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CREDIT OPINION
20 April 2021

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University of Delaware

Update following revision of outlook to negative

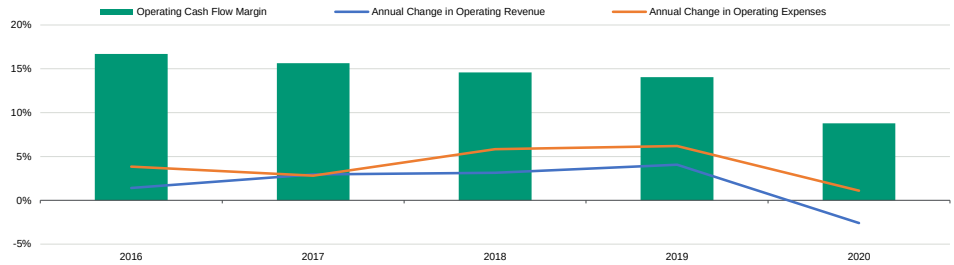
Summary

The University of Delaware's (UD, Aa1 negative) superior credit quality reflects its excellent strategic positioning as Delaware's land grant and flagship university with high non-resident enrollment and overall rising enrollment over the past five years bolstered by graduate offerings. The university's sound financial resources provide a strong cushion to operations that is above peers. Liquidity is superior on a relative basis, with monthly cash on hand equal to 349 days. Strategic investments in facilities and programs are being made with the aim of increasing market ranking and building strength in graduate programs, including development of the STAR campus in conjunction with private sector partners. Favorably, the university has comparatively low leverage and no borrowing is currently planned.

Offsetting challenges include narrowing of cash flow margins due to new hiring and other costs related to its strategic investments and more immediately due to the negative impact of covid on the budget, including reduced auxiliary revenue. The university also operates in a competitive environment and relies heavily on highly sought-after students from New York, New Jersey, Pennsylvania and Maryland.

On April 19, Moody's revised the outlook to negative from stable.

Exhibit 1
Operating performance softening as costs of strategic investments outpace revenue growth



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

» Solid wealth provides sound cushion for operations with fiscal 2020 spendable cash and investments a strong 1.4x expenses and 2.3x debt

» Robust liquidity, with 349 monthly days cash on hand, and fairly predictable calls on that liquidity

» 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

» Thinner financial operations reflect investment in its STAR campus, hiring and impact of the of the coronavirus on enrollment and auxiliary revenues reduces financial flexibility

» Gradual softening of reserves relative to expenses and debt, reflecting lower than peer growth in cash and investments and strategic investments

» Highly competitive higher education landscape reflected in lower yield rates on nonresident applicants, critical as over 65% of enrollment is from outside the state

» Moderate exposure to demand debt relative to peers, supported by bank facilities and interest rate swaps; OPEB liability of around $490 million for fiscal 2020 is elevated

Rating outlook

The negative outlook reflects the potential that operating cash flow margins will remain narrower beyond fiscal 2021 and fiscal 2022. As a result of the moderated operating performance and more limited growth in reserves relative to peers, the university's credit profile could become more aligned with an Aa2 rating over time. However, if the university's execution of its plan indicates increased likelihood for further strengthening of strategic position with a rebound in operating performance, the outlook could stabilize.

Factors that could lead to an upgrade

» Substantial growth of financial reserves and liquidity through positive operations and fundraising over the longer-term in line with peers

» Strengthening of brand demonstrated by stronger student demand with growing enrollment from a broader geographic area

Factors that could lead to a downgrade

» Sustained weaker operations from failure to increase revenue in light of growing expenses

» Cash flow margins that remain below 12% post pandemic

» Material spend down of financial reserves or additional borrowing not offset with stronger cash flow margins

» For revenue bonds, weakening of overall credit or debt service coverage from legal pledge

