MOODY'S INVESTORS SERVICE

CREDIT OPINION
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Update

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# The Catholic University of America, DC

## Rating Update - Moody's downgrades The Catholic University of America, DC's Revenue bonds to A3 from A2; outlook stable

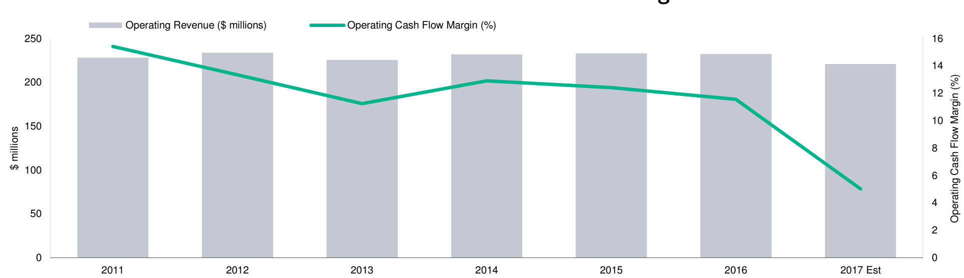
## Summary Rating Rationale

Moody's Investors Service has downgraded the rating on The Catholic University of America, DC's Refunding Revenue Bonds, Series 2010 to A3 from A2. The bonds were issued through the District of Columbia. The outlook is stable. The downgrade impacts $28 million of rated debt.

The downgrade reflects the increased competition for students culminating in a 5% decline in student revenue in fiscal 2017 and related decline in operating performance. While financial leverage will remain manageable, the action also incorporates ongoing capital needs and an expected $60 million increase in debt in the coming months.

The A3 rating on the revenue bonds of The Catholic University of America (CUA) incorporates its distinctively Catholic character, favorable location and prospects for donor support. The rating also acknowledges healthy financial reserves, with spendable cash and investments of roughly $400 million. These strengths are offset by high competition for students and limited pricing power as well as substantial capital needs and declining operating performance.

Exhibit 1
**Net tuition revenue miss in 2017 leads to decline in cash flow margin**




*Sources: Moody's Investors Service, audited financial statements and unaudited projections for fiscal 2017*

## Credit Strengths

» Diversified undergraduate and graduate programs and distinctive Catholic identity provide multiple ways to attract potential students

» Healthy financial reserves provide substantial cushion to debt and operations

» Leadership focused on strategic initiatives to foster revenue growth and student market effectiveness

» Growing donor support likely to continue, with total gift revenue doubling since 2012, to $33 million in 2016

## Credit Challenges

» Limited pricing power and increased competition as peers have increased financial aid

» Declining operating performance accelerated by miss of net tuition revenue targets in fiscal 2017

» Funding capital needs will require increased debt and increased donor support to enhance competitiveness

» Law school enrollment will likely remain depressed in light of broader climate

## Rating Outlook

The stable outlook is predicated on the university achieving earned revenue growth and gradually improving cash flow margins above the estimated 5% margin in fiscal 2017. Gains in donor support also support the stable outlook, with capital support offsetting the potential reliance on debt to fund capital investments. The outlook also reflects expectations of stable to gradually improving total wealth and unrestricted liquidity.

## Factors that Could Lead to an Upgrade

» Clear strengthening of pricing power demonstrated by material gains in net student charges

» Ongoing gains in donor support including gifts for student financial aid

» Ability to invest in facilities and programs while maintaining flexible reserves and manageable leverage

