

CREDIT OPINION

11 January 2016

New Issue

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John Carroll University, OH

New Issue - Moody's Revises John Carroll Univ.'s (OH)
 Outlook to Negative; Assigns A3 to Ser. 2016

Summary Rating Rationale

Moody's Investors Service has assigned an A3 rating to John Carroll University's (JCU) proposed issuance of approximately \$22 million Higher Educational Facility Revenue Bonds, Series 2016 (expected maturity in 2041). We also have affirmed the A3 rating on the existing revenue bonds. The outlook has been revised to negative, reflecting weakened operating performance in FY 2015 beyond expectations and an unplanned enrollment decline in fall 2015. These results are partially attributed to negative market interpretation after its accreditation was affirmed, but put on "notice" for being at risk for future accreditation reviews in the areas of student assessment outcomes, institutional effectiveness and planning, and communication and morale. Supporting the A3 rating are JCU's ample unrestricted reserves and strong liquidity. As a regional, tuition dependent private university having modest additional debt capacity, its viable niche as a Catholic, Jesuit university, attractive residential campus, and no plans for additional debt also support the rating. Offsetting factors include strong competitive pressures and relatively high financial leverage.

Credit Strengths

- » Robust liquidity with over 400 monthly days cash on hand cushioning potential operating implications from the March 2015 accreditation action and a complex debt structure
- » Moderately sized private university, with nearly \$92 million in revenue, and regionally recognized programs and Jesuit mission
- » Attractive campus resulting from ongoing capital investment with no near-term plans for new debt or significant use of reserves

Credit Challenges

- » Ongoing reputational risk from the March 2015 accreditation action when the university was put on "notice" for being at risk for noncompliance with certain criteria
- » Uneven net tuition per student growth and enrollment fluctuations from narrow student demand in a fiercely competitive market
- » Thinning operations and an operating deficit in FY 2015 as expense growth outpaced revenues in four of the past five years

Rating Outlook

The negative outlook reflects the prospects for a downgrade should the university be unable to return to near balanced operations in FY 2016 and stabilize demand in fall 2016.

Factors that Could Lead to an Upgrade

- » Successful execution of enrollment strategies, resulting in meeting projected freshmen enrollment goals of 800 students annually while consistently growing net tuition per student
- » Consistent generation of operating surpluses and cash flows to cover debt service greater than 2 times
- » Substantial increase in financial reserves with a much stronger cushion relative to debt and expenses

Factors that Could Lead to a Downgrade

- » Inability to generate close to balanced operating performance and grow net tuition revenue in FY 2016
- » Substantial deterioration of liquidity position
- » Failure to ameliorate accreditation issues or a prolonged negative impact on demand evidenced by enrollment declines

Key Indicators

Exhibit 1

	2011	2012	2013	2014	2015
Total FTE Enrollment	3,621	3,501	3,635	3,648	3,524
Operating Revenue (\$000)	85,364	89,866	88,401	90,019	91,604
Annual Change in Operating Revenue (%)	1.2	5.3	-1.6	1.8	1.8
Total Cash & Investments (\$000)	205,321	194,392	207,059	217,276	229,201
Total Debt (\$000)	66,000	64,622	58,792	69,308	76,296
Spendable Cash & Investments to Total Debt (x)	2.0	1.8	2.1	1.9	1.8
Spendable Cash & Investments to Operating Expenses (x)	1.6	1.4	1.4	1.5	1.5
Monthly Days Cash on Hand (x)	586	436	428	416	429
Operating Cash Flow Margin (%)	13.9	14.3	11.1	10.8	9.1
Total Debt to Cash Flow (x)	5.5	5.0	6.0	7.2	9.1

Source: Moody's Investors Service

Recent Developments

JCU's senior leadership continues to cooperate with its accreditor, the Higher Learning Commission (HLC), in ameliorating the issues related to the March 2015 "notice" letter. JCU will make progress addressing the concerns during each review milestone to be fully compliant for the 2018 formal review.

Detailed Rating Rationale

Market Profile: Negative Press from Accreditation Action Destabilizes Enrollment in an Already Competitive Market

A key driver for the negative outlook is JCU's critical need to manage market interpretation of the unresolved accreditation sanction. JCU's enrollment declined 3% in fall 2015 from a sharp drop in graduate enrollment and lower new student enrollment. Favorably, undergraduate demand showed some resilience, still generating a 23% yield and projected net tuition per student growth in FY 2016. JCU's strong graduation and retention rates relative to national averages and its noted key programs in communications and accounting, with its Jesuit mission remain viable market draws. The execution of these messages and ability to successfully recapture

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missed enrollment targets will be necessary to continue growing tuition revenue. Net tuition per student remains low relative to A3 peers at \$13,218 and continued growth would demonstrate market stability.

Strategic positioning is good, as the university's attractive campus is evidence of its commitment of continuous capital investment, an important factor to remaining competitive. It has used a combination of debt, gifts, and internal reserves to fund projects. It also benefitted from \$6 million of historical state and federal tax credits that effectively reduced its portion of renovating a historic residence hall.

Operating Performance: Expense Growth Exerts Increased Pressure on Net Performance

Management's heightened focus on budget management and process should lead to improved operations in FY 2016 and longer term to manage through likely modest revenue growth. The adjusted FY 2016 operating budget models a modest surplus compared to the actual \$1 million deficit in FY 2015. Future budgets are predicated on more conservative enrollment projections than used in prior years.

