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

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Table Of Contents

Rating Action

Stable Outlook

Credit Opinion

Enterprise Profile

Financial Profile

Related Research

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

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 rating's short-term component reflects our opinion of the university's self-liquidity. The outlook on the long-term rating is stable.

The University of Puget Sound had approximately \$67.5 million in debt outstanding as of June 30, 2021, which included \$31.5 million of variable-rate debt and a small amount of capital leases. The university has three interest rate swap agreements that synthetically fix its variable-rate debt. The university provides self-liquidity for its \$8.0 million of variable-rate demand bonds (VRDBs) with \$90.7 million available in same- and next-day liquidity as of March 31, 2022. Securing the bonds is a broad pledge of unrestricted revenue, gains, and other support, equivalent to a general obligation pledge of the university. The university's maximum annual debt service (MADS) is a modest 3.0% of fiscal 2021 adjusted operating expenses. We do not expect the university will issue any new debt in the outlook period.

The University of Puget Sound returned to in-person operations in fall 2021. In order to lessen the spread of COVID-19, the university implemented a vaccine mandate for all students, faculty, and staff. Following a large drop in full-time-equivalent (FTE) enrollment in fall 2020, enrollment was stable in fall 2021 at 2,118 students. Management reports stronger application numbers to date for fall 2022. With lower auxiliary revenue and lower enrollment in fiscal 2021, the university ended the year with a modest deficit of 2.5%. The university is expected to receive a total of approximately \$8.6 million in federal relief funding, of which over \$4 million remains available for use in fiscal 2022. We expect another deficit in fiscal 2022, albeit smaller than that of fiscal 2021.

Credit overview

We assessed University of Puget Sound's enterprise profile as strong, characterized by stabilized enrollment and consistent student quality, offset by weak acceptance and matriculation rates. We assessed the university's financial profile as strong, reflecting a track record of operating surpluses prior to fiscal 2020, solid financial resources, and robust financial policies. We believe these credit factors, combined, lead to an indicative stand-alone credit profile of

'a+' and a final rating of 'A+'.

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

- A strong cash and investment position that has grown over time, particularly relative to debt;
- A manageable debt burden, with a modest MADS and no additional debt expected in the outlook period; 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:

- Softness in demand metrics, with weakened selectivity and matriculation in recent years, and
- Limited revenue diversity, with student-derived revenue typically making up 86% of adjusted operating revenues.

The stable outlook reflects our view that the University of Puget Sound's strong balance sheet provides sufficient cushion for the current rating, despite a large enrollment decline in fall 2020 and a deficit in fiscal 2021. While management expects another deficit in fiscal 2022, enrollment was stable in fall 2021 and we expect a return to stronger operating results within the outlook period.

The University of Puget Sound, founded in 1888 in Tacoma, is a private residential liberal arts and science institution with an emphasis on undergraduate education. The university offers more than 50 areas of study, including a school of music and a school of business and leadership.

Environmental, social, and governance

In our view, the higher education sector continues to face elevated social risks due to the health and safety issues created by COVID-19, particularly with the emergence of new variants. However, we believe that the University of Puget Sound has taken steps to protect its community by implementing a vaccine requirement, conducting periodic asymptomatic testing, and enhancing HVAC systems. We believe the university's environmental and governance risks are in line with those of the sector as a whole.

Stable Outlook

Downside scenario

We could consider a negative rating action if the university generated ongoing deficits that caused a substantial decline in available resources. We would also view weakening of demand metrics, such as enrollment and retention, negatively.

Upside scenario

We could consider a positive rating action if the university strengthened its demand profile, primarily selectivity and matriculation, while maintaining or improving student quality. We would also expect the university to further grow available resources with the support of operating surpluses.

Credit Opinion

Enterprise Profile

Market position and demand

The University of Puget Sound has faced enrollment pressure in recent years. However, the university stabilized enrollment in fall 2021 following a large 17.6% decline in FTE enrollment in fall 2020. The stable result in fall 2021 was supported by improved retention rates and an increase in graduate students. Undergraduates make up approximately 86% of the student body. The university has good geographic diversity, with only 35% of students from Washington state.

