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University of San Francisco

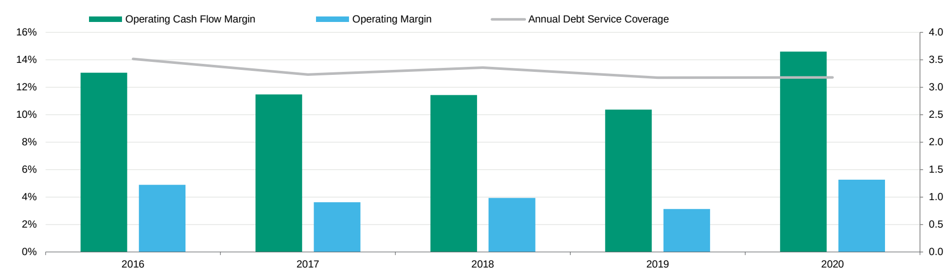
Update to credit analysis

Summary

The University of San Francisco's credit quality (A2 stable) reflects its very good strategic positioning as a relatively large urban Jesuit comprehensive university in San Francisco with diverse programming including a sizeable graduate student population. Sound fiscal management will continue to produce steady operating cash flow margins, which, together with improving philanthropic support, underpin growing cash and investments. These factors are counterbalanced by a highly competitive market that has led to weak incoming student matriculation in the context of a very high reliance on student charges. This trend has been exacerbated by lower enrollment in fall 2020 due to the city-imposed campus closure during the coronavirus pandemic. In addition, leverage is moderately elevated following borrowing to finance a housing development. The project is an important strategic measure to enhance attractiveness to students. The complexity of USF's debt structure including exposure to variable rate debt, covenants and swaps is an additional risk.

Exhibit 1

Sound operating cash flow margins provide flexibility and good coverage of debt service



Source: Moody's Investors Service

Credit strengths

» Urban location, Jesuit niche and substantial graduate and professional enrollment bolster market profile and add stability

» Responsive fiscal management leading to cash flow margin of 14.6% in fiscal 2020

» Growing philanthropic support for capital plan and strategic initiatives, with $42 million of gift revenue in fiscal 2020

Credit challenges

- » Highly competitive student market evidenced by low 7.6% matriculation of admitted students in the context of a high 83% reliance on income from student charges
- » Complex debt structure heightens risk, including exposure to variable rate debt, covenants with acceleration risk and swaps
- » Moderately elevated leverage with spendable cash and investments to debt estimated at 1.3x compared to 2.0x for A-rated peers
- » Lower liquidity than peers with 210 days cash on hand in fiscal 2020 compared with A2-rated median of 357 days

Rating outlook

The stable outlook incorporates our expectations of a return to generally stable enrollment that supports stronger financial performance following potential weakening in fiscal 2021 related to the coronavirus pandemic. The outlook also reflects no expectations of a material increase in debt and continued sufficient oversight of a moderately complex debt portfolio.

Factors that could lead to an upgrade

- » Substantial growth in cash and investments, particularly unrestricted reserves
- » Improved student demand, including sustained growth of net tuition per student and higher yield of accepted students

Factors that could lead to a downgrade

- » Inability to grow net tuition resulting in a thinning of operating cash flow margins
- » Sustained decline in enrollment
- » Additional borrowing absent commensurate growth of reserves and cash flow