## Factors that Could Lead to a Downgrade

» Inability to achieve growth in net tuition revenue

» Sustained move to weak operating performance

» Material decline in unrestricted liquidity

## Key Indicators

Exhibit 2

**CATHOLIC UNIVERSITY OF AMERICA, DC**

| | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 Est |
|---|---|---|---|---|---|---|---|
| Total FTE Enrollment | 7,143 | 7,232 | 7,128 | 7,023 | 6,864 | 6,367 | |
| Operating Revenue ($000) | 228,122 | 233,887 | 225,505 | 231,903 | 233,088 | 232,387 | 220,815 |
| Annual Change in Operating Revenue (%) | 5.3 | 2.5 | -3.6 | 2.8 | 0.5 | -0.3 | -5.0 |
| Total Cash & Investments ($000) | 336,487 | 342,405 | 362,143 | 391,663 | 409,240 | 393,182 | 412,529 |
| Total Debt ($000) | 112,454 | 109,474 | 102,552 | 99,503 | 99,826 | 94,545 | 90,829 |
| Spendable Cash & Investments to Total Debt (x) | 2.3 | 2.4 | 2.7 | 3.0 | 3.2 | 3.2 | 3.5 |
| Spendable Cash & Investments to Operating Expenses (x) | 1.2 | 1.2 | 1.3 | 1.4 | 1.4 | 1.4 | 1.4 |
| Monthly Days Cash on Hand (x) | 215 | 200 | 186 | 193 | 190 | 166 | 172 |
| Operating Cash Flow Margin (%) | 15.4 | 13.3 | 11.3 | 12.9 | 12.4 | 11.6 | 5.0 |
| Total Debt to Cash Flow (x) | 3.2 | 3.5 | 4.0 | 3.3 | 3.4 | 3.5 | 8.2 |
| Annual Debt Service Coverage (x) | 5.0 | 4.0 | 3.3 | 3.8 | 3.7 | 3.7 | 1.6 |

Total FTE Enrollment is for fall of indicated year

*Source: Moody's Investors Service*

## Detailed Rating Considerations

### Market Profile: Increasing competition impacts ability to generate net tuition revenue

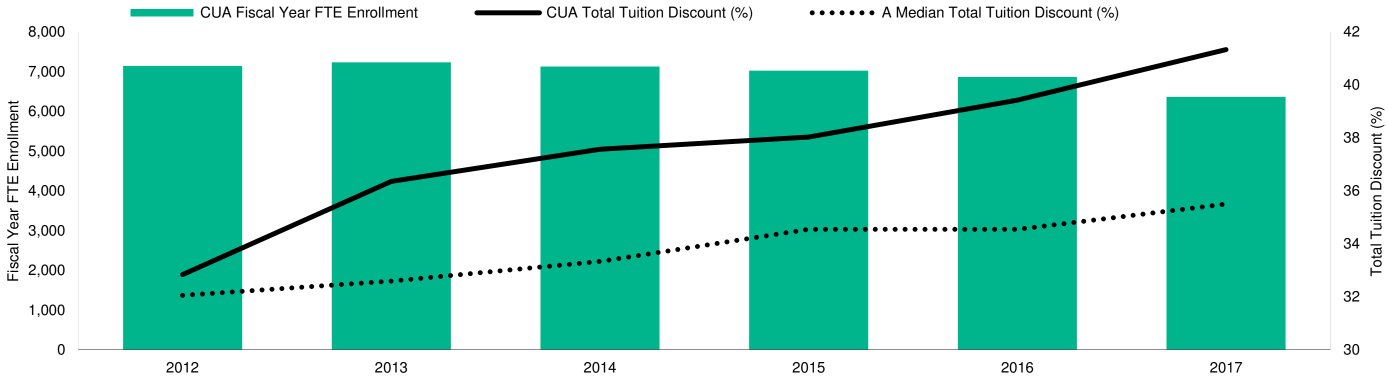
While CUA continues to invest in its enrollment management and marketing efforts, increasing competition and net price sensitivity have yielded revenue declines. Enrollment declined 7% in fall 2016 as yield on admitted students fell to 15%, from an average of 20% over the prior four years. Positively, the entering class did have slightly higher standardized test scores. Based on preliminary figures for fiscal 2017, the total tuition discount increased to 41%, well above the median for A rated private universities as shown in Exhibit 3.

The university's law school offers several distinctive programs including religious freedom and right to counsel work. Like many law schools, application volume and enrollment are down, but CUA's distinctive programs help distinguish CUA's law school. Several retirements in faculty ranks have aided the school's efforts to right size its expenses in line with revenue declines.

University guidance for the fall 2017 entering class calls for material gains of over 100 new students from the 723 first time in college students from the prior fall. Enrollment management efforts include refining the mix of need- and merit-based financial aid in light of sector changes. The university is increasing the centralization of the graduate admissions process and expects to make some gains based on better recruitment and marketing. New academic leadership, including at the engineering school, is committed to increasing the professionalization of the graduate school admissions processes.

