NEW YORK, July 25, 2014 -- Moody's Investors Service has assigned an A1 rating to The George Washington University's $300 million Taxable Bonds, Series 2014. At this time we have also affirmed the existing A1 ratings on the university's outstanding debt. The outlook is stable.

SUMMARY RATING RATIONALE

The A1 assignment in conjunction with the new sale incorporates the university's expected plan to refund approximately $130 million of outstanding debt and fund up to $170 million of general corporate purposes, including capital projects.

The A1 rating reflects George Washington University's market position as a large, urban comprehensive research university, located in Washington, DC, with growing net tuition revenue and considerable financial resource strength. The rating also incorporates the university's challenges, including high operating leverage, with pro forma debt to operating revenue of 1.41 times, limited donor support relative to reputational peers, and narrow debt service coverage.

The stable outlook reflects expectations of a continued strong student revenue growth, maintenance of healthy liquidity and limited plans for additional debt.

STRENGTHS

* The large urban comprehensive university continues to have solid student demand, serving 21,132 full-time equivalent students in fall 2013. Net tuition revenue per student increased 3.7% in fiscal 2013 to $27,056.

* Large financial resource pool totaling $1.74 billion at the end of FY 2013 provides a healthy cushion to debt and operations. Expendable financial resources of $1.5 billion covered pro forma direct debt by 0.98 times and annual operating expenses by 1.38 times.

* The university maintains healthy monthly liquidity with $634 million at June 30, 2014 equating to 224 days cash on hand.

* The university has improved prospects for donor support. Total gift revenue was $55.6 million in FY 2013.
CHALLENGES

*The university has uncommonly high operating leverage with pro forma debt of $1.55 billion, approximately 1.41 times FY 2013 operating revenue.

*George Washington University is likely to continue to generate thin debt service coverage with FY 2013 operating cash flow of 11.3% covering debt service by 1.9 times.

*Potential pressure on ability to grow net tuition revenue could challenge the university’s operating performance, since student charges comprised 62% of operating revenue in FY 2013.

*The university’s debt structure includes over $1 billion of bullet maturities in general obligation and non-recourse debt including over $400 million in bullet maturities through the end of fiscal 2018. The university’s debt strategy relies on ongoing market access to refinance bullet maturities.

*The university’s financial resources include relatively concentrated commercial real estate holdings near the urban campus, with the holdings comprising a significant 37% of total investments at the end of fiscal 2013.

DETAILED CREDIT DISCUSSION

USE OF PROCEEDS: Proceeds of the taxable series 2014 bonds are expected to refund approximately $130 million of outstanding debt, including non-recourse debt associated with investment real estate, fund up to $170 million of general corporate purposes, including capital projects, and pay costs of issuance. Following issuance of the taxable Series 2014 bonds, we expect pro-forma debt to increase moderately, from $1.38 billion $1.55 billion. The largest portion of the expected refunding, defeasance of an approximately $88 million non-recourse loan associated with the university’s 2100 Pennsylvania property, will likely occur during the first half of calendar year 2015.

LEGAL SECURITY: The bonds are an unsecured general obligation of the university. The indentures for the Series 2009, 2010, 2011, 2011A, 2012, 2012A, 2013 and 2014 Taxable Bonds do not include an additional bonds test. The university’s taxable Series 2007 documents include two additional bonds tests: aggregate Maximum Annual Debt Service not to exceed 12% of Unrestricted Revenues for the most recent fiscal year and Expendable Net Assets for the prior fiscal year to be not less than 50% of pro forma Long-Term Debt.

DEBT-RELATED DERIVATIVES AND DEBT STRUCTURE: The university has no debt-related interest rate derivatives. While the university has no variable rate debt, it has been aggressive in its use of bullet maturities. Through FY 2019 $630 million of bullet maturities associated with its taxable bonds and investment real estate debt will mature. 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 annual liquidity of over $800 million.

MARKET POSITION/COMPETITIVE STRATEGY: LARGE COMPREHENSIVE URBAN UNIVERSITY CONTINUED TO LEVERAGE ITS DC LOCATION

George Washington University (GWU) will maintain its well-established student market position as a large, comprehensive, urban university that continues to leverage its location in the nation’s capital to draw a healthy (46%/54%) mix of undergraduate and graduate students. Total full-time equivalent enrollment has remained in the 21,000 student range over the last several years. Net tuition per student was at $27,056 in FY 2013 up 3.7% from the prior year, and well above Moody’s median for A-rated private universities of $23,061 due to the university’s favorable reputation as well as high proportion of graduate and professional students. Graduate Arts and Sciences programs are complemented by Law, Medicine and other Medical degree offerings.

