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# University of Delaware, (DE)

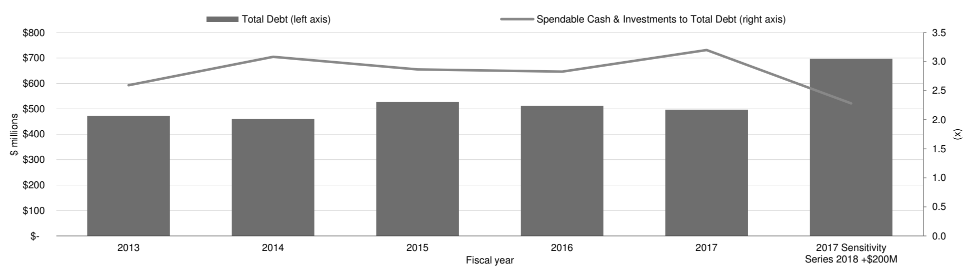
## Update to credit analysis

### Summary


The University of Delaware's excellent credit quality (Aa1 stable) reflects its solid market position as Delaware's land grant and flagship university with high non-resident enrollment, good financial resources supporting debt and operations, and favorable operating performance and cash flow generation. The university has introduced a new unsecured general obligation structure; all existing debt has a secured revenue pledge which has priority over the new unsecured structure. We do not currently make a rating distinction between the two securities reflecting healthy debt service coverage from pledged revenues generated from essential projects and mandatory fees and the closure of this indenture to future issuance.

Offsetting challenges include a forthcoming significant rise in leverage, due to new investments in its Science, Technology and Advanced Research (STAR) campus, and projected thinning in operations. The university also relies heavily on highly sought-after students from New York, New Jersey, Pennsylvania and Maryland.


Exhibit 1
**Financial leverage to rise with capital investments**




*Source: Moody's Investors Service*

### Credit strengths

» Strong market position as Delaware's flagship and land grant university with prominent academic and research programs and strong out-of-state attendance

» Growing balance sheet resources, with fiscal 2017 spendable cash and investments cushioning operations by a strong 1.7x

» Good liquidity, with almost 300 monthly days cash on hand, and fairly predictable calls on that liquidity

- Consistently strong operations, with a 15.6% operating cash flow margin for fiscal 2017 and 4.4x debt service coverage from all operating revenue
- Strong planning and oversight culture as well as fairly autonomous board that can control tuition and make other strategic decisions, providing financial and operational flexibility

## Credit challenges

- Highly competitive higher education landscape reflected in the lower yield rates on non-resident applicants, critical as over 60% of enrollment is from outside the state
- Leverage will increase with $200 million in proforma borrowing bringing debt to operating revenue to a moderately high 0.7x and debt to cash flow to 4.4x
- Thinning financial operations anticipated as university invests in its STAR campus
- Moderate exposure to demand debt relative to peers, supported by bank facilities and interest rate swaps
- OPEB liability of $550 million for fiscal 2017 expected to continue to grow

## Rating outlook

The stable outlook reflects Moody's expectations of rising student demand and growth in net tuition revenues, as well as growing balance sheet resources to offset increased leverage.

## Factors that could lead to an upgrade

- Substantial growth of financial resources and liquidity through positive operations and fundraising over the longer-term
- Strengthening of brand leading to stronger student demand with growing enrollment from a broader geographic area
- Easing of financial leverage

## Factors that could lead to a downgrade

- Failure to increase revenue in light of growing expenses, resulting in decline in operations
- Cash flow margins that fall to below 12%
- Weakening of student demand resulting in constrained or declining net tuition revenues
- Material spend down of financial resources or additional borrowing
- For revenue bonds, weakening of overall credit or debt service coverage from legal pledge