Key indicators

Exhibit 2
UNIVERSITY OF SAN FRANCISCO, CA

	2016	2017	2018	2019	2020	Median: A Rated Private Universities
Total FTE Enrollment	10,565	10,648	10,327	10,298	9,612	4,695
Operating Revenue ($000)	373,321	381,228	394,953	391,752	399,607	213,591
Annual Change in Operating Revenue (%)	4.9	2.1	3.6	-0.8	2.0	3.8
Total Cash & Investments ($000)	449,064	481,879	517,220	516,511	547,101	427,133
Total Debt ($000)	163,720	158,095	156,250	292,730	286,975	150,817
Spendable Cash & Investments to Total Debt (x)	1.9	2.1	2.3	1.2	1.3	1.9
Spendable Cash & Investments to Operating Expenses (x)	0.9	0.9	0.9	0.9	1.0	1.4
Monthly Days Cash on Hand (x)	207	201	192	197	210	350
Operating Cash Flow Margin (%)	13.1	11.5	11.4	10.4	14.6	14.2
Total Debt to Cash Flow (x)	3.4	3.6	3.5	7.2	4.9	5.1
Annual Debt Service Coverage (x)	3.5	3.2	3.4	3.2	3.2	2.9

Source: Moody's Investors Service

Profile

The University of San Francisco is a large, urban, Jesuit university with 9,612 full-time equivalent students in fall 2020 and $400 million of operating revenue in fiscal 2020. The university is located in the City of San Francisco.

Detailed credit considerations

Market Profile: urban location and substantial graduate programming support market position

USF's diverse programming, relatively large scope of operations, Jesuit niche and urban location in economically vibrant San Francisco will remain a competitive advantage. Strategic positioning is very good due to the university's location, strong reinvestment in campus facilities and demand for graduate and professional programs in nursing and teaching offsetting weaker, but stabilizing trends in other disciplines such as law and management.

Future enrollment growth will be challenged by a highly competitive landscape as reflected in a low and steadily declining yield on admitted students of 7.6% in fall 2020 from 14.3% in fall 2017. Worsening in fall 2020 however, largely reflected the impact of the coronavirus pandemic and city-imposed closure of most campus activities. Full time equivalent students (FTE) declined by 6.7% in fall 2020 including an 11.4% decline in undergraduates only partially offset by a 1.4% rise in graduates; a decrease in international students also contributed to lower enrollment. The decline in retention to 77% from 85% also reflected the pandemic's impact on continuing students.

USF's future ability to grow net tuition revenue is bolstered by the greater percentage of higher-paying graduate and professional students, at almost 40% of enrollment, and its plan to increase graduate students by 2% annually over the next decade. This approach is important given some space limitations on the university's main undergraduate Hilltop campus, while a downtown location offers prospects for expansion.

The university benefits from a lower fixed cost model, offering nursing and teaching programs in multiple locations in collaboration with other entities. The university will build on this strategy to grow more profitable programs, including the introduction of new undergraduate engineering courses, while selectively eliminating less attractive programs. USF is also engaging with community colleges to augment the number of transfer students, aimed at stabilizing this source of enrollment.

Operating performance: conservative budgeting key to operating results given high tuition dependence

Operating and operating cash flow margins will continue to be positive supported by careful fiscal stewardship and conservative budgeting, critical given the challenging market environment more recently exacerbated by the coronavirus pandemic, with associated pressures on financial aid. Fiscal 2021 operating cash flow will narrow due to the decline in enrollment in fall 2020 and minimal occupancy in dorms. The impact will be mitigated by reductions in costs through furloughs, salary cuts and a reduction in some positions as well as $7 million of federal funds available for institutional purposes. However, a planned restitution of salary cuts will also need to be absorbed in fiscal 2021.

In fiscal 2020, the 14.6% operating cash flow margin was improved over the prior year's 10.4% despite challenges of the coronavirus pandemic. Increased costs and housing refunds were offset by cost reductions through furloughs, hiring and salary reductions as well as increased gifts and federal CARES Act institutional funding of $3.6 million.

The university's heavy reliance on student charges – at 83% – remains a challenge given pressures to increase financial aid. This is partially mitigated by the university's program diversity and large pool of graduate and professional students.

Wealth and liquidity: resource growth generates large absolute wealth levels but provides lower cushion than peers

USF's resources, supported by gift revenue, surpluses and investment returns, will continue to grow. Total cash and investments amounted to $547 million in fiscal 2020 and have grown solidly, rising by 22% from fiscal 2016 to fiscal 2020. Flexible reserves (spendable cash and investments), however, provide rather thin coverage of operations at 1.0x expenses compared to A2-rated peers, with a median coverage of 1.4x.