GWU continues to enjoy strong student demand for its residential undergraduate degree offerings from eight colleges and schools. In the fall of 2013, the university accepted 34.4% of freshman applicants and yielded 31.4% of accepted students. GWU enjoys a national and international market reach. Approximately 45% of undergraduate students come from the mid-Atlantic region, with Californians comprising around 8% of the undergraduate population. Management reports that leading indicators for the fall 2014 entering class are in line with prior years, although application volume is down about 12% as the university began accepting only those applications filed through the Common Application process.

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 $181 million (preliminary) in FY 2014, up from $149 million in FY 2012. In FY 2013, federal agencies made up 71% of
awards, with the Department of Health and Human Services comprising 74% of federal awards. Funding pressure from the various sponsors combined with the competitive landscape could hamper ongoing research enterprise growth. However, management believes its proximity to federal agencies and programmatic initiatives including those in public health will give the university competitive advantages.

OPERATING PERFORMANCE: OPERATING CASH FLOW, WHILE STEADY, EXPECTED TO PROVIDE THIN COVERAGE OF INCREASING DEBT SERVICE

Between fiscal 2009 and fiscal 2012, the university increased investments in programs, faculty, and financial aid while many peers were focused on cost reduction or containment. As a result, GWU's operating performance softened; the three year average operating margin was just -0.4% in fiscal years 2011 through 2013. This produced limited debt service coverage averaging 1.9 times over the same period. We note that annual debt service obligations are relatively limited as a majority of the university's debt is issued as bullet maturities and does not amortize. The university has been able to deliver relatively consistent operating performance and we expect that pattern to continue.

GWU remains reliant on student charges, with tuition and auxiliary revenue comprising 61.7% of Moody's adjusted operating revenue in FY 2013. Other components of operating revenue include grants and contracts (15.7%), investment income (12.5%) and patient care/medical education agreements (5.3%).

GWU increased its budget for financial aid through FY 2010 and is slowly tapering its discounting to each entering class. On a blended basis across all students, Moody's calculation of total tuition discount shows slight improvement to 30.0% in FY 2013 from 30.4% in FY 2011. However, given strong competition and affordability concerns, GWU's ability to flex pricing power will remain somewhat constrained.

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. (Ba2 positive). Under agreements with its partner the university is reimbursed for providing personnel and other services ($30.4 million in FY 2013) and also receives a share of the DHP profits ($7.2 million in FY 2013). GWU also has an affiliation agreement with its faculty practice plan group, Medical Faculty Associates, Inc. (MFA). In FY 2013 the university recorded revenue of $10.7 million from MFA.

BALANCE SHEET POSITION: LARGE BASE OF FINANCIAL RESOURCES WITH MATERIAL DIRECT REAL ESTATE HOLDINGS

GWU will continue to benefit from a large pool of financial assets even as operating leverage remains elevated. The university’s total financial resources of $1.7 billion as of June 30, 2013 and $859 million of annual liquidity, provides substantial credit strength. Given narrow operating cash flow expectations and limited fundraising relative to its resources base, we believe the prospects for additional resource growth are somewhat limited, although gift revenue has been trending upward.

With the current approximately $170 million increase in direct debt to $1.55 billion, operating leverage will remain elevated with pro forma debt at 1.41 times fiscal 2013 operating revenue more than double Moody's median of 0.67 times for A-rated private universities. Our A1 rating and stable outlook reflect expectations of no additional debt through the end of fiscal year 2016. Expendable financial resources of $1.5 billion cushion pro forma debt by 0.98 times and provide a 1.38 times cushion relative to operating expenses. GWU's pro forma comprehensive debt of $1.73 billion includes $183 million of indirect debt, which is made up of operating leases. The majority of leased space is for administrative offices. Our direct debt figure for June 30, 2013 includes $224 million of non-recourse notes collateralized by real estate investments, while the pro forma direct debt figure includes $112 million of these notes as portions of the debt has been or is expected to be defeased.