Key indicators

Exhibit 2
UNIVERSITY OF DELAWARE

	2016	2017	2018	2019	2020	Median: Aa Rated Public Universities
Total FTE Enrollment	21,510	22,181	22,505	22,364	21,994	30,062
Operating Revenue ($000)	975,878	1,004,574	1,036,075	1,078,145	1,050,164	1,282,865
Annual Change in Operating Revenue (%)	1.4	2.9	3.1	4.1	-2.6	4.2
Total Cash & Investments ($000)	1,772,345	1,921,390	2,013,135	1,948,804	1,917,857	1,582,410
Total Debt ($000)	512,061	496,820	707,287	690,511	673,288	690,511
Spendable Cash & Investments to Total Debt (x)	2.8	3.2	2.4	2.3	2.3	1.5
Spendable Cash & Investments to Operating Expenses (x)	1.6	1.7	1.7	1.5	1.4	0.7
Monthly Days Cash on Hand (x)	380	399	472	381	349	157
Operating Cash Flow Margin (%)	16.7	15.6	14.6	14.0	8.8	11.8
Total Debt to Cash Flow (x)	3.1	3.2	4.7	4.6	7.3	4.1
Annual Debt Service Coverage (x)	4.6	4.4	3.9	3.6	2.6	2.8

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. The university is committed to Delawareans, accepting 85% of in-state applicants for its undergraduate and associate programs. The university offers a broad array of degrees from associates to doctorates to its nearly 22,000 full-time equivalent students in fall 2020 and has operating revenues in excess of $1 billion in fiscal 2020.

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 65% of its students from out-of-state, primarily from New York, New Jersey, Pennsylvania and Maryland. In addition, international students comprise just under 10% of the student body.

Strong retention evidences the quality of students and the good match of students to the institution. Total enrollment of 21,994 full-time equivalent students (FTEs) for fall 2020 was down a modest 1.7% due to the effects of the coronavirus pandemic mitigated by growth in graduate attendance. Following the pandemic, the university aims to grow undergraduate enrollment slowly at about 1% annually, while it projects graduate enrollment to grow at a faster 6% pace as new programs are implemented.

Investments in new graduate programs and in new facilities at the Science, Technology and Advanced Research facilities (STAR) campus – a 272-acre site formerly occupied by Chrysler Newark Assembly Plant – are designed to attract students and high performing research faculty. The university is partnering with industry, other universities, non-profits and local governments in the federally funded National Institute for Innovation in Manufacturing Biopharmaceutical (NIIMBL) building and other joint projects with industry. The ability to execute this strategy to grow future enrollment will face challenges given the competitive northeast student market.

Operating performance: narrowing of historically strong cash flows exacerbated by coronavirus pandemic

The university's operating cash flow margins will remain narrower in fiscal 2021 and beyond reflecting the university's plan to reduce size of surpluses over the next five years as it invests in new faculty to staff its programmatic and capital expansion. The impact of the coronavirus on auxiliary revenues and safety protocol has exacerbated these trends.

For the year ending June 30, 2020, the university generated a 1.5% operating deficit while its operating cash flow margin narrowed to 8.8% from 14% in the prior year. The narrowing was partially due to a 2.6% decline in revenues driven by refunds for housing. The university constrained spending to only 1% which mitigated the impact on the bottom line.

The university has a comparatively high reliance on student charges, well above many peer public universities and accounting for 56% of fiscal 2020 operating revenue. Most of this revenue is generated from students paying higher non-resident tuition. Net tuition per student is one of the highest of similarly-sized U.S. public universities at $21,570 for fiscal 2020. Student-based revenue is critical as the driver of pledged revenues for bonds issued prior to 2018.

State appropriations, are modest at 12% in fiscal 2020. They provide a steady stream of revenue to the university to offset the cost of providing full financial need for in-state residents. The university forecasts that appropriations will remain generally stable over the next several years. The state provides minimal capital funding, normally $3-6 million annually.

