

MOODY'S

INVESTORS SERVICE

New Issue: Moody's assigns A1 to Villanova University, PA's \$53M Ser. 2014 bonds; outlook stable

Global Credit Research - 18 Jun 2014

\$170M rated debt

VILLANOVA UNIVERSITY, PA
Private Colleges & Universities
PA

Moody's Rating

ISSUE

Revenue Bonds Series 2014

RATING

A1

Sale Amount \$53,115,000

Expected Sale Date 07/08/14

Rating Description Revenue: 501c3 Secured General Obligation

Moody's Outlook STA

Opinion

NEW YORK, June 18, 2014 --Moody's Investors Service has assigned an A1 rating to Villanova University's \$53.1 million of fixed rate Series 2014 revenue bonds expected to be issued through the Delaware County Authority. We have also affirmed the ratings on the outstanding bonds (see RATED DEBT). The rating outlook is stable.

SUMMARY RATING RATIONALE

The A1 rating with a stable outlook reflects Villanova University's ("VU") established national reputation as a Catholic university with diverse program offerings and consistently positive operating performance that has resulted in good financial resource growth and strong liquidity, with a moderate debt burden. Offsetting factors include strong competition that has compressed net tuition revenue growth, VU's high reliance on student charges and moderate financial resources relative to large A1-rated private universities.

STRENGTHS

*VU's largely unrestricted financial resource base allows for good financial flexibility. Fiscal year (FY) 2013 unrestricted liquidity of \$337 million translates into nearly one year coverage of operating expenses.

*An experienced management team with strong financial controls and conservative budgeting and planning is evidenced by a favorable cash flow margin of 14.6% and three-year average debt service coverage of 3.5 times in FY 2013.

*Diverse undergraduate and graduate programs with a national reputation for academics and intercollegiate athletics contribute to stable enrollment of 9,563 full-time equivalent (FTE) students in fall 2013 with a similar expectation for fall 2014.

*Villanova recently announced a \$600 million comprehensive campaign, which should drive growth in financial resources.

*Manageable leverage with debt to operating revenue of 0.46 times provides some debt capacity at the current rating. All of the university's debt is fixed-rate and amortizing.

CHALLENGES

*A high reliance on student charges (82% of total operating revenue) requires careful enrollment and tuition revenue management. Net tuition revenue growth was stagnant in FY 2013 with expectations of slim growth in the near-term, reflecting an increased discount rate to 27% in FY 2013 from 22% in FY 2009.

*Villanova shows moderate financial resources relative to A1-rated peers, with FY 2013 expendable financial resources of \$325 million cushioning debt 1.8 times and operations 0.9 times.

*VU continues to move forward to obtain local approvals for a very large capital project which, if approved, could result in a substantial debt issuance that would likely pressure debt metrics relative to the rating category.

DETAILED CREDIT DISCUSSION

USE OF PROCEEDS: The Series 2014 bonds are being issued to provide funds to advance refund all or a portion of the outstanding Series 2005 and 2006 revenue bonds and to pay issuance costs.

LEGAL SECURITY: The bonds are secured by a lien and security interest in the university's unrestricted revenues. The university covenants to generate net revenue at least equal to 100% of annual debt service requirements. There are no debt service reserve funds.

DEBT STRUCTURE AND DEBT-RELATED INTEREST RATE DERIVATIVES: All of the university's pro-forma debt will be fixed-rate and scheduled to amortize over the next 18 years with the majority of the debt amortizing by FY 2025. Villanova has one \$5 million line of credit, which has not been drawn upon. The university does not have any swaps.

MARKET POSITION: SOLID REPUTATION AS A LARGE COMPREHENSIVE CATHOLIC UNIVERSITY DRIVES STABILITY IN A HIGHLY COMPETITIVE MARKET

Villanova, located in an affluent Philadelphia suburb west of the city, maintains stable student demand given its national profile as a large residential Catholic university with a diverse array of undergraduate and graduate programs. The university enrolled 9,563 FTEs in fall 2013 and anticipates modest total enrollment growth in fall 2014 primarily due to popular graduate programs despite declines at its law school. Management does not plan to grow the undergraduate population.

The university's high net tuition per student, which measured \$27,877 in FY 2013 reflects both positive student demand in a very competitive market and its professional graduate programs. Reflecting national trends, net tuition revenue growth has been more modest post-recession from rising competition and increased tuition discounting. Villanova attracts students from across the country and abroad, but remains concentrated in Pennsylvania, New York and New Jersey and other northeastern states, which are generally facing declining high school graduates. VU's academic reputation and successful basketball program continues to draw national attention to support ongoing demand. Applications for first-time undergraduate students exceeded prior highs and management anticipates selectivity and matriculation ratios similar to prior years, at 49% and 23%, respectively, with no dramatic growth in the 27% discount rate.

OPERATING PERFORMANCE: NARROWING OPERATING MARGINS EXPECTED DUE TO PLANNED EXPENSE GROWTH AND CONTINUED CAPITAL RENEWAL, BUT WILL STILL REMAIN HIGHLY POSITIVE

VU should continue to produce favorable operating surpluses given management's strong fiscal oversight and conservative budgeting. Margins tightened in recent years driven by slower net tuition revenue growth in the face of rising expenses. Cash flow remains good at 14.6% in FY 2013 although down from 18% in FY 2011 and FY 2014 will remain similar to slightly lower than FY 2013. The university has a three-year operating margin of 9.0% from FYs 2011-2013 with average debt service coverage of 3.5 times over the same period.

