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Washington Higher Education Facilities Authority University of Puget Sound; Private Coll/Univ - General Obligation

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Credit Profile

Washington Hgr Ed Fac Auth, Washington

University of Puget Sound, Washington

Washington Ed Fac Auth (University of Puget Sound) PCU_GO

<i>Long Term Rating</i>	A+/A-1/Stable	Affirmed
Washington Hgr Ed Fac Auth (University of Puget Sound) rev bnds		
<i>Long Term Rating</i>	A+/Stable	Affirmed

Rating Action

S&P Global Ratings affirmed its 'A+' long-term rating on the University of Puget Sound, Wash.'s outstanding revenue bonds, issued by the Washington Higher Education Facilities Authority. At the same time, S&P Global Ratings affirmed its 'A+/A-1' rating on the university's series 2001 weekly rate demand revenue bonds. The outlook on the long-term rating is stable.

The University of Puget Sound had approximately \$68.6 million in debt outstanding as of June 30, 2020, of which \$32.5 million, or about 47%, was issued as variable-rate bonds. The university provides self-liquidity for its variable-rate demand bonds (VRDBs) with nearly \$86 million available in same- and next-day liquidity. The university also has three interest rate swap agreements that were secured in order to synthetically fix its variable-rate debt. Securing the bonds is a broad pledge of unrestricted revenue, gains, and other support, equivalent to a general obligation pledge of the university.

In response to the COVID-19 pandemic, the University of Puget Sound transitioned to remote instruction in March 2020. The university issued refunds for room and board totaling \$4.3 million. As part of the federal government's Coronavirus Aid, Relief, and Economic Security (CARES) Act, the University of Puget Sound received \$1.4 million in relief funds. Half of the amount was designated as direct aid to students, and half was used to offset room and board refunds. As of June 30, 2020, approximately \$560,000 was recognized, and the remainder will be recognized in fiscal 2021. In fiscal 2020, the University of Puget Sound also received an employee retention tax credit of \$387,000 and a \$50,000 relief grant from the local county. With cost savings from furloughs, reduced hiring, and lower discretionary expenses, the university ended fiscal 2020 with effectively a break-even result, with a deficit of only 0.04%. We consider this a solid result in a year when many peer institutions experienced larger losses.

In fall 2020, classes were taught entirely online, and a limited number of students were on campus. Tuition was held stable with the prior year. Full-time-equivalent (FTE) enrollment fell significantly, declining 18% compared to the prior year to 2,113. Less than 1% of the student body is international, limiting the risk of enrollment declines from that population. The university is offering hybrid learning options in spring 2021, and dorm occupancy is approximately

50%. As part of the Higher Education Emergency Relief Fund II, authorized by the Coronavirus Response and Relief Supplemental Appropriations Act 2021 (CRRSAA), the university will receive a total of \$2.1 million. Approximately \$700,000 will be used for direct aid to student grants, and the remainder will reimburse the university for lost revenues and/or pandemic-related expenses. Due to the significant loss of revenue from tuition and auxiliary sources along with increased costs associated with the pandemic, the University of Puget Sound expects a negative operating result in fiscal 2021.

Credit overview

We assessed University of Puget Sound's enterprise profile as adequate, characterized by declining enrollment and retention rates, somewhat offset by solid and consistent student quality. We assessed the university's financial profile as strong, reflecting a track record of positive full-accrual operating results, despite break-even results seen in fiscal 2020 and potentially weaker results expected for fiscal 2021; a manageable debt burden; solid financial resources; and robust financial policies. We believe these credit factors, combined, lead to an initial indicative stand-alone credit profile of 'a'. As our criteria indicate, the final rating can be within one notch of the indicative credit level. In our opinion, the 'A+' final rating better reflects the University of Puget Sound's very strong available resources to debt ratios relative to those of peers.

The long-term rating reflects what we view as the university's following strengths:

- Disciplined financial management demonstrated by a track record of positive full-accrual operating surpluses, albeit with a break-even result in fiscal 2020 and a deficit expected in fiscal 2021;
- A very strong cash and investment position that has grown over time, particularly relative to debt; and
- A solid endowment relative to those of peers on a per-FTE basis.

