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Ratings

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# University of Delaware; Public Coll/Univ - Unlimited Student Fees

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# University of Delaware; Public Coll/Univ - Unlimited Student Fees

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|---|---|---|
| US$200.0 mil taxable bnds ser 2018 due 11/01/2059 | | |
| *Long Term Rating* | AA+/Stable | New |
| **Univ of Delaware rev bnds ser 2004A, 1993, 1997** | | |
| *Long Term Rating* | AA+/Stable | Affirmed |

## Rationale

S&P Global Ratings has assigned its 'AA+' long-term rating to the University of Delaware's (UD) approximately $200 million in taxable bonds, series 2018. At the same time, S&P Global Ratings affirmed its 'AA+' long-term rating on UD's bonds outstanding, and its 'AA+/A-1+' and 'AA+/A-1' ratings on the university's variable-rate debt. The rating's short-term component reflect liquidity from various banks through standby bond purchase agreements (SBPAs). The outlook is stable.

The 'AA+' rating reflects our view of UD's enterprise as extremely strong and financial profile as very strong, with favorable demand metrics, a solid management team, a history of consistently positive operating results with limited reliance on state appropriations, and an adequate balance sheet for the rating, although available resources could become constrained if additional debt is issued during the outlook period. Combined, these credit factors lead to an indicative stand-alone credit profile of 'aa+' and a long-term rating of 'AA+'.

The rating reflects our view of the following factors:

- Stable enrollment of about 22,000 students and a relatively broad geographical draw for a public flagship institution;
- A strong record of positive full-accrual operating results;
- Adequate financial resources for the rating, with expendable resources equal to 85% of adjusted operating expenses and 166% of pro forma debt; and
- A solid pooled investment portfolio (which included $1.3 billion in endowment funds) with a market value of $1.6 billion as of Dec. 31, 2017, and a below-industry-average endowment spending rate of 4.1%.

In our opinion, partially offsetting credit factors include the following:

- UD's location, in a region with high competition for students; and
- Reductions in state operating appropriations, although a limited level of dependence on the State of Delaware balances this.

Bond proceeds will fund capital projects consistent with UD's capital plan.

Prior to the series 2018 issuance, the university issued several series of revenue bonds pursuant to the 1989 Trust Agreement, of which about $450 million is outstanding. Securing the bonds is a senior lien on pledged revenues that include gross revenues from UD's housing, dining, and other revenue-producing facilities. A mandatory comprehensive student fee, student health fee, and student center fee, which all full-time undergraduate student pay, also secure the bonds. We view this broad revenue pledge as equivalent to an unlimited student fee pledge.

UD is issuing and securing the 2018 bonds with a new indenture. The bonds are unsecured general obligations of the university, payable solely from its general revenues. The series 2018 bonds will hold a subordinate position on those revenues, which have been previously pledged to the university's prior revenue bonds. However, UD has covenanted to not issue any additional series of revenue bonds secured by a senior lien on the pledged revenues. At the same time, the 2018 bonds will benefit from additional, significant available revenues not pledged to the previously issued debt. For fiscal 2017, total net pledged revenues were $64 million, which will pay debt service on prior obligations before the 2018 bonds. The additional revenues available for the debt service on the 2018 bonds are approximately double the size of the net pledged revenues at $125 million in fiscal 2017. As per our criteria, we may rate subordinated obligations at the same level as senior obligations when the subordinate obligation holders receiving additional security such as a pledge of another revenue stream not pledged to senior-lien holders if we believe this additional security improves their position sufficiently. Given the magnitude of the additional revenues, and that the university has covenanted not to issue additional debt under the senior lien, we rate the 2018 bonds on par with the prior obligations.

Total pro forma debt with this issue is approximately $675 million (including bonds, notes, capital leases, and lines of credit). Beyond a small lease and the purchase of approximately $25 million in housing debt in fiscal 2019, management does not have any additional, board-approved direct debt plans during our two-year outlook period.