The university's $300 million comprehensive campaign will help further build its reserves. USF has raised $255 million in cash and pledges so far, with the campaign slated to conclude in 2022. In fiscal 2020, total gifts rose to $42 million and are expected to remain at similar levels in fiscal 2021. While USF lags its peers in philanthropy, the gap is narrowing with gifts per student doubling from fiscal 2015 to fiscal 2020. Gifts will support the endowment, scholarships, facilities and program support.

Fiscal 2020 investment returns of 7.3% (calculated to be in line with June 30, year end) is very strong relative to peers. Asset allocation is diversified with 49% in equities, 7.6% in fixed income, 12.8% in hedge funds and 21.9% in private equity.

Liquidity

USF's liquidity will remain sufficient relative to operations but is not expected to rise significantly over the next several years. Monthly liquidity of around $203 million in fiscal 2020 has grown modestly over the past three years, providing a relatively low 210 days cash on hand, weaker than the median 357 days held by peers.

In September 2020, the university took on a $50 million line of credit with JP Morgan but has not drawn, and has no plans to draw, on the line and will likely not renew it upon expiration in September 2021. The LOC has financial covenants including a DSCR of 1.1x and a liquidity ratio of 75%, which if not met are events of default. There is also a rating trigger of A2 from Moody's and a Material Adverse Event clause (COVID excluded).

Leverage: moderately elevated leverage remains manageable

USF's leverage is moderately elevated with spendable cash and investments covering debt by a comfortable 1.3x, but lower than the 2.0x of peers. Debt affordability, as measured by debt to cash flow at 4.9x, reflects good cash flow generation and is comfortably in line with A2 peers.

USF does not have major capital needs given ongoing investment in plant, including a new 600-bed student housing facility funded through a $140 million borrowing in fiscal 2019. Debt service is expected to be funded through increased housing revenue given limited existing on-campus housing and prohibitively expensive off-campus alternatives. The new project will also enhance the university's strategic positioning due to the importance of housing to attract undergraduate students and to better fulfill the university's strong mission of community.

Management reports no debt plans, with most capital needs to be met through fundraising, including the renovation of a basketball facility and a new facility for engineering programs.

Legal security

Rated bonds are initially secured by a gross unrestricted revenue pledge of the University of San Francisco. The gross unrestricted revenue pledge will be terminated when outstanding bank debt is retired, currently expected in fiscal 2037. When the pledge is terminated, rated bond will be an unsecured general obligation of USF.

Debt structure

The majority of total debt is regularly amortizing with 23% at variable rates and hedged with swaps. The series 2018A of $140 million is fixed rate with a 40-year maturity. Delayed principal payments begin in fiscal 2038, which will ease the burden of debt service on the budget but somewhat constrain the university's future capacity to borrow. Series 2018B of $36 million refinanced series 2011 and matures in 2036.

A 2012 term loan with JPMorgan Chase (JPMC) amortizes in small annual amounts with a final payment date of 2030 following an amendment in fiscal 2021. A 2017 tax-exempt fixed term loan with First Republic Bank has delayed principal until fiscal 2022 with a final maturity in fiscal 2037. An additional $69 million CEFA series 2017 bonds are in a direct bank placement in an index mode with an initial 10-year term and relatively level debt service.

All of the university's unrated debt contains certain covenants which, if breached, could result in acceleration of the bonds and loans, complicating its debt structure. Financial covenants require the university to maintain liquidity and debt service coverage ratios as follows in Exhibit 3.

Exhibit 3

Financial covenants vary by bank agreement

	2012 Term Loan (JP Morgan)	Series 2017 Variable Rate (JP Morgan)	Series 2017 (First Republic)
Liquidity ratio	199%	119%	119%
Liquidty ratio minimum	75%	75%	75%
Debt service coverage ratio	3.28x	3.28x	2.80x
Debt service coverage ratio minimum	1.10x	1.10x	1.10x

Definitions of ratios differ.

