New Issue: Moody's assigns A3 to Xavier University, OH's $47.5M Ser. 2015C; outlook stable

Global Credit Research - 13 Feb 2015

$96M pro-forma rated debt

OHIO HIGHER EDUCATIONAL FACILITY COMMISSION
Private Colleges & Universities
OH

Moody's Rating

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<td>Revenue Bonds, Series 2015C</td>
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<td>Sale Amount</td>
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Rating Description Revenue: 501c3 Unsecured General Obligation

Moody's Outlook STA

NEW YORK, February 13, 2015 --Moody's Investors Service assigns an A3 rating to Xavier University's (Xavier or XU) proposed $47.5 million of fixed rated Series 2015C Revenue Bonds (expected to mature in FY 2038) to be issued through the Ohio Higher Educational Facility Commission. We also affirm the A3 rating on the university's outstanding rated bonds. The outlook is stable.

SUMMARY RATING RATIONALE

Assignment of the A3 rating is attributable to Xavier's established regional reputation as a private Catholic university with programmatic diversity and consistent gift support.

The rating also incorporates XU's ability to achieve positive operating performance and adequate debt service coverage through strong budgetary controls.

The rating is constrained by a high degree of operating and balance sheet leverage and pressures on top line revenue growth due to declining enrollment.

OUTLOOK

The stable outlook reflects expectations of positive operating performance and adequate debt service coverage. It also incorporates the expectation of no additional debt or significant use of reserves within the next 18 to 24 months.

WHAT COULD MAKE THE RATING GO UP

- Significant growth in financial resources and liquidity providing a stronger cushion to debt and operations
- Increased student demand leading to consistent net tuition revenue growth

WHAT COULD MAKE THE RATING GO DOWN

- Sustained operating deficits and weaker cash flow
- Significant decline in liquidity and flexible financial reserves
- Large additional borrowings absent growth in financial resources and revenue
STRENGTHS
- Consistently strong cash flow driven by prudent fiscal management
- Established regional demand as a private Catholic Jesuit university offering a variety of undergraduate and graduate programs providing a cushion against moderate enrollment volatility
- Relatively large $170 million revenue base for the rating category enabling it to achieve efficiencies
- Lower risks of put and remarketing with the refinancing of the Series 2008A and 2008B variable rate demand bonds

CHALLENGES
- Three consecutive years of stagnant operating revenue driven by tepid net tuition revenue growth
- Highly competitive market evidenced by declining total enrollment and weak yield of first year students
- High financial leverage with expendable financial resources cushioning pro-forma debt 0.9 times and pro-forma debt to operating revenues of 1.1 times in FY 2014

RECENT DEVELOPMENTS
In addition to the proposed refinancing of the Series 2008C fixed rate bonds, XU is refunding the Series 2008A and 2008B bonds on March 12 with proceeds from a direct bank placement (Series 2015A and Series 2015B bonds) which closed on February 10. We have reviewed draft documents. While this proposed refinancing has eliminated put risk and letter of credit risk, certain events of default could lead to acceleration of the debt, including but not limited to breach of financial covenants or reporting requirements, material adverse changes, and bankruptcy. The Series 2015A and 2015B bonds have a variable rate tied to LIBOR and a mandatory tender on February 1, 2025.

DETAILED RATING RATIONALE
MARKET POSITION: SOFTENING ENROLLMENT DRIVEN BY COMPETITIVE STUDENT MARKET
Xavier's more targeted approach to undergraduate recruitment resulted in another strong first-year class size that has led to increasing undergraduate enrollment amid declining graduate enrollments. However, total enrollment declined again in fall 2014 by 1% to 5,920 full-time equivalent (FTE) students. The lower graduate enrollment and highly competitive undergraduate market is demonstrated by a slight contraction of net tuition per student of 0.1% to $17,104 in FY 2014 and likely pressure for FY 2015 given an increased discount rate.

The slide in graduate students is primarily due to XU's declining enrollment in its large teacher education population and high competition in MBA programs, particularly in the Cincinnati region. Management forecasts graduate enrollment to stabilize by fall 2016 as it has reorganized the enrollment and recruiting functions. Failure to grow net tuition revenue given the university's material dependence on student charges revenue (77% in FY 2014), would likely pressure the rating longer term.

OPERATING PERFORMANCE, BALANCE SHEET, AND CAPITAL PLANS: OPERATING SURPLUSES ACHIEVED DESPITE REVENUE PRESSURE; COMPREHENSIVE CAMPAIGN AIDS MARGINS AND FINANCIAL RESOURCE GROWTH
Despite flat revenues since FY 2012, Xavier's strong fiscal oversight has driven positive margins averaging a three-year annual operating surplus of 3.7% in FY 2014. The improved margins are the result of expense containment and good unrestricted gift revenues. The fiscal 2014 operations benefited from various initiatives, chiefly the university's reduction in force that eliminated 51 non-faculty positions (8% of the workforce) with the majority of the savings realized in FY 2015. The cash flow margin was a strong 18.1% leading to a three-year average debt service coverage of 2.3 times from FY 2012-2014.