## Outlook

The stable outlook reflects our expectation that, during our two-year outlook period, student demand and enrollment will likely be stable and UD will continue achieving positive full-accrual operations. We do not anticipate any significant new debt during the outlook period, and would expect the university to meet any additional debt with commensurate growth in resources.

### Downside scenario

A negative outlook or rating action during the outlook period could follow a significant deterioration in enrollment or financial operations, or significant additional debt without a commensurate growth in resources such that financial resources become inconsistent with the rating. Although we understand that state appropriations are a relatively small part (approximately 11%) of operating revenues, a significant decline that hurts UD's operating performance could also result in a negative rating action.

### Upside scenario

We do not believe a positive outlook or rating action is likely within the outlook period unless there is significant endowment growth, improved levels of cash and investments as a share of operating expenses and debt levels, and an increase in financial margins to levels that are commensurate with those of higher rated public universities.

# Enterprise Profile

### Industry risk

Industry risk addresses the higher education sector's overall cyclicality 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, UD has good geographic diversity with about 62% of students from out of state. Therefore, the national GDP per capita anchors our assessment of the university's economic fundamentals.

### The university

UD, tracing its roots as a private institution in the 1700s, became the land-grant college for the state in 1867. The main campus is in the center of Newark, 15 miles southwest of Wilmington. The university served 23,774 students as of fall 2017, or 21,898 full-time equivalents (FTEs). Although it has the capacity to expand enrollment, there are no plans to do so significantly. UD's housing system has 44 dormitory buildings on the main campus in Newark. Management expects approximately 7,500 students to reside in university housing this fall (which is about 40% of undergraduate students attending the main campus), and nearly all undergraduates attend full-time. There is a freshman residency requirement except for students living within 30 miles of campus.

As Delaware's flagship higher education institution, UD has a high level of autonomy to set fees without direct legislative influence. However, it also benefits from the 'AAA' general obligation debt rating we have on the state. In addition, we view UD's financial management as strong, which strong operating margins and good endowment levels and financial resources reflect. In our opinion, these attributes give it a measure of flexibility and insulation during economic downturns and the ability to leverage its strength to achieve its mission.

However, UD depends on continued high enrollment from out-of-state students because only 38% of enrolled students are Delaware residents (a level that has been fairly stable in the past couple of years). We believe the risk in the out-of-state student pool is low given the university's competitive cost structure and financial flexibility.

### Market position and demand

We believe UD enjoys good demand, stable enrollment, and solid student quality. Total fall 2017 headcount was 23,774 and total FTE enrollment was 21,898, up 1.8% from a year earlier. The number of completed freshmen applications for fall 2017 was 27,510, which was the largest in the university's history, up 5.5% from fall 2016 applications. We expect this strong demand to continue. Although the university does not have specific growth plans, it continues to increase total enrollment incrementally. UD's fall 2017 freshman class was at 4,312. For fall 2018, it anticipates continued enrollment growth based on applications and deposits to date. Management continues to focus on increasing its graduate and professional programs in the next several years, in line with its growing research opportunities.

UD's student quality has been consistent, and the university has increased its acceptance of out-of-state students in the past few years. Management indicates this relates in part to strategic changes to enrollment offerings and financial aid packaging, as well as competitive pricing. For fall 2017, total freshmen applications were 27,510, selectivity was 60.5%, and the matriculation rate was 26%. UD competes for applicants with both private and public universities, including Pennsylvania State University; University of Maryland College Park; Rutgers University, N.J.; University of Connecticut; Villanova University, Pa.; and James Madison University, Va. Its tuition and fees are competitive with those of the peer set.