## Key indicators

Exhibit 2
UNIVERSITY OF DELAWARE

| | 2013 | 2014 | 2015 | 2016 | 2017 | Proforma | Median: Aa Rated Public Universities |
|---|---|---|---|---|---|---|---|
| Total FTE Enrollment | 20,512 | 21,153 | 21,325 | 21,510 | 22,181 | 22,181 | 28,405 |
| Operating Revenue ($000) | 891,369 | 918,605 | 962,329 | 975,878 | 1,004,574 | 1,004,574 | 1,104,854 |
| Annual Change in Operating Revenue (%) | 4.1 | 3.1 | 4.8 | 1.4 | 2.9 | 2.9 | 4.4 |
| Total Cash & Investments ($000) | 1,506,445 | 1,721,727 | 1,826,736 | 1,772,345 | 1,921,390 | 1,921,390 | 1,201,140 |
| Total Debt ($000) | 472,107 | 460,761 | 526,748 | 512,061 | 496,820 | 696,820 | 597,459 |
| Spendable Cash & Investments to Total Debt (x) | 2.6 | 3.1 | 2.9 | 2.8 | 3.2 | 2.3 | 1.3 |
| Spendable Cash & Investments to Operating Expenses (x) | 1.5 | 1.7 | 1.7 | 1.5 | 1.7 | 1.7 | 0.7 |
| Monthly Days Cash on Hand (x) | 256 | 261 | 271 | 281 | 296 | 296 | 162 |
| Operating Cash Flow Margin (%) | 16.9 | 17.9 | 17.9 | 16.7 | 15.6 | 15.6 | 12.0 |
| Total Debt to Cash Flow (x) | 3.1 | 2.8 | 3.1 | 3.1 | 3.2 | 4.4 | 4.4 |
| Annual Debt Service Coverage (x) | 6.2 | 5.9 | 5.1 | 4.6 | 4.4 | 3.8 | 3.0 |

Proforma includes the issuance of $200 million in bonds and cash flow from fiscal 2017; debt service is net of Build America Bonds subsidy.
FTE enrollment excludes associate arts program and includes professional students.
*Source: Moody's Investors Service*

## Profile

The University of Delaware, the land grant university for the state, was chartered for higher education by the state in 1833 and became a university in 1921. The main campus is in Newark, Delaware and the university draws a high 60% of students from out-of-state. UD is committed to Delawareans, accepting 85% of in-state applicants for its university and associate programs. UD offers a broad array of degrees from associates to doctorates to its over 22,000 full-time equivalent students and has operating revenues in excess of $1 billion.

## Detailed credit considerations

### Market profile: favorable student demand as state's flagship and high out-of-state enrollment

The strategic positioning of the University of Delaware is excellent, anchored by its role as the State of Delaware's (Aaa) flagship and land-grant university, accepting about 85% of in-state applicants for its university and associate degree programs. Conveniently located on the northeast corridor train line between New York City and Washington, DC, the university attracts 60% of its students from out-of-state, primarily from New York, New Jersey, Pennsylvania and Maryland. In addition, international students comprise around 9.5% of the student body.

Known among undergraduates for its manageable size, the university will continue to show strong student demand from state residents and out-of-state students. Total enrollment of over 22,000 full-time equivalent students (FTEs) for fall 2017 is up over 3% from the prior year. Over the medium term, the university expects undergraduate enrollment to rise on average by just over 1% annually, while graduate enrollment is slated to grow at a faster 6% pace.

The university's ambitious development plans will help to attract students and high performing research faculty. Most development will take place at the university's STAR campus, a 272-acre site formerly occupied by Chrysler Newark Assembly Plant and located adjacent to its main campus. The 40-80 year development plan starts with a privately financed 10-story building on the site in which the university has leased space for it health sciences programs, and the Chemours Discovery Hub being built by the private sector for chemical research. In addition, UD was awarded a $70 million grant by the Department of Commerce to set up a National Institute for Innovation in Manufacturing Biopharmaceutical (NIMBL) with partners in industry, universities, non-profits and local governments, and is planning to build a new biopharmaceutical building on the site to house this activity.

### Operating performance: history of strong cash flows expected to narrow, but will continue to provide solid debt service coverage

University of Delaware's cash flow margins are expected to continue to narrow in fiscal 2018 and over the medium term. For the year ending June 30, 2017, the university produced a strong three-year average operating margin of 5.4%; a 15.6% operating cash flow margin was generated in fiscal 2017, albeit down from the prior three-year average of 17.5%. In fiscal 2018, and over the next five years, cash flow margins will narrow to around 13-15% as expense growth will outpace revenue growth. Expenses will be driven by the university's investment in new faculty to staff its programmatic and capital expansion and the rise in costs related to other post-employment benefits (OPEB).

UD has a comparatively high reliance on student charges, well above many peer public universities, accounting for 57% of fiscal 2017 operating revenues. Most of this revenue is generated by the majority of students paying higher non-resident tuition. Net tuition per student is also one of the highest of similarly-sized U.S. public universities at $20,479 for fiscal 2017, up 1.7% from the prior year. Student-based revenue is critical as the driver of pledged revenues for bonds issued prior to 2018.

