Moody's assigns Aa1 to University of Delaware's $51M Rev. Bds. Ser. 2015; stable outlook

Global Credit Research - 15 Apr 2015

$323M rated debt

UNIVERSITY OF DELAWARE
Public Colleges & Universities
DE

Moody's Rating

<table>
<thead>
<tr>
<th>ISSUE</th>
<th>RATING</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue Bonds, Series 2015</td>
<td>Aa1</td>
</tr>
<tr>
<td>Sale Amount</td>
<td>$50,925,000</td>
</tr>
<tr>
<td>Expected Sale Date</td>
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</tr>
<tr>
<td>Rating Description</td>
<td>Revenue: Public University Limited Pledge</td>
</tr>
</tbody>
</table>

Moody's Outlook STA

NEW YORK, April 15, 2015 --Moody's Investors Service assigns a Aa1 rating to the University of Delaware's (UD's) proposed $50.9 million Revenue Bonds, Series 2015. At the same time we affirm the Aa1 ratings on outstanding rated debt. The rating outlook is stable.

SUMMARY RATING RATIONALE

The Aa1 rating reflects University of Delaware's strong market position as Delaware's land grant and flagship university with high non-resident enrollment, good financial resources supporting debt and operations, and consistently favorable operating performance and cash flow generation. Although pledged revenues reflect a relatively small part of total revenues, the Aa1 rating reflects that the revenue pledge is the only legal pledge, there is strong debt service coverage from pledged revenues generated from essential projects and pledged revenues include three mandatory fees charged to all undergraduate students.

Offsetting challenges are its location and high reliance on the very competitive northeastern and eastern seaboard regions of the country, a growing OPEB liability and moderate exposure to demand debt relative to peers, which is supported by bank facilities.

OUTLOOK

The stable outlook reflects expectations of continued strong student demand and growth in net tuition revenues, strong cash flow generation and growing balance sheet resources.

WHAT COULD MAKE THE RATING GO UP

- Substantial growth of financial resources and liquidity through positive operations and fundraising over the longer-term
- Stronger student demand with growing enrollment
- Limited additional debt
- Substantial research activity growth

WHAT COULD MAKE THE RATING GO DOWN
- Sustained weakening of student demand resulting in constrained or declining net tuition revenues
- Consistently weaker operations and cash flow
- Further debt plans without further balance sheet growth

STRENGTHS
- Strong market position as Delaware's flagship and land grant university with prominent academic and research programs in technology and engineering
- Consistently strong operations, with a 17.8% operating cash flow margin for FY 2014 and 6.1 times average debt service coverage from all revenue
- Growing balance sheet resources, with FY 2014 expendable financial resources cushioning pro forma debt by 2.1 times
- Good liquidity, with 260 unrestricted monthly days cash and 419% monthly liquidity to demand debt
- Currently no additional debt plans for at least the next three years
- Fairly autonomous governance structure that allows the board to control tuition pricing and make other strategic decisions, providing financial and operational flexibility

CHALLENGES
- Highly competitive higher education landscape reflected in the 20% yield on non-resident applicants, critical as over 60% of enrollment is from outside the state
- Moderate exposure to demand debt relative to peers, supported with bank facilities and interest rate swaps
- Growing OPEB liability of $277 million for FY 2014

RECENT DEVELOPMENTS
Recent developments are incorporated in the Detailed Rating Rationale.

DETAILED RATING RATIONALE

MARKET POSITION: FAVORABLE STUDENT DEMAND AS STATE'S FLAGSHIP AND LAND GRANT UNIVERSITY AND HIGH OUT-OF-STATE ENROLLMENT

University of Delaware, the State of Delaware's flagship and land-grant university, will continue to show strong student demand from state residents and out-of-state students. Total enrollment of over 21,000 full-time equivalent students (FTEs) for fall 2014 is up over 3% from the prior year. Total enrollment is diverse with 23.1% of minority or international students. An attractive location in the Northeast/Atlantic Seaboard region, the majority of enrolled students are non-residents both at the undergraduate and graduate levels.