### Fundraising

On Nov. 10, 2017, UD announced the $750 million "Delaware First" fundraising campaign, with nearly $600 million raised to date. For fiscal 2016, it raised $52 million in pledges and gifts and about $40 million in fiscal 2017. During the past 50 years, UD has received substantial gifts from the Unidel Foundation Inc., a charitable corporation whose primary purpose is to aid and promote higher education in Delaware. During that time, the foundation has contributed $32 million to the endowment funds. In addition, during the past few years, the university has received expendable funds for general purposes, which we expect to continue at a comparable level in the near term. In our opinion, UD has generated significant momentum with this current capital campaign and several landmark gifts, and we view this positively.

### Management and governance

A 32-member board of trustees (BOT) governs university operations. Board members include four ex-officio members, including the state governor, the university's president, the state grange master, and the state board of education's president. We understand that the board elects 20 members, whereas the governor appoints the remaining eight subject to the consent of a majority of elected members of the state Senate. BOT members typically serve six-year terms. The board has administrative and financial oversight of the university's activities. Its duties and responsibilities include setting tuition and fees, developing an institutional plan, determining academic programs, establishing administrative policies, approving debt issuances, and granting degrees.

The president, Dr. Dennis Assanis, has held this position since July 1, 2016, and under his leadership, there have been some changes to senior management, but we note that most key senior management positions have been stable, especially in the finance department. Prior to joining UD, Dr. Assanis was provost and senior vice-president for academic affairs at Stony Brook University and vice-president for Brookhaven National Laboratory Affairs. Under his leadership, the university has gone public with a $750 million campaign and announced several transformational partnerships. Overall, we view the management team as a strength as UD has consistently generated operating surpluses. The university has a robust enterprise risk management that identifies, assesses, mitigates, and monitors risks, which we view favorably.

## Financial Profile

### Financial management policies

UD has formal policies for liquidity, investments, and debt. The university meets the standards for annual disclosure requirements and is beginning to report interim full-accrual results. The financial policies assessment reflects our opinion that, while there may be some areas of risk, the organization's overall financial policies are not likely to negatively affect its ability to pay debt service. Our analysis of the school's 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 to comparable institutions.

### Financial performance

UD's reliance on state appropriations continues to be limited, in our view, with those accounting for only 10.6% of fiscal 2017 operating revenues. Appropriations were up modestly in fiscal years 2016 and 2017, reaching $121 million, and we expect appropriations for fiscal 2018 to decline modestly. Overall appropriations support remains lower than 2008-2009 levels. In addition to operating support, UD receives a small amount of capital appropriations from the state. The amount varies depending on capital requirements that are eligible for appropriations. Management expects to receive $5.5 million in capital appropriations for fiscal year 2018.

In fiscal 2017, the university continued to produce what we consider solid financial results. It reported a full-accrual operating surplus of $34 million or 3% of adjusted operating expenses. For fiscal 2018, management expects that operating performance will again generate a full-accrual surplus, which will be comparable but slightly less than fiscal 2017 levels given some strategic investments. We believe that the university's margins will continue to be pressured over the medium term, but improve beyond then. The majority of revenues come from tuition (50.4% of fiscal 2017 operating revenues), followed by grants at 15.8% and auxiliary revenues at 11.3%. The tuition discount rate has increased somewhat over the past few years but is still comparable to that of rated peer institutions, at 26.5% in fiscal 2017.

### Available resources

As of June 30, 2017, expendable resources were $942 million, representing 85% of adjusted operating expenses and 166% of pro forma debt. We consider these metrics adequate for the rating. Cash and investments were stronger at $1.92 billion, representing 178% of adjusted operating expenses and 291% of pro forma debt.

As of Dec. 31, 2017, the pooled investment portfolio (which includes $1.3 billion in endowment funds) market value was $1.6 billion and exceeded previous highs before the recession. UD reports $276.5 million in unfunded commitments related to its private-equity investments as of Dec. 31, 2017, a level we believe is manageable. Historically, the endowment spending rate is normally targeted at 4.5%-5.5% of the 12-quarter average market value as of Dec. 31. However, starting with fiscal 2014, the board revised its spending policy to target 4%-5% of the 12-quarter average market value as of Dec. 31, which is more conservative.

