Rating Update: Moody's affirms University of Puget Sound, WA’s A1 and VMIG 1; outlook stable

Global Credit Research - 07 May 2014

$40.4M rated debt

UNIVERSITY OF PUGET SOUND, WA
Private Colleges & Universities
WA

Opinion

NEW YORK, May 07, 2014 --Moody's Investors Service has affirmed the A1 rating on University of Puget Sound's (WA) outstanding rated debt and the VMIG 1 short-term rating on the Series 2001 bonds based on self-liquidity. The outlook is stable.

SUMMARY RATING RATIONALE

University of Puget Sound's A1 rating reflects its established market position with its campus in Tacoma, WA, as a national liberal arts university, ample financial resource and liquidity cushions for debt and operations and thoughtful and conservative fiscal management leading to consistently positive operations with good cash flow and debt service coverage. Offsetting challenges are a debt structure with approximately half variable rate demand debt hedged by interest rate swaps and operations in a highly competitive market.

The VMIG 1 rating on the Series 2001 Variable Rate Bonds is based on the university's strong self-liquidity coverage of those bonds, with active management and clear policies and procedures around liquidation and liquidity coverage.

STRENGTHS

* Growing financial resources provide strong support for debt and operations, with expendable financial resources of $189 million for fiscal year (FY) 2013 cushioning debt 2.4 times and operations 1.7 times.

* Conservative budgeting and active expense management drive consistently favorable operating performance with a three-year average operating margin of 2.6% and operating cash flow margin of 17.6% providing strong debt service coverage of 4.5 times. FY 2014 is expected to be in line with FY 2013.

* An established student market position is evidenced by growing net tuition per student and stable, if low, freshman matriculation rates.

* There are no new debt plans for the next two to three years.

* Self-liquidity is sufficient to support the tender features of the Series 2001 Variable Rate Bonds, currently in weekly mode.

CHALLENGES

* Growth of net tuition revenue is a key credit challenge given the university's 79% reliance on student charges. Increases to the financial aid budget resulted in stagnant net tuition revenue from FY 2012 to 2013, although net tuition revenue is projected to grow for FY 2014. Total tuition discount has increased to 39.2% in fall 2013 from 33.7% in fall 2009.

* The university is seeing increased competition with other national liberal arts colleges, regional private institutions and West Coast public universities, as reflected by relatively weak selectivity and matriculation rates for freshmen (85% of applicants were admitted in fall 2013, and 17% of those admitted chose to enroll.)

* There is substantial variable rate debt exposure at 53% of total debt with swaps outstanding, although the Series 2012B bonds of $29.1 million are variable rate bonds directly placed with Wells Fargo Municipal Capital Strategies,
LLC with a seven year reset date (August 29, 2019), reducing remarketing risk.

*A new outsourced Chief Investment Officer (OCIO) model brings some manager concentration, with plans to invest 40% or more of endowment within five fund of funds under one manager.

DETAILED CREDIT DISCUSSION

The university is in the public phase of its "One [of a Kind]" campaign with a goal of $125 million, raising $112 million to date. Of the total goal, nearly half is targeted to the endowment, with much dedicated for financial aid; the balance is for capital projects and annual giving. The campaign is targeted to end June 2015.

The university’s strong liquidity management has been a key credit strength and is expected to continue as the university transfers its endowment to an outsourced CIO model with Perella Weinberg Partners. Governed by the Board’s Investment Policy, Perella Weinberg has authorization to manage the day to day investment decisions on a discretionary basis within the constraints of the policy. The university expects to maintain similar liquidity levels with $70 million (of its overall endowment) in its liquidity pool, or assets that can be liquidated within one week. These assets will be held by Wells Fargo Bank. The remainder will be distributed among two portfolios, Agility (approximately 50%, invested in 5 fund of funds) and illiquid Legacy investments (approximately 25%), with the entire pooled endowment overseen by Perella Weinberg Partners (PWP). Target asset allocation is 15% to private capital, 45% global equities, 15% real assets, 15% absolute return, and 10% global fixed income. As of 2/28/14, the endowment was valued at $308 million, with a 9.3% fiscal year-to-date return.

The university has utilized self-liquidity for the tender features of the Series 2001 bonds, currently in weekly mode since issuance. There are acceptable remarketing procedures as well as capable treasury functions and staff to oversee the self-liquidity levels. At March 31, 2014, the university held approximately $30 million of same day liquidity on a discounted basis, providing good coverage of 2.9 times. Same day liquidity is largely comprised of investments in Moody’s-rated Wells Fargo Money Market Funds, checking and deposit accounts, and US Treasuries and Agencies.

LEGAL SECURITY: All bonds, including the Series 2012B direct placement, are issued on parity and are general obligations of the university.