The long-term rating also reflects our assessment of the university's weaknesses:

- Enrollment pressure, with four consecutive years of declines in FTE and a particularly large 18% drop in fall 2020, reflecting a highly competitive market for students and challenges driven by the pandemic;
- Softness in demand metrics relative to those of peers, with weakened matriculation, retention, and selectivity in fall 2020; and
- Limited revenue diversity, as indicated by student-derived revenue that made up nearly 86% of revenue in fiscal 2020.

The stable outlook reflects our view that despite a significant enrollment decline in fall 2020 and weakened operating results posted in fiscal 2020, the University of Puget Sound's strong balance sheet provides sufficient cushion for the current rating level. The large enrollment drop in fall 2020 was partially driven by a high number of deferrals and leaves of absence, some of which we expect the university will be able to convert to future enrollment.

The University of Puget Sound, founded in 1888 in Tacoma, is a private residential liberal arts institution with an emphasis on undergraduate education. In recent years, it has introduced new programs, including biochemistry, bioethics, biophysics, molecular and cellular biology, neuroscience, Latina/Latino studies, and German and East European culture and history.

Environmental, social, and governance (ESG) factors

In our view, higher education entities face elevated social risk due to uncertainty on the duration of the COVID-19 pandemic and the uncertainty around its total effect on the university's operations. We view this as a social risk under our ESG factors. We believe management has taken prudent actions regarding the health and safety of students, faculty, and staff, and has limited the risk associated with the community spread of COVID-19 through primarily remote instruction in fall 2020 and dedensification in spring 2021. Additionally, the school is regularly testing all students on campus. Despite elevated social risk, we consider the University of Puget Sound's environmental and governance risks in line with our view of the sector.

Stable Outlook

Downside scenario

We could consider a negative rating action in the outlook period if the university were to experience further weakening of demand metrics, particularly enrollment, matriculation, and retention. We could also consider a negative rating action if the university fails to return to positive full-accrual operating results following fiscal 2021 or if negative operations cause a significant deterioration of the university's available resources. Further unforeseen pressures from the pandemic that cause material weakening of demand, finances, or the trajectory of the school's plan to mitigate the effects of the COVID-19 outbreak may also result in a negative rating action.

Upside scenario

While unlikely during the outlook period, we could consider a positive rating action if the University of Puget Sound strengthened its demand profile through growth in FTE enrollment and matriculation while maintaining or improving student quality. We would also expect the university to maintain available resource levels and sustain healthy, positive full-accrual operating results.

Credit Opinion

Enterprise Profile

Economic fundamentals

In our view, the university has good geographic diversity. About 35% of students are from Washington State. Therefore, our assessment of University of Puget Sound's economic fundamentals is anchored by the U.S. GDP per capita.

Market position and demand

In part due to the remote method of instruction and challenges resulting from the pandemic, the university's FTE enrollment declined sharply by 18% in fall 2020 to 2,113 from 2,563 in fall 2019. Over 260 students took a leave of absence or deferred enrollment. While we believe the University of Puget Sound operated prudently for the safety of students, faculty, and staff, the school is known for its on-campus experience, and we view this enrollment decline as significant. Given that the school has experienced consistent enrollment decreases since fall 2017, we view enrollment

pressure as a key credit risk. Applications for fall 2020 totaled 5,202, effectively stable with results for fall 2019. Initial projections for fall 2021 suggest applications could drop slightly. We would view a trend of growing applications favorably and note the management team is undertaking several initiatives to refresh marketing materials and increase recruitment in Washington State, where the high school population is increasing. The university also recently added a new welcome center to campus.

The freshman-to-sophomore retention rate fell in fall 2020 to 76% from 81% the prior fall. Improving the retention rate is a key priority for management. While the undergraduate population accounts for the vast majority (86%) of the student population, the university also offers graduate programs. Graduate FTE also declined to 256 in fall 2020, a drop of 9% relative to the previous fall.