UD competes with area flagship universities, including Pennsylvania State University and University of Maryland. Under Delaware First, it accepts about 90% of in-state applicants and meets financial need. In-state demand is strong, with 60% of accepted Delawarean applicants enrolling at UD. For non-residents, the 20% yield reflects the less favorable tuition for non-state residents.

Growth of the research platform is a key strategic goal of the university. Activity is generally steady, at about $138 million of research expenditures. Awards grew from $134 to $138 million for FY 2014. The university has a number of research centers, but noted prominence in the areas of the environment and energy. The university expects research to expand as the university opened its Interdisciplinary Science and Engineering Lab (ISE), a $132 million building funded by gifts and UD funds, in 2013, to provide needed research space. It also signed a partnership agreement with the Army RDECOM at nearby Aberdeen Proving Ground, one of the Army's sites for research and development that will provide other research opportunities.

In FY 2010, UD acquired the STAR campus, a 272-acre site formerly occupied by Chrysler Newark Assembly Plant and located adjacent to its main campus. With a long-term 40-80 year development plan in place, UD relocated its health sciences programs to the campus, as well as future bioscience research buildings.
operating performance, balance sheet, and capital plans: strong cash flow provides solid debt service coverage; good liquidity and manageable leverage

University of Delaware will continue to generate strong operating cash flow providing good debt service coverage. For FY 2014, the university produced a three-year average operating margin of 6.9% from FY 2012-FY 2014 and a 17.8% operating cash flow margin for FY 2014. With its high 54% reliance on student charges and the continued favorable student demand, particularly from non-residents, the university is expected to continue to grow net tuition revenue.

UD has a comparatively high reliance on student charges, well above many peer public universities, accounting for 54% of FY 2014 operating revenues. Net tuition per student is one of the highest of U.S. public universities at $18,305 for FY 2014, up nearly 2% from the prior year and reflecting the share of students paying higher non-resident tuition. Student-based revenue growth is critical as the driver of pledged revenues and the performance of these revenue streams going forward will be the key driver for continued ample debt service coverage.

State appropriations represent a modest 13% of FY 2014 operating revenues. State funding was steady at $117 million for FY 2014 and the current 2015, and is budgeted the same for the upcoming FY 2016. The state provides small amounts of capital funding, normally $3-4 million annually but did increase to $13.5 million in FY 2012 and the Governor has included $8 million for special projects in his proposed budget for FY 2016.

The State of Delaware’s very strong financial management characteristics and history of maintaining ample budgetary reserves through recent economic cycles support its Aaa rating, the highest long-term debt rating, on the state’s general obligation (GO) bonds. For more information on the State of Delaware, please see Moody’s report of October 6, 2014.

The University of Delaware has ample and growing financial resources to cushion debt and liquidity to support its demand debt. In FY 2014, UD’s $1.1 billion of expendable financial resources is up from $726 million in FY 2012. Expendable financial resources provide an adequate cushion for pro-forma debt (2.1 times) and annual operations (1.3 times).

Investments are well diversified, with 47% in global equities, 15% in fixed income and cash, 18% in hedged funds and 20% in private investments including real estate. For FY 2014, UD reported a 14.4% 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 supporting the university’s portfolio of private investments and hedge funds, respectively, to provide expertise for future investment.

University of Delaware has good gift revenues, with three-year average gift revenues of $56 million and $2,633 average gifts per student reflecting the silent phase of a $550 million capital campaign. The university has raised over $302 million to date, with a significant portion already received, and is on track to achieve its goal by 2018.

The university is completing its capital plan with an additional $130 million of spending from FY 2016-2018. Funding will come from operations, gifts and state funding. This excludes any development on the STAR campus which, if sizeable, could impact the university’s rating.

Liquidity

Liquidity is healthy, with $555 million of unrestricted monthly liquidity for FYE 2014, up significantly from $459 million at FYE 2012. This translates to a favorable 260 monthly days cash or 419% of monthly liquidity to demand debt.