The approved spending rate for fiscal 2017 was 4.15% and the recommended rate for fiscal 2018 is 4.14%. We view the asset allocation as comparable with that of other rated peers. The endowment's return for calendar 2017 was 13.2%.

### Debt and contingent liabilities

The university issued $57.5 million in series 2013C bonds that were in a three-year term mode with a mandatory put May 2, 2016, but these have since been converted to daily interest rate mode and are backed by a standby liquidity facility from TD Bank N.A. The SBPA is set to expire April 30, 2019.

After the issuance of the series 2018, the long-term debt structure will consist of about 20% variable-rate and 80%

fixed-rate bonds. UD has entered six interest rate swaps, for a total notional amount of about $134.4 million, which hedges the interest rates on its variable-rate bonds. Morgan Stanley Capital Services Inc. is the counterparty for the university's swap and PNC Bank N.A. is the counterparty on the Blue Hen Project's associated swap. As of June 30, 2017, the mark-to-market value of the swaps, including the one from the project, was negative $25.4 million. We understand that UD has not posted collateral for any rate swap agreements. Overall, we view the swap portfolio as posing limited credit risk to the university given the magnitude of the financial resources relative to the termination payments.

### Pension plans and other postemployment benefits

UD provides retirement benefits for employees through two retirement plans. Substantially all faculty and professional employees participate in a 403(b) defined-contribution plan. All salaried and hourly staff employees participate in the Delaware State Employees' Pension Plan, a cost-sharing defined-benefit plan. The university's policy is to pay its share of the annual premium accrued in connection with these two plans and there are no unfunded benefits. UD also provides other postretirement benefits, primarily for retiree health care. We understand that as of June 30, 2017, it had a $550 million postretirement benefit obligation it had not funded. It is taking steps to reduce postretirement obligations, which we view positively, as, in our opinion, this is a significant unfunded obligation.

**University of Delaware--Enterprise And Financial Statistics**

| | --Fiscal year ended June 30-- | | | | |
|---|---|---|---|---|---|
| | **2018** | **2017** | **2016** | **2015** | **2014** |
| **Enrollment and demand** | | | | | |
| Headcount | 23,774 | 23,009 | 22,852 | 22,680 | 22,166 |
| Full-time equivalent | 21,898 | 21,510 | 21,325 | 21,153 | 20,512 |
| Freshman acceptance rate (%) | 60.5 | 60.9 | 58.5 | 65.9 | 61.6 |
| Freshman matriculation rate (%) | 25.9 | 24.9 | 26.4 | 25.4 | 24.3 |
| Undergraduates as a % of total enrollment (%) | 79.7 | 80.4 | 80.3 | 80.3 | 80.0 |
| Freshman retention (%) | 91.3 | 91.5 | 92.4 | 91.5 | 92.0 |
| Graduation rates (six years) (%) | 83.2 | 82.9 | 81.0 | 81.2 | 81.7 |
| **Income statement** | | | | | |
| Adjusted operating revenue ($000s) | N.A. | 1,141,570 | 1,108,604 | 1,093,164 | 1,035,166 |
| Adjusted operating expense ($000s) | N.A. | 1,107,242 | 1,066,656 | 1,029,066 | 980,637 |
| Net operating income ($000s) | N.A. | 34,328 | 41,948 | 64,098 | 54,529 |
| Net operating margin (%) | N.A. | 3.10 | 3.93 | 6.23 | 5.56 |
| Change in unrestricted net assets ($000s) | N.A. | 79,468 | (106,475) | (39,027) | 108,097 |
| Tuition discount (%) | N.A. | 26.5 | 26.4 | 26.1 | 25.6 |
| Tuition dependence (%) | N.A. | 50.4 | 50.5 | 50.3 | 49.5 |
| Student dependence (%) | N.A. | 61.7 | 62.2 | 62.0 | 61.3 |
| Research dependence (%) | N.A. | 15.8 | 15.6 | 15.7 | 16.5 |
| Endowment and investment income dependence (%) | N.A. | 6.0 | 6.0 | 5.6 | 5.3 |
| **Debt** | | | | | |
| Outstanding debt ($000s) | N.A. | 496,820 | 512,061 | 526,748 | 491,153 |

