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American University, DC; CP; Joint Criteria; Private Coll/Univ - General Obligation

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Credit Profile		
US$125.0 mil General Obligation ser 2015 dtd 03/10/2015 due 03/10/2045		
Long Term Rating	A+/Stable	New

Rationale

Standard & Poor's Ratings Services assigned its 'A+' rating to American University's (AU) $128.5 million series 2015 taxable bonds. At the same time, we affirmed our 'A+' long-term rating and underlying rating (SPUR) on the District of Columbia's revenue bonds issued for AU. In addition, we affirmed our 'A+' issuer credit rating (ICR) on the university, as well as our 'A-1' short-term rating on the series 2011 commercial paper (CP) program. The outlook is stable.

The 'A+' rating reflects our opinion of AU's relatively stable enrollment and continued robust operations, and increasing financial resources. We expect that the university's substantial operating surpluses and solid demand profile will allow for further balance-sheet growth during the ongoing period of increased capital spending, such that the financial resources remain sound for the rating despite the additional debt expected.

At the same time, Standard & Poor's affirmed its 'AAA/A-1+' rating on the series 2006 bonds, reflecting the application of low-correlation joint criteria with a letter of credit (LOC) from Royal Bank of Canada (which substituted JPMorgan Chase Bank N.A. in December 2014) and the 'A+' SPUR on AU's debt. The 'A-1+' short-term rating component reflects the Royal Bank of Canada LOC, which expires Dec. 22, 2017.

The LOCs on the series 1999 and 2003 bonds were replaced with direct-purchase agreements with Wells Fargo (with expiration Feb. 1, 2018). The series 2008 is now a direct purchase with US Bank (with expiration February 2020). In our opinion, this debt remains a contingent liability given the expiration within five years and the put risk associated with the direct-purchase agreements.

The 'A-1' rating reflects our view of AU's self-liquidity program. The university has committed several sources of funds, including its working capital and endowment to support its outstanding unenhanced CP program ($125 million is authorized). As of Jan. 31, 2015, AU held cash, fixed-income, and domestic equity assets in excess of $594 million. Standard & Poor's continues to monitor both the sufficiency and liquidity available on a monthly basis to ensure the university can cover a failed remarketing for the outstanding CP. Standard & Poor's considers the university's credit quality profile high, reflecting its high credit policy standards. In our opinion, there is ample liquidity provided through the money held in domestic equities, cash and high-quality, short-term, fixed-income securities.

Credit factors that we believe support the rating include:

- Continued robust financial performance in fiscal 2014;
- An increasing endowment and adequate expendable resources to pro forma debt; and
- A still low debt burden in fiscal 2014.

In our opinion, factors that offset the positives include the university's:

- Significant contingent liability exposure related to direct-purchase debt, variable-rate demand bond, and CP (until it's refinanced), which has potential put risk if AU's debt is accelerated;
- Upcoming increased capital spending and additional debt represented by a $75 million direct-purchase term loan done in 2011 as well as the expected $128 million to be issued to complete various capital projects (incremental $63.5 million because $65 million CP debt was already outstanding as of the last audit).

A general obligation (GO) of the university secures the outstanding debt.

Outlook

The stable outlook reflects our view of the university's continued robust operating performance and solid demand. However, offsetting credit factors include what we consider only adequate financial resources compared with pro forma debt, a measurable degree of event-driven risk associated with both its high level of variable-rate demand debt and direct-purchase debt exposure, and upcoming increased capital spending.

We could consider a negative outlook during the next one to two years if expendable resources compared with debt do not remain in line with the rating, or if there is a substantial decrease in enrollment or operating performance from current levels. A higher rating or positive outlook is unlikely during the next one to two years due to the university's only adequate financial resources for the current rating and increasing pro forma debt load.

Enterprise Profile

Organization

American University is on two campuses on 84 acres in northwest Washington, D.C. As an independent, private, coeducational institution, the university offers both graduate and undergraduate degrees through six major divisions: the College of Arts and Sciences, School of Public Affairs, Kogod School of Business, School of International Service, School of Communication, and Washington College of Law.