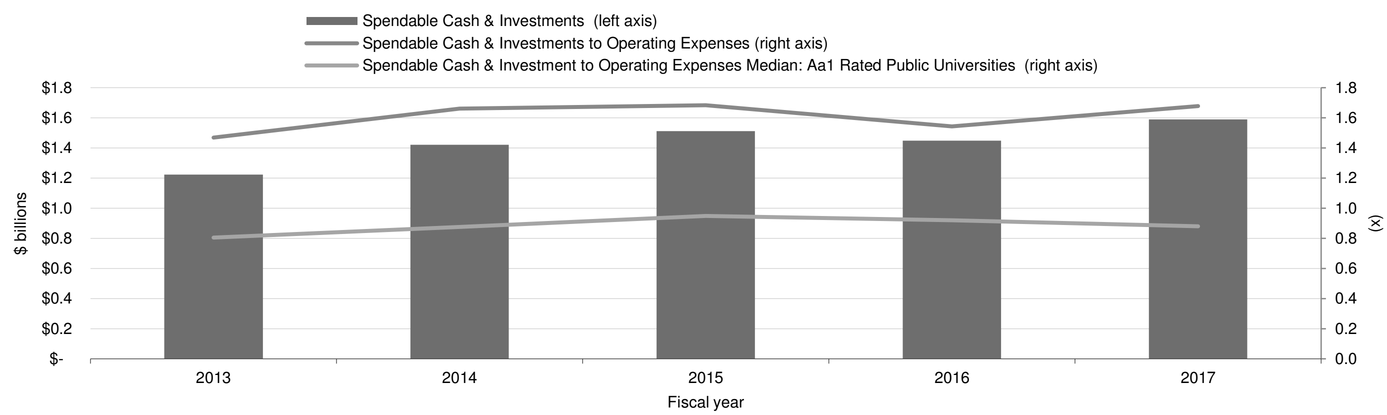
State appropriations, although modest, provide a steady stream of revenue to the university to offset the cost of providing full financial need for in-state residents. They represent a relatively small 12% of fiscal 2017 operating revenues and are expected to remain stable over the next several years. The state also provides minor amounts of capital funding, normally $3-6 million annually.

**Wealth and liquidity: above average wealth and good liquidity provide solid cushion to operations and debt**

The University of Delaware's sizeable financial resources, which provide a strong cushion for debt and operations, are likely to grow more slowly as a portion of cash flows will be directed to planned large capital expenditures. In fiscal 2017, UD had total cash and investments of $1.9 million. Its level of spendable cash and investments stood at $1.6 million, compared to $1.2 billion in fiscal 2013, a rise of 30%. These reserves cover annual operations by a strong 1.7x compared to the Aa1-median for public universities of 0.9x (see Exhibit 3). While coverage of proforma debt will decline to 2.3x from 3.2x, it remains in line with peers.

Exhibit 3

**Financial resources provide strong coverage of operations**




*Source: Moody's Investors Service*

Investments are well diversified, with 50% in domestic and global equities, 9% in fixed income and cash, 16% in hedge funds and 20% in private investments including real estate. For fiscal 2017, UD reported a 12.1% investment return on its endowment, comparable to peer institutions for the period. Cambridge Associates is the overall investment advisor, with Hamilton Lane and Albourne America providing investment advice for private equity and hedge fund investments, respectively.

University of Delaware has good gift revenue, with three-year average gift revenue of $42 million, although average gifts per student at $1,897 are below the $3,185 of Aa1-rated peers. In November 2017, the university launched the public phase of a $750 million capital campaign (increased from $550 million) of which nearly $600 million has been raised. In fiscal 2018, the university reports record levels of giving that are likely to exceed $100 million.

**Liquidity**

Liquidity will continue to be healthy, providing a good cushion for operating expenses, potential calls from its debt portfolio and calls from its unfunded investment commitments. The university had $705 million of unrestricted monthly liquidity at fiscal year-end 2017, up significantly from $532 million at fiscal year-end 2013. A broad measure of liquidity, monthly days cash on hand is a favorable 297 days.

### Leverage: significant rise in debt is manageable given strong resources and expectations of continued growth

The university's historically low leverage is projected to rise significantly to $696 million in fiscal 2018 from $496 million with the forthcoming bond issuance of $200 million. Debt to operations will rise to 0.7x, which is above average compared to other highly rated public universities. Debt affordability, as measured by debt to cash flow, will remain manageable at 4.4x, but up from 3.1x in fiscal 2017. As a result, we estimate that debt service coverage could fall to 3.3x in fiscal 2018, down from 4.4x in fiscal 2017.