DEBT STRUCTURE: The university’s total debt at June 30, 2013 includes 53% variable rate demand debt. However, 74% of the variable rate demand debt ($29.2M) is held in long-term mode with a seven year reset date in 2019, resulting in substantially less liquidity risk. The $10.4 million of Series 2001 variable rate debt is supported by self-liquidity. In the event of a liquidity demand due to an acceleration of either the Series 2001 or Series 2012B bonds, Puget Sound has substantial unrestricted monthly liquidity - $135 million at June 30, 2013, with generally consistent levels projected for June 30, 2014. Unrestricted monthly liquidity supports demand debt by 340%, representing an adequate mitigant to any risk of acceleration.

The Series 2012B bonds placed with Wells Fargo are governed by a Continuing Covenant Agreement (CCA). There are two financial covenants in the agreement - an annual debt service coverage ratio of at least 1.25 times and an annual liquidity coverage ratio of at least 0.75 times of unrestricted cash and marketable securities to funded debt. At 6/30/2013, the university’s coverage levels were 4.6 times debt service coverage and 1.6 times liquidity coverage. Estimated covenant coverage for 6/30/14 is 4.2 times debt service coverage; liquidity coverage was 1.8 times at 3/31/14. Failure to meet the covenant would result in an Event of Default, which could lead to immediate acceleration of the bonds.

INTEREST RATE DERIVATIVES: The university is counterparty to three interest rate swaps to hedge its variable rate debt. The counterparty for the two swaps on the 2006 bonds is Bank of New York Mellon (rated Aa2/P-1). The counterparty for the swap hedging the Series 2001 bonds is Societe General (rated A2/P-1).

A swap termination can occur if Puget Sound’s underlying rating is below Baa3 for the Series 2006 swaps and Baa3 or below for the Series 2001 swap. No termination will occur if the university posts collateral within 10 days. There is no other collateral posting requirement. At March 31, 2014, the swaps’ market value was negative $10.5 million. While the swaps add risk to the university’s debt structure, the university’s ample liquidity cushion mitigates the risk of termination payments.

Outlook

The stable outlook reflects expectations of continued strong liquidity and balance sheet cushions supporting debt and operations, continued growth in net tuition per student, favorable operating performance and cash flow generation, and no near-term debt plans.
WHAT COULD MAKE THE RATING GO UP

Significant growth of financial resources coupled with strengthened student demand, including net tuition per student growth, could result in positive rating action.

WHAT COULD MAKE THE RATING GO DOWN

Negative rating action could result from additional balance sheet leverage or deterioration of student demand, as evidenced by sustained pressure on net tuition per student.

KEY INDICATORS (FY 2013 financial data, Fall 2013 enrollment data)

Full-Time Equivalent Enrollment: 2,745 students
Primary Selectivity: 85%
Primary Matriculation: 17.1%
Net Tuition per Student: $23,956
Educational Expenses per Student: $32,024
Average Gifts per Student: $5,429
Total Cash and Investments: $321 million
Total Direct Debt: $78.7 million
Expendable Financial Resources to Direct Debt: 2.4 times
Expendable Financial Resources to Operations: 1.7 times
Monthly Days Cash on Hand: 512 days
Monthly Liquidity to Demand Debt: 340%
Operating Revenue: $112 million
Operating Cash Flow Margin: 17.6%
Three-Year Average Debt Service Coverage: 4.28 times
Reliance on Tuition and Auxiliaries Revenue (% of Moody's Adjusted Operating Revenue): 79.2%

RATED DEBT:

Revenue and Revenue Refunding Bonds, Series 2012A: A1 Stable
Puget Sound University Revenue Bonds (1998): A1 Stable
Weekly Rate Demand Revenue Bonds, Series 2001: A1 Stable, VMIG 1

The principal methodology used in this rating was U.S. Not-for-Profit Private and Public Higher Education published in August 2011. An additional methodology used in the short-term rating was Rating Methodology for Municipal Bonds and Commercial Paper Supported by a Borrower's Self-Liquidity published in January 2012. Please see the Credit Policy page on www.moodys.com for a copy of these methodologies.

REGULATORY DISCLOSURES

For ratings issued on a program, series or category/class of debt, this announcement provides certain regulatory disclosures in relation to each rating of a subsequently issued bond or note of the same series or category/class of debt or pursuant to a program for which the ratings are derived exclusively from existing ratings in accordance with Moody’s rating practices. For ratings issued on a support provider, this announcement provides certain regulatory disclosures in relation to the rating action on the support provider and in relation to each particular rating action for securities that derive their credit ratings from the support provider's credit rating. For provisional ratings,
this announcement provides certain regulatory disclosures in relation to the provisional rating assigned, and in relation to a definitive rating that may be assigned subsequent to the final issuance of the debt, in each case where the transaction structure and terms have not changed prior to the assignment of the definitive rating in a manner that would have affected the rating. For further information please see the ratings tab on the issuer/entity page for the respective issuer on www.moodys.com.