The Investment Committee of the Board of Trustees is responsible for the oversight of the endowment. The Investment Office staff includes a Chief Investment Officer overseen an investment and investment operations staff. The university's endowment had a 9.0% return in fiscal year 2013, including the appreciation of the direct real estate investments. Of the March 31, 2014 total endowment investments of $1.4 billion, 37% was investment real estate. The majority of the real estate investments are associated with the two commercial office buildings mentioned above and the rental payments GWU expects to receive from Boston Properties, Inc. (P)Ba2 stable for the long-term ground lease of the university's Square 54 site. While manager diversity is healthy in the pooled funds, we note the concentration in the Foggy Bottom area commercial real estate market. Though that real estate market has experienced significant price appreciation over recent decades the university's financial strength is
sensitive to changes in that particular market.

With $982 million of board designated endowment and $395 million of working capital at the end of fiscal 2013, 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 $634 million as of June 30, 2013 equating to 223.5 monthly days cash on hand.

The university continues to fund an ambitious capital program. Purchases of property plant and equipment totaled over $400 million in the FY 2011 through FY 2013 period. The pattern continued in FY 2014 as the majority of construction costs associated with the $275 million Science and Engineering Hall were funded with working cash. Approximately $170 million of the Series 2014 bonds will be used to fund capital projects over the next several years thereby limiting further depletion of working cash.

The university has no plans for additional debt through the end of fiscal year 2016 and has limited capacity for additional debt at the A1 level. Debt service in FY 2013 (including the non-recourse notes) was a manageable 5.9% of operating expenses, though this is primarily interest payments. Adjusted maximum annual debt service (MADS, estimated at 8% of total pro-forma debt as approximation of interest and principal expense) ramps up to an uncommonly high 12.5% of operating expenses. Importantly, we note the university closely manages its debt, including the mix of instruments used and liquidity needs of the portfolio.

While total gift revenue at GWU has remained below its large, A-rated private university peers, Moody’s notes that resource levels have been aided by increased philanthropic support in recent years with average total gift revenue of $55 million for the three-year period ending with FY 2013. Management continues to make strategic investments in the development office to boost donor support. In June 2014 the university began the public phase of $1 billion campaign. To date the university has raised $525 million. Of the total, 40% is for student support and scholarships. Should this target be achieved, the university’s revenue diversity would be enhanced, allowing it greater flexibility to meet net tuition revenue targets.

GOVERNANCE AND MANAGEMENT: STRATEGIC PLAN GUIDES INVESTMENTS FOR NEXT DECADE

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 university’s culture of long-range planning.

The university may acquire the Corcoran College of Art + Design along with its college and art gallery building in the District. The transfer that would also see most of the Corcoran’s art collection transfer to the National Gallery of Art is subject to court approval with uncertain timing. The operating impact to the university should remain manageable as the college is small with around 300 students and can be readily incorporated into similar programs. Under the proposal GWU would receive a $10 million endowment with the transfer as well as $35 million to be used for capital renovations of the building.

Outlook

The university’s stable outlook reflects expectations of continued solid market position, healthy liquidity relative to debt and operating expenses, cash flow performance covering debt service and limited additional leverage. While working capital declined in FY 2014 as major capital projects were funded, the stable outlook is predicated on the university maintaining healthy monthly liquidity at or above current levels.

WHAT COULD MAKE THE RATING GO UP

Sustained improved operating performance, increased liquid financial resources, improved revenue diversity, increased philanthropic support and reduction in operating leverage could drive a rating upgrade.

WHAT COULD MAKE THE RATING GO DOWN

Deterioration in financial resources, including unrestricted liquidity, deterioration in operating performance, inability
to grow net tuition revenue, or material increase in debt could lead to downward pressure.

KEY INDICATORS (FY 2013 financial data including pro-forma debt, fall 2013 enrollment)

Total Enrollment: 21,132 full-time equivalent students

Operating Revenue: $1,104 million

Primary Selectivity: 34.4%

Primary Matriculation: 31.4%

Net Tuition per Student: $27,056

Educational Expenses per Student: $40,157

Average Gifts per Student: $2,591

Operating Cash Flow Margin: 11.3%

Three-Year Average Debt Service Coverage: 1.86 times

Reliance on Tuition and Auxiliary Revenue (% of Moody's Adjusted Operating Revenue): 61.7%

Total Cash and Investments: $2,085 million

Total Pro Forma Direct Debt: $1,551 million

Expendable Financial Resources: $1,513 million

Expendable Financial Resources to Pro Forma Debt: 0.98 times

Expendable Financial Resources to Operations: 1.38 times

Monthly Liquidity: $634 million

Monthly Days Cash on Hand: 224 days

Pro Forma Debt to Operating Revenue: 1.41 times

RATED DEBT

Series 2007: A1, insured by National Public Finance Guaranty (formerly MBIA)


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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