The university is undertaking an expansion in its "Campus Framework Plan" amounting to nearly $500 million over the next three years. Projects include a $156 million biopharmaceutical building, investments in student residences, athletic facilities, and basic infrastructure for the STAR campus. Funding will come from the planned bond issuance, operating revenues, gifts, and state funding. In addition, in fiscal 2019, the university will finance the purchase of an existing student housing project for approximately $25 million and enter into a capital lease for $35 million on the STAR campus.

#### Debt structure

The University of Delaware's debt profile has moderate 26% exposure to variable rate debt mitigated by its balance sheet reserves and liquidity. Standby bond purchase agreements (SBPAs) support the tender features of UD's series 2004B, 2005, and 2013C bonds.

The SBPA for the $32.2 million outstanding series 2004B bonds is provided by Bank of America, N.A. and expires on April 5, 2021. The SBPA for the $32.9 million outstanding series 2005 bonds is provided by TD Bank, N.A. and expires on May 31, 2021. In the event of a liquidity draw, UD has sufficient funds to reimburse the bank through a two-year term-out period for TD Bank and 90 days for Bank of America. The SBPA for the $57.4 million outstanding Series 2013C bonds is provided by TD Bank, N.A. and expires on April 30, 2019.

The forthcoming series 2018 bonds are fixed rate, maturing in 2058 and are expected to be structured to wrap around existing debt so that the result will be relatively flat debt service through 2035 with declining debt service through 2058.

#### Debt-related derivatives

The university's liquidity and debt management practices mitigate risks associated with its debt structure with swaps. UD entered into or guaranteed floating to fixed rate interest rate swaps with a total notional amount of $133.2 million as of June 30, 2017; the total market value was a $25.4 million liability for the university. The university is not required to post collateral at Aa1, with the threshold beginning at $50 million at Aa2.

#### Pensions and OPEB

UD's post-retirement benefit costs are slightly elevated and will rise over time. UD offers a defined contribution plan for substantially all faculty and professional employees. Its contribution rate is 11% of annual base salary, with total contributions of $30 million in fiscal 2017. All other employees are covered by the Delaware State Employees' Pension Plan, which is well funded at nearly 90%, and, for fiscal 2017 UD's pension contribution was $5.4 million. Total pension contributions amount to $35.9 million or a moderate 3.8% of expenses.

The unfunded OPEB liability has risen significantly and was $550 million at fiscal 2017, up from $277 million in fiscal 2014. Although the liability will continue to rise, the impact on financial resources will remain manageable. UD offers other post-retirement benefits, primarily health care benefits, to faculty and professional staff. Employer contributions amounted to $16.1 million or a low 1.7% of the budget.

### Governance and management: state support along with greater autonomy underpins excellent strategic positioning

UD's governance structure is a credit strength as it permits the university more autonomy than its public university counterparts over its operations. The State Charter, which can only be amended with board approval, grants the board full management of UD's affairs, including setting tuition and fees, adoption of its budget and all powers regarding the investment and control of all funds. Originally a private college, UD became a public university in 1921 and its board structure reflects its roots as a private institution. The Board of Trustees has 32 members, four ex-officio members including UD's president and the governor. Eight trustees are appointed by the governor of the State of Delaware and the remaining 20 are elected by the board. All appointments are confirmed by the state Senate.

Fiscal practices are prudent and underpin strong financial performance. The board provides close oversight of the university's strategic investments and debt management. In recent years, the university has also prudently lowered its endowment draw to a range of 4%-5% of the average of the trailing 12 quarters of its endowment to help preserve financial resources. The university's multi-year operating and capital planning provide the tools to make adjustments to its expansion activities should projected enrollment and development objectives not materialize as anticipated.

Legal security

With the planned issuance of the series 2018 bonds, the university has introduced a new unsecured general obligation structure which will apply to all of its future bond issues. Revenue bonds issued in prior years are secured by pledged revenues consisting of gross revenues received by UD from the operation of project facilities, and as such, will have a priority over bonds with the unsecured general obligation structure. However, given the university's healthy consolidated debt service coverage, the net pledged revenues healthy 1.9x coverage of revenue bonds, flat revenue bond debt service and anticipated increase in pledged revenues, as well as closure of the indenture to further issuance, we do not currently make a rating distinction between the two securities. A distinction is possible should debt service coverage deteriorate.

Pledged revenues include housing, dining, health care facilities, as well as book stores and parking, and three mandatory student fees that must be paid by all undergraduate students. There is no debt service reserve fund for the revenue bonds. There is a rate covenant of at least 1.25x debt service coverage from net pledged revenues. UD also covenants to maintain its project facilities in good, working order, using any of its legally available revenues for those purposes.

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