Wealth and liquidity: very good financial reserves and robust liquidity provide solid cushion to operations and debt

The university's sizeable financial resources provide a strong cushion for debt and operations but are likely to ease as cash flow is directed to planned capital spending and operating cash flow margins thin. In fiscal 2020, the university had total cash and investments of over $1.9 billion. Its level of spendable cash and investments stood at $1.5 million covering annual operations by a strong 1.4x compared to the Aa1-median for public universities of 1.0x. While cash and investments provide a very solid buffer to operations, the rate of growth is below peers, reflecting a modest and gradual erosion in comparative credit quality.

Investments are well diversified, with nearly 50% in domestic and global equities, 9% in fixed income and cash, 14% in hedge funds and 26% in private investments including real estate. For fiscal 2020, the university reported a -0.2% investment return on its endowment, lower than peers. The university has a CIO that closely manages investments with the Investment Committee.

The university has good gift revenue, with three-year average gift revenue of $55 million through fiscal 2020, although average gifts per student at $2,490 are below the $3,260 of Aa1-rated peers. The university successfully raised $800 million as of June 2020, in excess of its $750 million goal. It is considering increasing its goal to $1 billion and extending the campaign by 18 to 24 months.

Liquidity

Liquidity will continue to be robust, providing a good cushion for operating expenses, potential calls from its debt portfolio and calls from its unfunded investment commitments but will ease as the university draws funds to invest in capital expenditures and other strategic investments. The university had $937 million of unrestricted monthly liquidity at fiscal year-end 2020, providing 349 monthly days cash on hand compared to the median of Aa1-rated public universities of 223 days.

In fiscal 2021 the university undertook a $100 million line of credit with TD Bank expiring February 24, 2024. Events of default contain a rating trigger for a rating below Baa2/BBB.

Leverage: debt is manageable given strong resources and expectations of continued growth

The university's debt burden is expected to remain moderate with minimal additional borrowing anticipated as significant borrowing of $200 million was undertaken in fiscal 2018. Spendable cash and investments to debt remains favorable at 2.3x and in line with peers. However, debt affordability, as measured by debt to cash flow, is less favorable at 7.3x or double the 3.7x of Aa1-rated peers in fiscal 2020 in part reflecting the decline in the operating cash flow margin.

The university has undertaken significant capital investments of $745 million over the past five years largely with its own revenues and gifts, while debt increased over that time frame by only $160 million. Projects completed include a $156 million biopharmaceutical building, athletic facilities, basic infrastructure for the STAR campus, and the purchase of an existing student housing project for approximately $25 million. The university is also rebuilding the McKinly lab that was largely destroyed in a fire in November 2018 with bond proceeds originally issued for a 600-bed student accommodation; the project has been delayed due to the coronavirus. Progress on completing an Athletic Center, a Well-being center and student housing renovations are ongoing.

Legal security

In 2018, the university introduced an unsecured general obligation structure which applies to series 2018, series 2019 and series 2019A bonds. Prior revenue bonds are secured by pledged revenues and have priority over the general obligation bonds. 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. Gross pledged revenues amply cover pledged debt service.

There is an additional bonds test for pledged revenue bonds at least 1.25x debt service coverage from net pledged revenues. However, the indenture for pledged revenue bonds has been closed and the university intends to issue bonds with a general unsecured obligation in the future. UD also covenants to maintain its project facilities in good, working order, using any of its legally available revenues for those purposes

Debt structure

The university's debt profile, has a moderate 17% 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 which expire in on April 5, 2024 (Bank of America, N.A.), May 31, 2021 (TD Bank, N.A.) and April 30, 2022 (TD Bank, N.A.) respectively. 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.

In fiscal 2019, the university entered into a capital lease for $35 million for the STAR tower to house its health science programs.