Based on performance for the first six months of fiscal 2015, operating results should be positive. A continued softening of graduate enrollment will continue to constrain net tuition revenue growth in FY 2015. In light of missed graduate enrollment targets of the past few years, management reports it will budget enrollment more conservatively in the FY 2016 budget because it remains committed to maintaining surpluses.

XU is in the quiet phase of a $240 million capital campaign, which includes a target of $100 million for the
endowment, $80 million from the Annual Fund for various programs, and the remaining $60 million is to be raised to fund capital projects. To date, a total of $75 million has been raised of which $45 million has been collected. The university is assessing the feasibility for building a new Recreation Center. The project is a fundraising priority, but the university will be assessing different funding options. Project costs, funding sources, program planning and full design are expected to take approximately two years. We will assess the impact of any potential debt issuance on Xavier's credit profile when more solid plans materialize.

Plans for capital expenditures for facilities during the next three years are focused on renewal of existing facilities. Overall, the buildings on Xavier's campus are relatively young in their life cycle with an age of plant of 9.7 years. XU will complete an $18 million renovation of Alter Hall, the university's main classroom building for the fall 2015 semester. The total project is being funded without debt, primarily from cash flows.

Liquidity

Monthly liquidity has increased by over 30% since FY 2012 to $129 million from retained surpluses, unrestricted gifts and healthy investment returns, providing a very strong 317 monthly days cash on hand. Improved liquidity is credit positive given XU's leverage, although the debt restructuring has reduced exposure to calls on liquidity.

DEBT AND OTHER LIABILITIES: HIGH LEVERAGE; RECENT RESTRUCTURINGS REDUCE CERTAIN DEBT STRUCTURE RISKS

Xavier's approach over the past several years to debt restructuring and refinancings was strategic, eliminating letter of credit exposure by the end of FY 2015 while reducing costs and debt.

Debt Structure

Approximately 38% of pro-forma debt (includes the proposed refunding of Series 2008 A, B, C bonds and May 1, 2015 principal payments) is variable rate (before swaps) and the university has no demand debt. However, 48% of XU's debt portfolio has bank debt exposure and is subject to financial covenants and certain requirements that could lead to acceleration of debt if breached. XU's debt is amortizing and reaches peak pro-forma debt service of $13.3 million in FY 2028, with maturities extending out to 2042.

Financial Covenants include an agreement to maintain maximum annual debt service to total unrestricted operating revenues of less than 12% and expendable net assets of at least equal to 50% of long-term debt. At FYE 2014, the ratios were 8% and 94%, respectively.

Debt-Related Derivatives

XU has three floating-to-fixed interest rate swap agreements with total $117.5 million notional across two counterparties, one a forward swap starting May 1, 2016. Under each agreement, termination events include downgrade of either party's credit rating below BBB/Baa2. Xavier would be required to post collateral at a threshold of $20 million and $25 million, respectively, per each agreement at its current rating level. The aggregate mark-to-market on the swaps at June 30, 2014 was a liability to XU of $15.9 million and there was no collateral posted.

Pensions and OPEB

Xavier participates in a defined contribution plan that covers substantially all full-time employees through which the university and plan participants make contributions. XU's contributions totaled $5.1 million in FY 2014, approximately 3% of total expenses.

In addition to the defined contribution plan, XU also sponsors a defined benefit health care plan that provides post-retirement medical benefits to full-time employees who meet minimum age and service requirements. As of January 1, 1995, the plan was amended to require employee contributions and established a maximum monthly benefit to be provided by the university. At FYE 2014, the OPEB liability was $4.5 million, easily managed given the university's financial resources.

MANAGEMENT AND GOVERNANCE: FISCAL STEWARDSHIP LEADS TO IMPROVED OPERATING PERFORMANCE AMID REVENUE PRESSURE

XU's stable executive leadership team and board have demonstrated the ability to achieve and commitment to favorable operating performance amid revenue pressures. Two consecutive years of expense reductions leading to a higher surplus in FY 2014 demonstrates this commitment. While expenses have declined, management
continues to invest in priority areas and programs with the aim of growing revenue. For example, XU plans to hire a chief marketing officer in 2015 in recognition of a highly competitive market and importance of dedicating a full-time employee to outreach and branding.

KEY STATISTICS (FY 2014 financial data, fall 2014 enrollment data)
- Full-Time Equivalent Enrollment: 5,920 students
- Total Financial Resources: $261 million
- Total Pro-forma Direct Debt: $187 million (includes proposed refunding of Series 2008 A, B, C bonds and May 1, 2015 principal payments)
- Total Operating Revenue: $170 million
- Reliance on Student Charges (% of Moody's-adjusted Operating Revenue): 77%
- Monthly Days Cash on Hand: 317 days
- Operating Cash Flow Margin: 18%

OBLIGOR PROFILE
Xavier University, founded in 1831, is a Jesuit Catholic comprehensive private university located in Cincinnati, Ohio. In fall 2014, the university enrolled 5,920 FTE students of which 75% were undergraduates.

LEGAL SECURITY
The bonds are a general obligation of the university. In addition, XU has pledged a lien on and a security interest in all revenues and income of the university. There is no debt service reserve fund.

USE OF PROCEEDS
Proceeds of the Series 2015C bonds are expected to be used to advance refund all or a portion of the Series 2008C bonds 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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