Regulatory disclosures contained in this press release apply to the credit rating and, if applicable, the related rating outlook or rating review.

Please see www.moodys.com for any updates on changes to the lead rating analyst and to the Moody's legal entity that has issued the rating.

Please see the ratings tab on the issuer/entity page on www.moodys.com for additional regulatory disclosures for each credit rating.

Analysts

Eva Bogaty
Lead Analyst
Public Finance Group
Moody’s Investors Service

Diane F. Viacava
Additional Contact
Public Finance Group
Moody’s Investors Service

Contacts

Journalists: (212) 553-0376
Research Clients: (212) 553-1653

Moody’s Investors Service, Inc.
250 Greenwich Street
New York, NY 10007
USA

© 2014 Moody’s Corporation, Moody’s Investors Service, Inc., Moody’s Analytics, Inc. and/or their licensors and affiliates (collectively, “MOODY’S”). All rights reserved.

CREDIT RATINGS ISSUED BY MOODY’S INVESTORS SERVICE, INC. (“MIS”) AND ITS AFFILIATES ARE MOODY’S CURRENT OPINIONS OF THE RELATIVE FUTURE CREDIT RISK OF ENTITIES, CREDIT COMMITMENTS, OR DEBT OR DEBT-LIKE SECURITIES, AND CREDIT RATINGS AND RESEARCH PUBLICATIONS PUBLISHED BY MOODY’S (“MOODY’S PUBLICATION”) MAY INCLUDE MOODY’S CURRENT OPINIONS OF THE RELATIVE FUTURE CREDIT RISK OF ENTITIES, CREDIT COMMITMENTS, OR DEBT OR DEBT-LIKE SECURITIES. MOODY’S DEFINES CREDIT RISK AS THE RISK THAT AN ENTITY MAY NOT MEET ITS CONTRACTUAL, FINANCIAL OBLIGATIONS AS THEY COME DUE AND ANY ESTIMATED FINANCIAL LOSS IN THE EVENT OF DEFAULT. CREDIT RATINGS DO NOT ADDRESS ANY OTHER RISK, INCLUDING BUT NOT LIMITED TO: LIQUIDITY RISK, MARKET VALUE RISK, OR PRICE VOLATILITY. CREDIT RATINGS AND MOODY’S OPINIONS INCLUDED IN MOODY’S PUBLICATIONS ARE NOT STATEMENTS OF CURRENT OR HISTORICAL FACT. MOODY’S PUBLICATIONS MAY ALSO
control of, MOODY'S or any of its directors, officers, employees, agents, representatives, licensors or suppliers, arising from or in connection with the information contained herein or the use of or inability to use any such information.

NO WARRANTY, EXPRESS OR IMPLIED, AS TO THE ACCURACY, TIMELINESS, COMPLETENESS, MERCHANTABILITY OR FITNESS FOR ANY PARTICULAR PURPOSE OF ANY SUCH RATING OR OTHER OPINION OR INFORMATION IS GIVEN OR MADE BY MOODY'S IN ANY FORM OR MANNER WHATSOEVER.

MIS, a wholly-owned credit rating agency subsidiary of Moody's Corporation ("MCO"), hereby discloses that most issuers of debt securities (including corporate and municipal bonds, debentures, notes and commercial paper) and preferred stock rated by MIS have, prior to assignment of any rating, agreed to pay to MIS for appraisal and rating services rendered by it fees ranging from $1,500 to approximately $2,500,000. MCO and MIS also maintain policies and procedures to address the independence of MIS's ratings and rating processes. Information regarding certain affiliations that may exist between directors of MCO and rated entities, and between entities who hold ratings from MIS and have also publicly reported to the SEC an ownership interest in MCO of more than 5%, is posted annually at [www.moodys.com](http://www.moodys.com) under the heading "Shareholder Relations — Corporate Governance — Director and Shareholder Affiliation Policy."

For Australia only: Any publication into Australia of this document is pursuant to the Australian Financial Services License of MOODY'S affiliate, Moody's Investors Service Pty Limited ABN 61 003 399 657AFSL 336969 and/or Moody's Analytics Australia Pty Ltd ABN 94 105 136 972 AFSL 383569 (as applicable). This document is intended to be provided only to "wholesale clients" within the meaning of section 761G of the Corporations Act 2001. By continuing to access this document from within Australia, you represent to MOODY'S that you are, or are accessing the document as a representative of, a "wholesale client" and that neither you nor the entity you represent will directly or indirectly disseminate this document or its contents to "retail clients" within the meaning of section 761G of the Corporations Act 2001. MOODY'S credit rating is an opinion as to the creditworthiness of a debt obligation of the issuer, not on the equity securities of the issuer or any form of security that is available to retail clients. It would be dangerous for "retail clients" to make any investment decision based on MOODY'S credit rating. If in doubt you should contact your financial or other professional adviser.