While the university's decision to address affordability has limited top line revenue growth, it has maintained operating surpluses. However, lack of net tuition revenue growth could pressure the outlook or rating as 82% of total operating revenues are derived from student charges absent diversification to other revenue streams. Villanova benefits from some diversity within tuition revenue because of its mix of undergraduate, graduate, and continuing education students. Net tuition revenue growth for FY 2012, FY 2013 and projected FY 2014 are below 2%, but the FY 2015 budget reflects a modest improvement to nearly 3%.

BALANCE SHEET/CAPITAL: DEMONSTRATED FINANCIAL RESOURCE GROWTH BUT REMAINS MODERATE COMPARED TO RATING CATEGORY

VU's financial resources will continue to rise in the near-term from gifts from a comprehensive campaign and from operating surpluses. Villanova's financial resources increased more than 50% over the past five years to \$515 million in FY 2013 due to gift revenue, investment returns and retained surpluses. Expendable financial resources of \$325 million provided an adequate cushion to debt and operating expenses at 1.8 times and 0.9 times, respectively, in FY 2013. Although higher, the financial resource cushion is moderate compared to A1-rated peers. Villanova has good unrestricted monthly liquidity of \$337 million providing nearly one year coverage of operating expenses at 352 days.

As of April 30, 2014, the market value of VU's endowment portfolio totaled \$488 million, with a fiscal year to date (FYTD) return 10.9% (May 31 fiscal year end). VU maintains good liquidity within the endowment with 45% of assets available daily and 65% of assets available monthly. The endowment allocation included 26% domestic equity, 19% hedge funds, 17% global equity, 9% inflation hedging assets, 8% emerging markets, 7% private capital, 7% bonds, 4% cash, and 3% opportunistic. Cambridge Associates is the university's investment advisor.

Continued strong gift revenues and fundraising capacity is expected as Villanova has announced its \$600 million comprehensive campaign in the fall of 2013, double the prior campaign goal of \$300 million that concluded in 2007. At fiscal year end, VU reported about \$325 million raised, with approximately \$100 million in cash and the balance in pledges, including \$53 million in deferred gifts. A large \$250 million of the campaign goal is dedicated for the endowment, followed by \$150 million for facilities, \$125 million for academic programming and \$75 million toward the annual fund.

Villanova has some debt capacity at the current rating given its revenue and financial resource growth. However, potential future debt plans of approximately \$150 million could pressure the rating or the outlook absent continued financial strengthening and operating performance sufficient to provide continued strong debt service coverage. The total estimated project cost is \$250 million and includes construction of residence halls adding approximately 1,100 new beds, a retail component and parking structure on land adjacent to campus currently occupied by a parking lot. The proposed project must be approved by the township, but has been delayed for several years due to community resistance. Given the uncertainty of the project to receive approval and the timeframe, we have not incorporated the potential debt issuance into the current rating.

MANAGEMENT AND GOVERNANCE: STABLE SENIOR LEADERSHIP WITH STRONG FISCAL MANAGEMENT AND PLANNING

Villanova's solid financial standing is attributable to management's strong oversight and multi-year planning. The board recently adopted a 5% operating margin floor (GAAP basis) to maintain Villanova's financial strength. While the university has consistently achieved margins in excess of 5%, this discipline demonstrates a commitment to maintain financial strength in light of planned continued investment in programs, salaries and capital renewal. The adoption of this policy may lead to smaller surpluses compared to prior years, but we expect that the university will reduce expenses to at least meet their target. Management's ability to consistently produce operating surpluses demonstrates conservative budgeting practices as key to investing in campus facilities with a manageable use of debt. Investing in facilities is one important component in maintaining at least stable demand in a highly competitive market environment.

VU's board of trustees is currently composed of 34 voting members with diverse professional experiences, including nine members of the Augustinian Order.

OUTLOOK

The stable outlook reflects expectations for more moderate but still positive operating margins and solid debt service coverage despite continued expense growth. It also incorporates rising financial resources from gift revenues. The outlook does not incorporate VU's potential large scale capital plans because the timing of the project remains unknown.

WHAT COULD CHANGE THE RATING UP

Upward rating pressure could result from a substantial increase in expendable financial resources both in total and relative to cushion to debt and operating expenses while maintaining positive operations, revenue growth and solid demand metrics.

WHAT COULD CHANGE THE RATING DOWN

Downward rating pressure could result from significant additional debt without compensating growth in financial resources and revenue. Negative operations, particularly if driven by declines in net tuition revenue demonstrating

pressure on VU's student market could also trigger downward rating movement.

KEY INDICATORS (FY 2013 financial data, fall 2013 enrollment data)

Full-Time Equivalent Enrollment: 9,563 students

Primary Selectivity: 48.9%

Primary Matriculation: 22.7%

Net Tuition per Student: \$27,877

Educational Expenses per Student: \$31,805

Average Gifts per Student: \$3,898

Total Cash and Investments: \$577.0 million

Total Pro-Forma Direct Debt: \$183.0 million

Expendable Financial Resources to Pro-Forma Direct Debt: 1.78 times

Expendable Financial Resources to Operations: 0.88 times

Monthly Days Cash on Hand: 351.6 days

Operating Revenue: \$401.1 million

Operating Cash Flow Margin: 14.6%

Three-Year Average Debt Service Coverage: 3.51 times

Reliance on Tuition and Auxiliaries Revenue (% of Moody's Adjusted Operating Revenue): 82.0%

RATED DEBT:

Series 2005: A1; Insured by National Public Finance Guarantee Corp (Formerly MBIA)

Series 2006: A1; Insured by AMBAC

Series 2010, 2012 and 2014: A1

PRINCIPAL RATING 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.moody.com for a copy of this methodology.

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