Management is targeting modest enrollment growth in the next few years, under a strategic enrollment plan. The plan includes refreshing marketing materials and expanding video content. Additionally, the enrollment plan seeks to improve the use of analytics, increase application volumes, launch new graduate programs, and improve retention. The team has already seen progress toward these goals. Recently, the university was featured on an episode of Amazon Prime's "The College Tour." The school also launched a master's in public health program. First-year retention improved to 88% in fall 2021, and management reports strong application numbers for fall 2022. However, selectivity remains weak compared to peers at 88%, and matriculation is reflective of a highly competitive environment, at under 10%. Despite enrollment pressure, student quality remains stable and higher than rating category medians. We would view improvement in selectivity and matriculation rates as well as continued enrollment stability as a positive credit factor.

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, which is a key resource for the strategic enrollment plan. In January 2022, the university launched the silent phase of its current campaign with a working target of \$150 million.

Management and governance

The University of Puget Sound has a stable and experienced management team. The university's president, Dr. Isiaah Crawford, has been in his role since 2016. Recently, the university added a vice president for institutional equity and diversity to the executive team. The chief financial officer is retiring after more than 30 years at the university. The university recently announced her successor as well as the next vice president for university relations. The board has been stable, with primarily rotational changes.

The university operates according to a 2018-2028 strategic plan with goals to advance institutional excellence, academic distinction, and student success; enrich campus learning through increased diversity, inclusion, and access; support and inspire faculty and staff members; enhance engagement with the community; and expand institutional assets by pursuing entrepreneurial opportunities.

The management team budgets conservatively, including contingencies in the budgeting process. Although the university does not budget for depreciation, budgets include planned maintenance, which helps to offset depreciation

expenses on a full-accrual basis. 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. There is a formal policy of maintaining sufficient liquidity to cover operational and capital needs, as well as meet self-liquidity requirements in association with the series 2001 VRDBs. Cash and debt management is centralized and overseen by the executive vice president and chief financial officer.

Financial Profile

Financial performance

Until fiscal 2020, the university had a long track record of positive margins on a full-accrual basis. Due to impacts of the COVID-19 pandemic, fiscal 2020 ended with a break-even result, followed by a modest deficit of 2.5% in fiscal 2021. In particular, a large enrollment decline in fall 2020 contributed to lower tuition and auxiliary revenue, which was partially offset by significant expense measures and relief funding. Management projects a smaller deficit in fiscal 2022. However, we view the University of Puget Sound's track record of conservative budgeting 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 in the next few years.

As with many private universities of its size, the University of Puget Sound is dependent on student tuition and fees, which usually account for approximately 86% of adjusted revenue. Net tuition revenue has declined for four years, due to increased discounting and decreased enrollment. The university's discount rate is now 48%, up from recent years but similar to the discount rates of peer institutions. Tuition typically increases 3%-4% per year. For the 2020-2021 school year, the university held tuition stable due to the remote method of instruction and in recognition of the overall negative economic environment. Tuition then increased by 7.6% in fall 2021 to \$55,390, remaining in line with peers.

Available resources

The University of Puget Sound's available resources remain a credit strength and, similar to peers, the university saw excellent balance sheet growth in fiscal 2021. Cash and investments increased by 22% while expendable resources grew 35%. To calculate expendable resources, we use net assets "without donor restrictions" instead of the formerly classified unrestricted net assets. We also factor in \$179.3 million of net assets "with donor restrictions" that would have been classified as "temporarily restricted net assets" under the old FASB standards for comparability purposes.

As of June 30, 2021, the University of Puget Sound's endowment market value increased by 25% to \$474.2 million. The asset allocation was moderately conservative, primarily invested in global equities, absolute return, real assets, and private capital. The university is gradually decreasing the endowment's investments in fossil fuels. 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.

Debt and contingent liabilities

In June 2021, the university issued series 2021A and 2021B bonds to refinance the series 2019 and 2012A bonds, respectively, through a 10-year direct purchase agreement. The series 2012A fixed-rate bonds have a call date in October 2022. The direct placement agreement includes provisions that allow for principal acceleration. However, terms for the 2021 bonds are more favorable than those for the previous 2019 direct placement agreement. Covenants

for the 2021 bonds include liquidity coverage and debt service coverage requirements that the university far surpassed in fiscal 2021. While the direct purchase provisions present contingent liquidity risk, we believe this risk is remote and the university has sufficient resources with over \$90 million available in same- and next-day liquidity. The 2021A bonds are variable rate while the 2021B bonds are fixed rate.