Demand and enrollment

Total headcount increased in fall 2014 following a small decline in the previous year. Total university headcount increased to 13,063 for fall 2014 compared with 12,817 for fall 2013; 7,708 or 59% were undergraduates. Management expects undergraduate enrollment to be relatively stable fall 2015. Freshman applicants declined in fall 2014, with applications down 13.8% to 15,121, a decline due in part to additional essay requirements for the AU application. The school accepted 46% of applicants for fall 2014, and 26%, or 1,789, chose to attend. We view student quality as good based on incoming students' average SAT scores of 1,244 and an average freshman-to-sophomore retention rate of 89%. Management reports that applications and deposits for fall 2015 are solid. with an expected increase in yield and many applicants going with early decision. Graduate applications declined in fall 2014, similar to other universities. For fall 2014, graduate applicants decreased to 6,215, the fewest graduate applicants since fall 2008.

Management

The most recent management change was the appointment of the CFO, who was the acting interim CFO at the time of the last review. He has been with the organization for many years and we believe that overall, the senior team remains stable and the detailed financial management and tenure of the management team as a whole provides stability at the current rating. Management provides two-year detailed operating budgets that reflect contingencies, deferred maintenance, and routine plant renewal, which is less than annual depreciation expense, but do not reflect generally accepted accounting principles (GAAP) accounting. We view the detailed budgets and capital forecasts, as well as management's ongoing focus on revenue growth and cost control positively, as they all provide stability to the university as it enters a period of increased capital spending.

The board of trustees, which is self-perpetuating, has 30 members, with a limit of no more than 50. Trustees serve for a minimum of a three-year term. Board members are approved by both the General Board of Higher Education and the Ministry of the United Methodist Church.

Financial Profile

Operating performance

AU has demonstrated consistently positive operating performance, with a robust operating surplus. The surplus in fiscal 2014 was $45.3 million compared with $40.9 million in fiscal 2013. The university's operating performance lends considerable strength to the overall credit profile. We understand the surplus results from growth in net tuition revenue due to a strong focus on cost controls with expenses below budget for the year. As with most private universities, AU relies heavily on tuition and other student-generated fees to support operations. For fiscal 2014, student-generated fees constituted 87% of operating revenues. In our opinion, the overall tuition discount rate is low at almost 22%, partly due to the university's graduate programs, though the discount rate is up from fiscal 2009 (when it was 20%) due to the student body's greater financial need during the recession. For fall 2014, tuition was $41,316, a 3% increase from fall 2013 tuition. Management expects solidly positive operating results for fiscal 2015.

Financial resources

Financial resources are consistent with the rating when compared with operating expenses and outstanding debt as of April 30, 2014, with expendable resources of $740.2 million equal to 128% of operating expenses and 177% of outstanding debt. To date, AU issued $100 million in CP and part of the 2015 debt issuance will be used to refinance the outstanding CP. When compared with pro forma debt of $481.9 million, expendable resources weaken to 154%, which is still in line with the median. The healthy operating performance and maintenance of solid overall enrollment offset the lighter financial resources compared with pro forma debt. We expect financial resources to grow during the next one to two years due to continued solid cash flows and investment returns. It is our view that balance-sheet growth will aid the absorption of the additional debt.

Endowment

The endowment increased to $546 million as of April 30, 2014, up from $485 million as of fiscal 2013 year-end, with a 18% return for the fiscal 2014 year. As of fiscal 2014 year-end, 68% of the total market value is unrestricted of the total market value (Last year, we reported it was 92%, but that value was incorrect) and 68% is stable from the prior year.

As of June 2014, the endowment asset allocation is 36% domestic equities, 17% international equities, 5% emerging markets, 5% real estate, 5% real assets, 18% hedge funds, 4% private equity, and 10% fixed income. The university's endowment spending policy is 5% of a rolling three-year average.