We consider demand flexibility average, with a softening of key metrics in fall 2020. The first-year selectivity rate weakened to 87% in fall 2020 from 84% in fall 2019. The first-year matriculation rate has historically been weak and saw further softening in fall 2020, dropping to 9% from 14% in fall 2019. We would view improvement in selectivity and matriculation rates as well as application numbers as a positive credit factor. Despite the enrollment pressure, student quality for fall 2020 remained stable and higher than rating category medians, with an average SAT score of 1234 and an average ACT score of 28.

In 2020, the university successfully met its internal five-year fundraising goal, raising \$51 million compared to a target of \$43 million. These funds helped to finance the school's new welcome center. Management is currently planning for the next comprehensive fundraising campaign.

Management and governance

The University of Puget Sound governing board comprises 28 members who can serve three three-year terms. The committees include executive, academic and student affairs, development and alumni relations, finance and facilities (including subcommittees for investment, facilities and real estate), audit, compensation, trusteeship, and honorary degrees, as well as periodic ad hoc committees. The board membership has been fairly stable, with primarily rotational changes recently.

The president, Dr. Isiaah Crawford, has held his role at the university since 2016. More recently, the university gained a new university counsel in 2019 and a nice vice president for enrollment in June 2020. The University of Puget Sound has added a cabinet-level position for a vice president of institutional equity and diversity, and a search to fill this position is underway.

Management operates according to the guidance of a strategic plan whose goals are to advance institutional excellence, academic distinction, and student success; enrich the campus learning environment through increased diversity, inclusion, and access; support and inspire faculty and staff members; enhance engagement with the community; and fully leverage and expand assets as an institution by pursuing entrepreneurial opportunities. Aside from the new strategic plan, the university implemented an enterprise risk management program in 2010 that reviews and assesses operational, strategic, financial, and physical risks with associated risk mitigation strategies. Management regularly monitors and refines the budget, which has helped the school consistently generate slight positive margins on a generally accepted accounting principles (GAAP) basis. The management team also budgets conservatively, including contingencies in the budgeting process. Although officials do not budget for depreciation, they budget for

planned maintenance, which helps to offset depreciation expenses on a full-accrual basis. We view the overall management team as stable and a credit strength of the university.

Financial Profile

Financial management policies

The University of Puget Sound has formal policies for liquidity, investments, and debt, a five-year planning model for operations, and a long-term campus master plan. In addition to a formal policy of maintaining sufficient liquidity to cover operational and capital needs, as well as meet self-liquidity requirements in association with its series 2001 VRDBs, cash and debt management is centralized and overseen by the executive vice president and chief financial officer. The university produces annual reports on an accrual basis to meet standard annual disclosure requirements. The financial policies assessment reflects our opinion that, while there may be some areas of risk, the university's overall financial policies are not likely to impair its future ability to pay debt service. Our analysis of financial policies includes a review of the university's financial reporting and disclosure, investment allocation and liquidity, debt profile, contingent liabilities, and legal structure, and a comparison of these policies with those of similar institutions.

Financial performance

Until fiscal 2020, the university posted positive operating results on a full-accrual basis every year since fiscal 2013. Despite the challenges presented by COVID-19, in fiscal 2020 operations were effectively break even, with only a 0.04% deficit. Management projects softer operating results in fiscal 2021 due to continued pressure on tuition and auxiliary revenue. Net tuition revenue began to decline in fiscal 2018 and has continued to fall modestly since, partly the result of increased discounting and decreased enrollment. However, we view the University of Puget Sound's track record of conservative budgeting and positive margins as a credit strength. With management's proven commitment to financial discipline, including efforts to control instruction expenses, we believe a return to positive margins is likely following the pandemic, and we would view a return to those margins favorably.

As with many private universities of its size, the University of Puget Sound is dependent on student tuition and fees, which account for approximately 86% of adjusted revenue. Tuition typically increases 3%-4% per year, remaining in line with that of peer institutions. For the 2020-2021 school year, the university held tuition stable with the prior year at \$51,470 due to the remote method of instruction and in recognition of the overall negative economic environment.