The university has three interest rate swap agreements to synthetically fix its variable-rate debt. The swaps had a negative mark-to-market value of \$9.1 million of June 30, 2021. Basis risk exists as the floating leg of the swap is linked to 67% of the one-month LIBOR swap rate and the agreements allow for higher interest rates upon a lowering of the university debt rating. There is a low degree of collateralization and termination risk as the university is required to post collateral should its rating fall 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, we believe the debt structure is somewhat aggressive.

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

	--Fiscal year ended June 30--					Medians for 'A' rated private colleges & universities
	2022	2021	2020	2019	2018	2020
Enrollment and demand						
Headcount	2,173	2,210	2,608	2,666	2,701	MNR
Full-time equivalent	2,118	2,113	2,563	2,619	2,633	3,451
Freshman acceptance rate (%)	88.3	86.9	83.8	88.3	83.9	67.5
Freshman matriculation rate (%)	9.2	8.7	14.2	12.9	11.9	MNR
Undergraduates as a % of total enrollment (%)	85.9	85.9	88.2	88.7	89.3	80.3
Freshman retention (%)	88.0	76.3	80.9	80.6	85.9	85.5
Graduation rates (six years) (%)	74.2	77.1	76.2	75.6	78.1	MNR
Income statement						
Adjusted operating revenue (\$000s)	N.A.	150,563	172,890	175,724	172,840	MNR
Adjusted operating expense (\$000s)	N.A.	154,487	172,953	170,761	169,706	MNR
Net operating income (\$000s)	N.A.	(3,924)	(63)	4,963	3,134	MNR
Net operating margin (%)	N.A.	(2.54)	(0.04)	2.91	1.85	0.70
Change in unrestricted net assets (\$000s)	N.A.	24,306	(2,294)	5,129	13,802	MNR
Tuition discount (%)	N.A.	48.2	44.8	41.6	39.0	39.3
Tuition dependence (%)	N.A.	71.2	74.3	71.5	71.3	MNR
Student dependence (%)	N.A.	77.0	86.1	85.8	86.0	85.3
Research dependence (%)	N.A.	0.1	0.1	0.1	0.2	MNR
Endowment and investment income dependence (%)	N.A.	15.0	9.6	9.4	8.8	MNR
Debt						
Outstanding debt (\$000s)	N.A.	67,484	68,647	70,551	72,315	121,080
Current debt service burden (%)	N.A.	3.51	2.93	3.02	2.87	MNR

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

	--Fiscal year ended June 30--					Medians for 'A' rated private colleges & universities
	2022	2021	2020	2019	2018	2020
Current MADS burden (%)	N.A.	3.02	2.87	2.96	2.99	3.90
Financial resource ratios						
Endowment market value (\$000s)	N.A.	474,232	378,614	380,507	369,038	237,574
Cash and investments (\$000s)	N.A.	545,357	446,276	442,757	425,493	MNR
Unrestricted net assets (\$000s)	N.A.	314,591	290,285	292,579	287,450	MNR
Expendable resources (\$000s)	N.A.	368,386	273,015	290,371	280,967	MNR
Cash and investments to operations (%)	N.A.	353.0	258.0	259.3	250.7	144.7
Cash and investments to debt (%)	N.A.	808.1	650.1	627.6	588.4	294.2
Expendable resources to operations (%)	N.A.	238.5	157.9	170.0	165.6	88.8
Expendable resources to debt (%)	N.A.	545.9	397.7	411.6	388.5	180.6
Average age of plant (years)	N.A.	14.4	13.6	12.6	12.1	14.5

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 = unrestricted net assets + temp. restricted net assets - (net PPE- outstanding debt). Average age of plant = accumulated depreciation/depreciation and amortization expense.

Related Research

Through The ESG Lens 3.0: The Intersection Of ESG Credit Factors And U.S. Public Finance Credit Factors, March 2, 2022

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