## University of Delaware--Enterprise And Financial Statistics (cont.)

| | --Fiscal year ended June 30-- | | | | |
|---|---|---|---|---|---|
| | 2018 | 2017 | 2016 | 2015 | 2014 |
| Proposed debt ($000s) | N.A. | 200,000 | N.A. | N.A. | N.A. |
| Total pro forma debt ($000s) | N.A. | 675,190 | N.A. | N.A. | N.A. |
| Pro forma MADS | N.A. | 41,128 | N.A. | N.A. | N.A. |
| Current debt service burden (%) | N.A. | 3.46 | 3.59 | 3.40 | 3.35 |
| Current MADS burden (%) | N.A. | 3.01 | 3.20 | 3.47 | 3.39 |
| Pro forma MADS burden (%) | N.A. | 3.71 | N.A. | N.A. | N.A. |
| **Financial resource ratios** | | | | | |
| Endowment market value ($000s) | N.A. | 1,289,925 | 1,192,718 | 1,274,692 | 1,242,266 |
| Cash and investments ($000s) | N.A. | 1,966,473 | 1,851,763 | 1,917,026 | 1,810,368 |
| Unrestricted net assets ($000s) | N.A. | 1,292,198 | 1,212,730 | 1,319,205 | 1,358,232 |
| Expendable resources ($000s) | N.A. | 942,206 | 838,690 | 1,033,104 | 1,135,361 |
| Cash and investments to operations (%) | N.A. | 177.6 | 173.6 | 186.3 | 184.6 |
| Cash and investments to debt (%) | N.A. | 395.8 | 361.6 | 363.9 | 368.6 |
| Cash and investments to pro forma debt (%) | N.A. | 291.2 | N.A. | N.A. | N.A. |
| Expendable resources to operations (%) | N.A. | 85.1 | 78.6 | 100.4 | 115.8 |
| Expendable resources to debt (%) | N.A. | 189.6 | 163.8 | 196.1 | 231.2 |
| Expendable resources to pro forma debt (%) | N.A. | 166.0 | N.A. | N.A. | N.A. |
| Average age of plant (years) | N.A. | 15.0 | 13.3 | 14.0 | 14.2 |

Note: Total adjusted operating revenue equals unrestricted revenue less realized and unrealized gains/losses and financial aid. Total adjusted operating expense equals unrestricted expense. Pro forma debt equals fiscal 2017 long-term debt (inlcuding capital leases) plus $200 million in series 2018 bonds minus fiscal 2018 principal repayments and BHH repayment. MADS--Maximum annual debt service. N.A.--Not available.

## Ratings Detail (As Of March 30, 2018)

| | | |
|---|---|---|
| University of Delaware var rate rev bnds ser 2013C dtd 04/18/2013 due 11/01/2037 | | |
| *Long Term Rating* | AA+/A-1+/Stable | Affirmed |
| University of Delaware PCU_USF | | |
| *Long Term Rating* | AA+/Stable | Affirmed |
| University of Delaware PCU_USF | | |
| *Long Term Rating* | AA+/Stable | Affirmed |
| University of Delaware PCU_USF | | |
| *Long Term Rating* | AA+/A-1/Stable | Affirmed |
| University of Delaware PCU_USF | | |
| *Long Term Rating* | AA+/Stable | Affirmed |
| **Delaware Econ Dev Auth (Univ of Delaware) rev bnds, ser 2009A** | | |
| *Long Term Rating* | AA+/Stable | Affirmed |
| **University of Delaware rev bnds ser 2005** | | |
| *Long Term Rating* | AA+/A-1+/Stable | Affirmed |