations in maintaining credit quality.

The university continues to fund an ambitious capital program. Purchases of property plant and equipment totaled $617 million in the FY 2012 through FY 2014 period. The university has no plans for additional debt at this time and has limited capacity for additional debt at the A1 level absent strengthening of cash flow.

In August 2014 the university acquired the Corcoran College of Art + Design along with its college and art gallery building through a court order that provided for most of the Corcoran's art collection to be transferred to the National Gallery of Art. The operating impact to the university should remain manageable as the college was small with around 300 students and can be readily incorporated into similar programs. Under the proposal GWU will use some of the related proceeds to fund renovations to the building, including $35 million to be spent in the next few years.

Liquidity

With $1.1 billion of board designated endowment and $110 million of working capital at the end of fiscal 2014, GWU has a large base of cash and investments not subject to donor restrictions. The liquidity profile is aligned with the A rating category, with monthly liquidity of $530 million as of June 30, 2014 equating to 175 monthly days cash on hand.

DEBT STRUCTURE AND OTHER LIABILITIES

Debt Structure

The university has all fixed-rate and all taxable debt. Through the current plan of finance GWU will extend the average life of its debt to over 16 years as some near-term bullet maturities are refunded. Because management plans to issue new debt as part of its treasury management, the university is exposed to market access and interest rate risks in the intervening years. These risks, however, are partially mitigated by the university’s sound treasury management and healthy liquidity.

Debt-Related Derivatives

None.

Pensions and OPEB

University employees participate in a defined contribution retirement plan. Some retired employees are receive health care and life insurance benefits from the university. The benefits are funded as payments are made. The OPEB liability was a manageable $35 million in fiscal 2014.

MANAGEMENT AND GOVERNANCE: STRATEGIC PLAN GUIDES PROGRAM AND FACILITIES INVESTMENTS

In the fall of 2012 the university developed a strategic plan to guide its next decade. While the plan acknowledges that the location in the District of Columbia is a clear strength, it also comes with limits including an enrollment cap that GWU must manage to at its Foggy Bottom campus. One source of funding for the future initiatives will be the Innovation Task Force that has identified savings through a rigorous process that can be re-invested in the academic program. Philanthropic support is another crucial source of funds for the plan and management has prioritized moving its donor support more in line with peers.

Although the additional expenses and commitments involve new risks, we view management’s clear focus on measured outcomes, financial stewardship and liquidity management as crucial mitigants to those risks. The recent agreement to enter into a long term energy purchase agreement in partnership with American University (A1 stable) also point to the university’s culture of long-range planning.

KEY STATISTICS (FY 2014 financial data, fall 2014 enrollment data)

- Total Full-Time Equivalent Enrollment: 21,409 students
- Total Cash and Investments: $2.0 billion
- Total Financial Resources: $1.8 billion
- Total Pro Forma Direct Debt: $1.6 billion
- Total Operating Revenue: $1.1 billion
- Reliance on Tuition and Auxiliaries (% of Moody's operating revenues): 61%

OBLIGOR PROFILE

George Washington University (GWU) is a large, comprehensive, urban university that continues to leverage its location in the nation’s capital to draw a healthy (47%/53%) mix of undergraduate and graduate students. Total full-time equivalent enrollment has remained in the 21,000 student range over the last several years. Graduate Arts and Sciences programs are complemented by Law, Medicine and other Medical degree offerings. The university has a growing sponsored research enterprise, with $185 million in research expenditures in FY 2014.

LEGAL SECURITY

The bonds are an unsecured general obligation of the university.

USE OF PROCEEDS

Proceeds will be used primarily to refund near-term bullet maturities including the $50M Taxable Bonds, Series 2007 and $112M 2000 Pennsylvania Avenue loan early in FY 2016. Management intends to also use the proceeds to refund the $168M Taxable Bonds, Series 2012A likely in FY 2018.

PRINCIPAL METHODOLOGY

The principal methodology used in this rating was U.S. Not-for-Profit Private and Public Higher Education published in August 2011. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

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