Exhibit 3

**Declining number of students combined with increasing tuition discounting led to revenue decline in 2017**




Proxy for CUA Fiscal Year FTE Enrollment based on fall enrollment for the fiscal year
*Source: Moody's Investors Service*

## Operating Performance: Decline in operating performance in 2017

Despite a $14 million underperformance in revenue against budget in 2017, management still expects to deliver a 5% operating cash flow margin. While the decline in operating performance is credit negative, management has demonstrated the ability to adjust expenses while still making programmatic investments to support the university's long term strategy. The stable outlook is predicated on gradual improvement above the preliminary 5% cash flow margin in 2017, especially in light of plans for a 67% increase in debt. Tuition and auxiliaries comprised 70% of operating revenue, while grant and contracts were 11% and investment income was 9%.

## Wealth and Liquidity: Resources provide substantial buffer to revenue fluctuation

CUA's financial reserves have generally grown in recent years due to retained surpluses and market returns and now provide a substantial cushion relative to debt and operations. The investment portfolio is relatively conservative, and the university uses an investment consultant as part of its oversight of the investment portfolio. The long term pool was up approximately 10% for the 12 months ending April 2017.

CUA's strategy calls for increasing donor support, and the university has invested in additional gift officers, information technology and processes to enhance performance of its advancement office. Total gift revenue was $34 million in fiscal 2016, well above the $21 million three-year average of the prior years. Given competitive pressure in generating net tuition revenue growth, donor support will remain crucial to the university's ongoing ability to invest in facilities, programs and student financial aid.

### LIQUIDITY

Unrestricted liquidity at the university will remain healthy but limited relative to many A rated peers. For fiscal 2016, monthly liquidity of $95 million translates to 166 monthly days cash on hand.

## Leverage: Manageable pro forma leverage as incremental debt funds infrastructure investments

CUA will continue to make measured used of debt, helping support the A3 rating. The university plans to issue approximately $60 million in additional debt later in calendar 2017 to fund energy and utility investments as well as life safety and code compliance investments. The university has several older buildings and has historically underinvested in their maintenance and systems. Favorably, management expects the incremental debt service costs to be fully met by utility and maintenance cost savings as several of the utility systems are at the end of their useful lives. When combined with scheduled amortization pro forma direct debt increases to $151 million. Spendable cash and investments covers this pro forma debt by roughly two times, pointing to a strong cushion.

### DEBT STRUCTURE

CUA's debt is all amortizing and fixed rate. CUA has covenanted to maintain liquid unrestricted net assets equal to at least 80% of the outstanding principal amount of debt; as of April 30, 2016, this ratio was at 228%. The university's Series 2015 parity bonds were privately placed with a bank.

#### DEBT-RELATED DERIVATIVES

The university has no debt related derivatives.

#### PENSIONS AND OPEB

CUA has no pension or OPEB exposure. The university offers eligible employees a defined contribution retirement plan.

### Governance and Management: New governance structure increases the voice of lay leadership

As the university seeks to enhance its strategic positioning and long term financial health, it has adopted a new governance structure. Under the new structure, a predominantly lay Board of Trustees is combined with a smaller group of fellows who will retain certain reserve powers. Because of its role within the Catholic church, the changes required Vatican approval and took several years to coordinate.

The lay expertise and financial support of reconstituted board should serve the university's goals of increasing its responsiveness to the changing higher education landscape while also maintaining its uniquely Catholic character. This restructured board combined with the broader planning initiatives of the university support its good strategic positioning despite the heightened competition for students and ongoing need to invest in student life facilities to make gains against key competitors.

## Legal Security

The revenue bonds are an unsecured general obligation of the university.

## Use of Proceeds

Not applicable.

## Obligor Profile

The Catholic University of America is a private university sponsored by the Roman Catholic Bishops of the United States. The university is located on a 180 acre campus in northeast Washington, DC. CUA offers undergraduate, graduate and professional degree programs. The university enrolls approximately 6,400 FTE undergraduate, graduate and professional students.

## Methodology

The principal methodology used in this rating was Global Higher Education published in November 2015. Please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

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