Capital plans

During the next three to five years, management plans to complete the projects discussed in recent years. Recently completely projects included construction of new residence halls and academic buildings at a cost of $124 million. The remaining significant projects include a law school campus project and east campus development, for a cost of $240 million. The remaining projects are set to be completed by 2016. Management plans to fund the $364 million projects with a mixture of fundraising, cash reserves, and $203 million of debt represented by the $75 million of the series 2011 term loan and the $128 million fixed-rate bonds (new money and funds to refinance already outstanding of CP).

Debt and contingent liabilities

As of April 30, 2014, total outstanding debt was $418.7 million, compared with an endowment value of $546 million. Of total pro forma debt (assuming $128 million in fixed-rate new debt and refinancing funds take out the existing CP), about 47% would be fixed rate and the remainder is variable rate. All of the debt has bullet maturities. Excluding those bullet maturities, the debt burden was, in our opinion, low at 2.5% operating expenses in fiscal 2014. We believe there is a considerable degree of put risk associated with AU's largely variable-rate debt and contingent structure (variable-rate and direct-purchase debt) because financial resources could be stretched should the university need to purchase some or all of its debt if it cannot be remarketed or accelerated. In addition, the bullet maturities associated with all of the long-term debt is an offsetting credit factor.

In June 2011, the university entered into a fixed-rate term loan for $75 million with JPMorgan Chase Bank, maturing on June 14, 2021. On an event of default, which is tied to events such as nonpayment of debt service and violation of covenants--such as debt service coverage below 1.6x and leverage below 85%--JPMorgan Chase may accelerate the bonds immediately. In January 2015, the university entered into two direct-purchase agreements with Wells Fargo, $58 million for the series 1999 and 2003 with expiration in 2018. The series 2008 is also a direct-purchase agreement with US Bank expiring in February 2020. We understand the covenants and events of default are similar to their other documents, and if violated, the bank may accelerate the bonds. As of Dec. 31, 2014, of the total portfolio, about $322 million could be liquidated within one day, offsetting the risk associated with acceleration of the series 2011 bonds.

AU has entered into six floating- to fixed-rate swaps with Morgan Stanley and Bank of America with a total notional amount of $216.7 million. It posted $33.6 million of collateral against its swap portfolio, due to a negative mark-to-market value.

American University, DC -- Selected Financial Statistics

	Fiscal year ended April 30					Medians
	2015	2014	2013	2012	2011	Private colleges and universities 'A' 2013
Enrollment and demand						
Headcount	13,063	12,817	13,157	12,980	13,047	MNR
Full-time equivalent	12,037	11,781	11,720	11,468	11,498	3,442
Freshman acceptance rate (%)	45.9	43.1	44.2	41.6	43.5	64.0

American University, DC -- Selected Financial Statistics (cont.)