Available resources

Available resources (as measured by expendable resources) remain solid and a credit strength. For fiscal 2020, the university had \$273 million in expendable resources, down 6% from \$290 million in fiscal 2019. Fiscal 2020 expendable resources equaled 158% of operating expenses and 398% of outstanding debt. Given the challenges of operations during the pandemic, we expect these ratios could soften in fiscal 2021. However, we note that these already-strong ratios are also somewhat deflated because property, plant, and equipment is more than double the university's debt outstanding. Cash and investments remain very solid for the rating and totaled \$446 million in fiscal 2020, up 1% from fiscal 2019. These ratios are also likely to soften in fiscal 2021; however, we expect the university's cash and investments will remain a credit strength.

As of June 30, 2020, the University of Puget Sound's endowment market value fell by 0.5% to \$379 million. However,

as of Dec. 31, 2020, management reports the endowment had rebounded to \$441 million. As of June 30, 2020, asset allocation was moderately conservative, with 40% in global equities, 18% in absolute return, 14% in real assets, 14% in private capital, 8% in global fixed income and cash, and 6% in hedge funds and other investments. The university is gradually decreasing the endowment's investments in fossil fuels. Management reports about \$129 million of investments within and outside of the endowment are available on a daily to weekly basis as of Dec. 31, 2020. Management has generally targeted a level of highly liquid funds in the endowment to meet its self-liquidity needs for its debt agreements and for operations as described in its pooled endowment and pooled cash investment policies. The university has an endowment spending policy of 5% of a trailing 36-month average market value with a two-year lag, which we view as sustainable. In fiscal 2020, the actual endowment draw totaled \$15.5 million, or an effective 5% draw in fiscal 2020.

Debt and contingent liabilities

The University of Puget Sound had approximately \$68.6 million in debt outstanding as of June 30, 2020, of which \$32.5 million, or about 47%, was issued as variable-rate bonds. Securing the bonds is a broad pledge of unrestricted revenue, gains, and other support, equivalent to a general obligation pledge of the university. The series 2001 VRDBs are currently in weekly mode, and the university provides self-liquidity for these bonds with nearly \$86 million available in same- and next-day liquidity and over \$129 million available on a weekly basis. The series 2019 direct placement debt agreement includes provisions that allow for principal acceleration. Events of default include rating triggers below 'BBB-', cross-default provisions, and liquidity and debt coverage covenant default provisions. We believe several provisions of the agreement pose contingent liquidity risk. However, there are sufficient resources to cover contingent liquidity exposure from the variable-rate and direct-purchase debt outstanding, as well as timely security liquidity procedures that conform to the indenture and ensure that bondholders will receive immediately available funds on the purchase date. The university has a \$5 million line of credit, which has never been drawn, but is available to provide liquidity for operations or variable-rate debt if needed.

The university has entered into three interest rate swap agreements to synthetically fix its variable-rate debt. It entered into one agreement with Societe Generale and two with Bank of New York Mellon. The swaps had a negative mark-to-market value of \$12.4 million of June 30, 2020. Basis risk exists given terms of the direct-purchase agreement, which allow for higher interest rates with a lowering of the university ratings and in that the floating leg of the swap is linked to 67% of the one-month LIBOR swap rate. There is a moderate degree of collateralization and termination risk as the university is required to post collateral should its rating falls below 'BBB' for the 2005 swap and below 'BBB-' for the 2006 swaps.

While the swaps are in place to hedge against fluctuations in variable interest rates and the university has managed its liquidity to meet financial covenants in debt agreements, we believe its debt structure is somewhat aggressive, with 47% of its debt outstanding subject to acceleration or remarketing risk. We note that the university has no immediate plans for debt, though management is considering a refinancing to realize net present value savings.