Debt-related derivatives

The university has modest swap exposure relative to its liquidity. UD entered into or guaranteed 6 floating to fixed rate interest rate swaps with a total notional amount of $141 million as of June 30, 2020; the total market value was a $38.0 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

The university's post-retirement benefit costs compared to peers are slightly elevated and will rise over time. The university 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 $36 million in fiscal 2020. All other employees are covered by the Delaware State Employees' Pension Plan, which is well funded at nearly 90%. Total pension contributions amount to around $50 million or a moderate 4.7% of expenses. The unfunded OPEB liability $487 million at fiscal 2020 is substantial and will continue to rise, although the impact on financial resources will remain manageable. The university offers other post-retirement benefits, primarily health care benefits, to faculty and professional staff. Employer contributions amounted to $12.8 million or a low 1.2% of the budget.

ESG considerations

Environmental

As is the case for most of the higher education sector, environmental considerations are not a material credit factor for the University of Delaware. According to Moody's affiliate Four Twenty- Seven, the university's location in Newark, Delaware has a high risk of water stress and hurricanes and a medium stress for extreme rainfall.

Social

Social considerations include relatively high tuition and a narrow pool of students with strong competition. Fierce competition in the region resulted in low a steadily decreasing yield of accepted students and reliance on students from surrounding states of New York, New Jersey, Pennsylvania and Maryland

We regard the coronavirus outbreak as a social risk under our ESG framework, given the substantial implications for public health and safety. The university experienced a modest 1.7% decline in fall 2020 enrollment with a decline in undergraduate students of 2.4% offset in part by a 2.0% rise in graduates. The 9.9% decline in the starting class will, nevertheless, flow through to next three years dampening enrollment, mitigated by deferrals of students expected to start in Spring or Fall 2021. As residences were operated at a lower density in Fall 2020 revenue losses will be elevated in fiscal 2021. A combination of federal and state funding and expense cuts will mitigate the effect of losses on operating results.

Governance

The university'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 the university'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, the university 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 the university'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. However, ambitious expansion plans are leading to narrower financial performance and going forward the ability to manage expenses within slower growth in revenues will be critical to the outlook.

Rating methodology and scorecard factors

The Higher Education Methodology includes a scorecard that summarizes the factors that are generally most important to higher education credit profiles. Because the scorecard is a summary and may not include every consideration in the credit analysis for a specific issuer, a scorecard-indicated outcome may or may not match an assigned rating. We assess strategic positioning on a qualitative basis, as described in the methodology.

The difference between the scorecard indicated outcome and assigned rating reflects temporarily depressed revenue growth as a result of the pandemic as well as prospects for stronger growth and operating performance over time based on strategic investments.

Exhibit 3

University of Delaware

Scorecard Factors and Sub-factors		Value	Score
Factor 1:	**Market Profile (30%)**		
	Scope of Operations (Operating Revenue) ($000)	1,050,164	Aa2
	Reputation and Pricing Power (Annual Change in Operating Revenue) (%)	(2.6)	B2
	Strategic Positioning	Aa	Aa
Factor 2:	**Operating Performance (25%)**		
	Operating Results (Operating Cash Flow Margin) (%)	8.8	A1
	Revenue Diversity (Maximum Single Contribution) (%)	51.9	A1
Factor 3:	**Wealth & Liquidity (25%)**		
	Total Wealth (Total Cash & Investments) ($000)	1,917,857	Aa1
	Operating Reserve (Spendable Cash & Investments to Operating Expenses) (x)	1.4	Aaa
	Liquidity (Monthly Days Cash on Hand)	349	Aaa
Factor 4:	**Leverage (20%)**		
	Financial Leverage (Spendable Cash & Investments to Total Debt) (x)	2.3	Aa1
	Debt Affordability (Total Debt to Cash Flow) (x)	7.3	Aa2
	Scorecard-Indicated Outcome		Aa3
	Assigned Rating		Aa1

Data is based on most recent fiscal year available. Debt may include pro forma data for new debt issued or proposed to be issued after the close of the fiscal year.

For non-US issuers, nominal figures are in US dollars consistent with the Higher Education Methodology.

Source: Moody's Investors Service

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