Freshman matriculation rate (%)	25.8	21.5	21.2	20.0	20.4	22.2
Undergraduates as a % of total enrollment (%)	59.0	57.3	57.8	57.8	56.1	77.7
Freshman retention (%)	89.0	88.0	90.0	90.3	90.7	86.5
Graduation rates (five years) (%)	80.0	81.0	79.0	N.A.	76.6	74.8
Income statement						
Adjusted operating revenue ($000s)	N.A.	622,427	607,171	590,567	569,343	MNR
Adjusted operating expense ($000s)	N.A.	577,120	566,311	550,147	521,854	MNR
Net operating income ($000s)	N.A.	45,307	40,860	40,420	47,489	MNR
Net operating margin (%)	N.A.	7.85	7.22	7.35	9.10	1.60
Change in unrestricted net assets ($000s)	N.A.	110,381	74,492	(6,241)	77,659	MNR
Tuition discount (%)	N.A.	21.8	22.4	21.9	21.7	34.2
Tuition dependence (%)	N.A.	75.2	75.4	74.8	74.5	70.5
Student dependence (%)	N.A.	86.8	86.6	86.9	86.8	MNR
Healthcare operations dependence (%)	N.A.	N.A.	N.A.	N.A.	N.A.	MNR
Research dependence (%)	N.A.	5.6	6.0	5.7	6.3	MNR
Endowment and investment income dependence (%)	N.A.	2.3	2.4	2.4	2.1	MNR
Debt						
Outstanding debt ($000s)	N.A.	418,676	383,930	340,875	255,875	89,201
Proposed debt ($000s)	N.A.	128,500	N.A.	N.A.	N.A.	MNR
Total pro forma debt ($000s)	N.A.	481,979	N.A.	N.A.	N.A.	MNR
Pro forma MADS	N.A.	N.A.	N.A.	N.A.	N.A.	MNR
Current debt service burden (%)	N.A.	2.48	2.10	2.37	1.97	3.93
Current MADS burden (%)	N.A.	N.A.	N.A.	N.A.	N.A.	MNR
Pro forma MADS burden (%)	N.A.	N.A.	N.A.	N.A.	N.A.	MNR
Financial resource ratios						
Endowment market value ($000s)	N.A.	546,130	485,297	466,234	455,002	197,497
Cash and investments ($000s)	N.A.	886,463	807,231	747,877	668,158	MNR
Unrestricted net assets ($000s)	N.A.	799,274	688,893	614,401	620,642	MNR
Expendable resources ($000s)	N.A.	740,268	645,346	598,324	530,357	MNR
Cash and investments to operations (%)	N.A.	153.6	142.5	135.9	128.0	139.3
Cash and investments to debt (%)	N.A.	211.7	210.3	219.4	261.1	243.8
Cash and investments to pro forma debt (%)	N.A.	183.9	N.A.	N.A.	N.A.	MNR
Expendable resources to operations (%)	N.A.	128.3	114.0	108.8	101.6	90.3
Expendable resources to debt (%)	N.A.	176.8	168.1	175.5	207.3	151.5
Expendable resources to pro forma debt (%)	N.A.	153.6	N.A.	N.A.	N.A.	MNR
Average age of plant (years)	N.A.	13.8	14.8	14.5	15.0	12.5

American University, DC -- Selected Financial Statistics (cont.)

Total adjusted operating revenue = unrestricted revenue less realized and unrealized gains/losses and financial aid. Total adjusted operating expense = unrestricted expense plus financial aid expense. Net operating margin = 100*(net adjusted operating income/adjusted operating expense). Tuition dependence = 100*(gross tuition revenue/adjusted operating revenue). Current debt service burden = 100*(current debt service expense/adjusted operating expenses). Current MADS burden = 100*(maximum annual debt service expense/adjusted operating expenses). Cash and investments = cash + short-term & long-term investments. Expendable resources = unrestricted net assets + temp. restricted net assets - (net PPE- outstanding debt). Average age of plant = accumulated depreciation/depreciation & amortization expense. MNR--Median not reported. N.A.--Not available.

Related Criteria And Research

Related Criteria

- USPF Criteria: Higher Education, June 19, 2007
- USPF Criteria: Commercial Paper, VRDO, And Self-Liquidity, July 3, 2007
- USPF Criteria: Contingent Liquidity Risks, March 5, 2012
- USPF Criteria: Municipal Applications For Joint Support Criteria, June 25, 2007
- Criteria: Joint Support Criteria Update, April 22, 2009

Related Research

- Alternative Financing: Disclosure Is Critical To Credit Analysis In Public Finance, Feb. 18, 2014

Ratings Detail (As Of March 3, 2015)		
CP		
Short Term Rating	A-1	Affirmed
ICR		
Long Term Rating	A+/Stable	Affirmed
District of Columbia, District Of Columbia		
American Univ, District Of Columbia		
Series 1999		
Unenhanced Rating	NR(SPUR)	
Long Term Rating	NR/NR	
Series 2003		
Unenhanced Rating	NR(SPUR)	
Long Term Rating	NR/NR	
Series 2006		
Unenhanced Rating	A+(SPUR)/Stable	Affirmed
Long Term Rating	AAA/A-1+	Affirmed

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