Debt Structure and Legal Covenants: Moderate Variable Rate Debt Supported by Bank Facilities

Debt Structure

The University of Delaware’s debt profile contains moderate 25% 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 and 2005 bonds and the Series 2001 taxable bonds guaranteed by UD that funded the construction of the Blue Hen Hotel.

The SBPA for the $32.1 million outstanding Series 2004B bonds is provided by Bank of America, N.A. and terminates on April 5, 2018. Upon the most recent renewal of this SBPA, the prior liquidity covenant requirement of 0.5 times coverage was dropped from the agreement. The SBPA for the $32.9 million outstanding Series 2005
bonds is provided by TD Bank, N.A. and terminates on May 31, 2016. 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 Series 2013C bonds are multi-modal bonds initially issued in term mode with a rate reset date on May 2, 2016.

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 six floating to fixed rate interest rate swap agreements - five with Morgan Stanley Capital Services with a total $154.1 million notional and one with PNC Bank N.A. with $8.7 million notional. At April 1, 2015 the total market value was a $32.7 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 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 $28 million in FY 2014. All other employees are covered by the Delaware State Employees’ Pension Plan, which is well-funded at 91% and, for FY 2014, UD’s pension expense was $12 million, less 2% of operating expenses.

The unfunded OPEB liability is growing and was $277 million at FYE 2014, up from $228 million in 2010. Employees in the state's pension plan are provided post-retirement benefits through the state. UD offers other post-retirement benefits, primarily medical insurance, to all other employees. Costs are funded as incurred and amounted to $5.3 million in FY 2014. Although the liability will continue to rise, the impact on financial resources will remain manageable.

GOVERNANCE AND MANAGEMENT

UD’s governance structure is a credit strength as it permits the university more autonomy than its public university counterparts over its operations and the ability to set tuition as needed to fund operations, including debt service, and strategic initiatives. 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 and the remaining 20 are elected by the board. All appointments are confirmed by the state Senate. 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.

The president will leave the university on June 30, 2015 to take the position as President and Chief Executive Officer of the Philadelphia Federal Reserve Bank. The university has appointed a search committee and will be conducting a national search. In the meantime, the current Dean of the College of Earth, Ocean, and Environment will serve as interim president.

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

- Full-Time Equivalent Enrollment: 21,153 students
- Total Financial Resources: $1.44 billion
- Total Cash & Investments: $1.74 billion
- Total Pro Forma Direct Debt: $499 million
- Total Operating Revenue: $919 million
- Reliance on Tuition and Auxiliaries Revenue (% of Moody's Adjusted Operating Revenue): 54.1%
- Monthly Days Cash on Hand: 260 days
- Operating Cash Flow Margin: 17.8%
- Three-Year Average Debt Service Coverage: 6.1 times
- State of Delaware Rating: Aaa, stable outlook
OBLIGOR 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 experiences strong out-of-state demand representing 62% of Newark enrolled students. It is committed to Delawareans, accepting 90% of in-state applicants. UD offers a broad array of degrees from associates to doctorates. It has extensive research activities, with $200 million of sponsored research expenditures for FY 2014.

LEGAL SECURITY

The university’s revenue bonds are payable from Pledged Revenues consisting of substantially all of the gross revenues received by UD from the operation of project facilities, including the housing, dining, health care facilities, as well as book stores and parking. It also includes three mandatory student fees that must be paid by all undergraduate students. Net revenue coverage of pro-forma maximum annual debt service (MADS) including the Series 2015 bonds is 1.9 times. There is no debt service reserve fund. There is a rate covenant of at least 1.0 times debt service coverage from pledged revenue. UD also covenants to maintain its project facilities in good, working order, using any of its revenues legally available for those purposes.

USE OF PROCEEDS

Proceeds of the Series 2015 bonds will be used to fund construction of the South Academy Street Residence Hall and pay issuance costs.

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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