University of Puget Sound, Washington--Enterprise And Financial Statistics

	--Fiscal year ended June 30--					Medians for 'A' rated private colleges & universities
	2021	2020	2019	2018	2017	2019
Enrollment and demand						
Headcount	2,210	2,608	2,666	2,701	2,791	MNR
Full-time equivalent	2,113	2,563	2,619	2,633	2,736	3,383
Freshman acceptance rate (%)	86.9	83.8	88.3	83.9	78.9	67.5
Freshman matriculation rate (%)	8.7	14.2	12.9	11.9	13.4	MNR
Undergraduates as a % of total enrollment (%)	85.9	88.2	88.7	89.3	89.9	81.0
Freshman retention (%)	76.3	80.9	80.6	85.9	85.7	85.1
Graduation rates (six years) (%)	77.1	76.2	75.6	78.1	79.8	MNR
Income statement						
Adjusted operating revenue (\$000s)	N.A.	172,890	175,724	172,840	172,300	MNR
Adjusted operating expense (\$000s)	N.A.	172,953	170,761	169,706	164,015	MNR
Net operating income (\$000s)	N.A.	(63)	4,963	3,134	8,285	MNR
Net operating margin (%)	N.A.	(0.04)	2.91	1.85	5.05	1.60
Change in unrestricted net assets (\$000s)	N.A.	(2,294)	5,129	13,802	37,421	MNR
Tuition discount (%)	N.A.	44.8	41.6	39.0	37.0	38.3
Tuition dependence (%)	N.A.	74.3	71.5	71.3	71.7	MNR
Student dependence (%)	N.A.	86.1	85.8	86.0	86.5	85.6
Health care operations dependence (%)	N.A.	N.A.	N.A.	N.A.	N.A.	MNR
Research dependence (%)	N.A.	0.1	0.1	0.2	0.2	MNR
Endowment and investment income dependence (%)	N.A.	9.6	9.4	8.8	8.4	MNR
Debt						
Outstanding debt (\$000s)	N.A.	68,647	70,551	72,315	73,595	106,232
Proposed debt (\$000s)	N.A.	N.A.	N.A.	N.A.	N.A.	MNR
Total pro forma debt (\$000s)	N.A.	68,647	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.	2.93	3.02	2.87	3.03	MNR
Current MADS burden (%)	N.A.	2.87	2.96	2.99	3.11	4.20
Pro forma MADS burden (%)	N.A.	N.A.	N.A.	N.A.	N.A.	MNR
Financial resource ratios						
Endowment market value (\$000s)	N.A.	378,614	380,507	369,038	344,560	240,596
Cash and investments (\$000s)	N.A.	446,276	442,757	425,493	395,692	MNR
Unrestricted net assets (\$000s)	N.A.	290,285	292,579	287,450	273,648	MNR
Expendable resources (\$000s)	N.A.	273,015	290,371	280,967	253,588	MNR
Cash and investments to operations (%)	N.A.	258.0	259.3	250.7	241.3	142.2

University of Puget Sound, Washington--Enterprise And Financial Statistics (cont.)

	--Fiscal year ended June 30--					Medians for 'A' rated private colleges & universities
	2021	2020	2019	2018	2017	2019
Cash and investments to debt (%)	N.A.	650.1	627.6	588.4	537.7	287.1
Cash and investments to pro forma debt (%)	N.A.	650.1	N.A.	N.A.	N.A.	MNR
Expendable resources to operations (%)	N.A.	157.9	170.0	165.6	154.6	89.0
Expendable resources to debt (%)	N.A.	397.7	411.6	388.5	344.6	178.3
Expendable resources to pro forma debt (%)	N.A.	397.7	N.A.	N.A.	N.A.	MNR
Average age of plant (years)	N.A.	13.6	12.6	12.1	11.7	14.1

N.A.--Not available. MNR--Median not reported. MADS--Maximum annual debt service. 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). Student dependence = 100*(gross tuition revenue + auxiliary 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 and long-term investments. Expendable resources = net assets without donor restrictions + net assets available for appropriation - (net PPE - outstanding debt). Average age of plant = accumulated depreciation/depreciation and amortization expense.

Related Research

Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020

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