JCU's cash flow margin has slowed, sliding from a 14% range generated annually over FY 2010-12 to a low of 9% in FY 2015. The relatively weaker performance in FY 2015 is partially attributed to \$600,000 of one-time expenses, but also from an imbalance of expense growth relative to revenues in four of the past five years. The planned restructuring of current principal maturities to a more level tenor will help ease near-term pressure on debt service coverage, assuming cash flow margins between 9-10%.

The university benefits from better revenue diversity than many at the rating level, which typically have upwards of 80% reliance on student charges compared to JCU at 73%. Other notable sources include 11% of revenue is generated from the endowment and 6% is from other revenues which include income from rental properties adjacent to campus.

Wealth and Liquidity: Financial Reserves and Liquidity Amply Cushion Debt and Expenses

JCU's reserve and liquidity position remain a key credit strength, supporting the A3-rating during this period of higher operating stress. Spendable cash and investments insulate debt and expenses a healthy 1.8 times and 1.5 times, respectively. While the reserves and cushion support the rating, growth will remain moderate. Growth of reserves has lagged peers due to relatively lower retained cash flow and thinner philanthropy. Cash and investments of \$229 million in FY 2015 are up only 1% from the prior high in FY 2007.

Gift flow has picked up since FY 2010 resulting from success in achieving support for its \$100 million comprehensive campaign. Scheduled to conclude in 2016, JCU has raised over \$95 million at the close of calendar year 2015. The three-year average gift revenue was \$9.4 million from FY 2013-15. This average does not include bequests, representing a sizeable 40% of the campaign total raised.

LIQUIDITY

JCU's monthly liquidity provides strong operational support with 429 monthly days cash, well above the private university A-rated median of 342 days. Liquidity should remain robust relative to the rating level but show modest growth due to thin cash flow and conclusion of the comprehensive campaign in 2016. JCU has a \$7.5 million annually renewable operating line of credit, which it has neither drawn upon in FY 2015 nor expects to in FY 2016.

Leverage: Relatively High Financial Leverage, but Declining; No Near Term Additional Debt Plans

Financial leverage is elevated, with debt to cash flow of 9.2 times compared to the A-rated FY 2014 median of approximately 5.4 times. However, leverage will moderate with \$13 million in principal repayment, or 17% of total debt, over the next five years, and no identified new debt plans. Absent significant improvement in cash flow and revenue growth, debt capacity at the current rating is limited.

DEBT STRUCTURE

JCU's debt structure is moderately complex, necessitating a higher monitoring to manage remarketing, acceleration, renewal, basis, and counterparty risks. Its debt portfolio has 40% variable rate debt (before swaps), financial covenants, and bullet maturities. The university has demonstrated prudent management of these risks, generating ample covenant headroom and staggering various tenders and maturities.

At FYE 2015, JCU was in compliance with its 1.0 times liquidity ratio and 1.0 debt service coverage covenants of 1.85 times and 1.79 times, respectively, for the [PNC Bank, N.A.](#) \$21 million construction loan and letter of credit (LOC) on the \$10.7 million Series 2001A

bonds. The Series 2001A bonds are rated Aa1/VMIG 1 based on joint default analysis assessing the credit quality of [J.P. Morgan Chase Bank, N.A.](#) and JCU. The LOC expires on February 1, 2017.

The Series 2014 multi-mode bonds (2034 maturity) were issued as fixed rate with a mandatory tender in 2018; one of the bank loans has a \$2 million bullet in 2021; and the \$21 million construction loan matures with a \$17 million bullet in 2023.

The proposed refinancing of the Series 2006 bonds will extend the maturity to 2041 and will be structured to wrap around the existing debt service and generate over \$10 million of cash flow savings through 2020.

DEBT-RELATED DERIVATIVES

The terms of JCU's four floating-to-fixed interest rate swaps mitigate some of the risk. There are no rating triggers or collateral posting requirements and all swaps expire on or prior to maturity of the associated debt. The swaps amortize with debt and have a notional amount of about \$29.8 million at FYE 2015. [PNC Bank, N.A.](#) is the counterparty on all swaps.

PENSIONS AND OPEB

JCU's defined contribution retirement plan costs are rising, but its approximately \$2.4 million contribution represents a manageable 2.5% of total operating expenses. The university has the legal flexibility to modify the plan and does not participate in a retiree health benefits plan.

Governance and Management: Leadership Focused on Strengthening Planning Processes and Executing Strategies

The renewed focus on strategic planning and invigorated leadership, including two new deans offering outside perspective and a significant contingent of administrators with historical knowledge will support stronger budgeting and planning for FY 2016 and beyond. This is an important development given currently thin operating performance and significant headwinds from high competition and any lingering negative market impact from the accreditor's on "notice" action.

Legal Security

All bonds are a general obligation of the university, with no debt service reserve fund.

Use of Proceeds

The proceeds of the proposed Series 2016 bonds will refinance the Series 2006 bonds and pay issuance costs.

Obligor Profile

John Carroll University is a Catholic Jesuit private university located in University Heights, Ohio, a suburb of Cleveland. It provides undergraduate programs in the liberal arts, sciences and business and selected master's level programs to over 3,500 students in fall 2015 and generated over \$91 million in operating revenue in FY 2015.

Methodology

The principal methodology used in this rating was Global Higher Education published in November 2015. Please see the Credit Policy page on www.moody's.com for a copy of this methodology.

Ratings

JOHN CARROLL UNIVERSITY, OH

Issue	Rating
Higher Educational Facility Revenue Bonds (John Carroll University 2016 Project)	A3
Rating Type	Underlying LT
Sale Amount	\$21,710,000
Expected Sale Date	01/27/2016
Rating Description	Revenue: 501c3 Unsecured General Obligation

Source: Moody's Investors Service

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