Source: University of San Francisco and Moody's Investors Service

Debt-related derivatives

USF has four swaps with Bank of America to hedge its variable rate debt with a notional amount of $65.3 million and a liability of $12.6 million as of 3/30/2021. The swaps have limited credit risk given the lack of collateral posting requirements. The university is, however, required to meet certain covenants – unrestricted net assets to debt of 60% and the Western Association of Schools and Colleges (WASC) accreditation for the law school – should it choose to amend the swaps.

Pensions and OPEB

The university's exposure to pension and other post-employment health benefits is limited. Participation in a defined contribution pension plan and a long-closed deferred compensation plan offers the university legal flexibility to change contributions. Currently, retirement-related expenses are approximately $15 million, a manageable 4% of total operations in fiscal 2020.

ESG considerations

Environmental

As is the case for most of the higher education sector, environmental considerations are not a material credit factor for the University of San Francisco. According to Moody's affiliate Four Twenty-Seven, the university's location in San Francisco, California, exposes it to high risks of extreme rainfall and sea level rise. It is also exposed to seismic activity risk; however, most buildings have been seismically upgraded.

Social

We regard the coronavirus outbreak as a social risk under our ESG framework, given the substantial implications for public health and safety. USF experienced a 6.7% decline in fall 2020 FTE's and its starting undergraduate class was 11% lower, which will have flow on effects in following years. As residences were not opened in fall 2020 due to City of San Francisco imposed restrictions, revenue losses will be elevated in fiscal 2021; however auxiliary revenues comprised a relatively smaller 10% of operating revenues pre-pandemic levels. Federal funding will help mitigate losses but fiscal 2021 is expected to narrow.

Other social considerations include relatively high tuition and a narrow pool of students with strong competition. Exposure to international students – 10% of the student body – is compounded by geographic concentration from China. Fierce competition in the region resulted in low a steadily decreasing yield of accepted students.

Governance

The university's sound fiscal stewardship underpins its very good strategic positioning. Conservative budgeting, multi-year forecasting, regular budgetary oversight, and concerted actions to reduce costs will contribute to improved financial performance. The prudent fiscal approach is further illustrated by lower endowment draws of 4.5% in recent years. The complexity of the debt structure, that includes variable rate debt, varied covenants with acceleration risk and swaps requires active oversight and debt management. Academic renewal with the introduction of new innovative programs and the elimination or reconfiguration of less attractive offerings is supportive to enhancing the university's market position. In addition, senior leadership and the board have strengthened oversight and management of admissions and fundraising.

Rating methodology and scorecard factors

The Higher Education Methodology includes a scorecard that summarizes the factors that are generally most important to higher education credit profiles. Because the scorecard is a summary and may not include every consideration in the credit analysis for a specific issuer, a scorecard-indicated outcome may or may not match an assigned rating. We assess strategic positioning on a qualitative basis, as described in the methodology.

Exhibit 4

University of San Francisco, CA

Scorecard Factors and Sub-factors		Value	Score
Factor 1:	**Market Profile (30%)**		
	Scope of Operations (Operating Revenue) ($000)	399,607	A1
	Reputation and Pricing Power (Annual Change in Operating Revenue) (%)	2.0	Baa3
	Strategic Positioning	A	A
Factor 2:	**Operating Performance (25%)**		
	Operating Results (Operating Cash Flow Margin) (%)	14.6	A1
	Revenue Diversity (Maximum Single Contribution) (%)	83.3	Ba2
Factor 3:	**Wealth & Liquidity (25%)**		
	Total Wealth (Total Cash & Investments) ($000)	547,101	Aa3
	Operating Reserve (Spendable Cash & Investments to Operating Expenses) (x)	1.0	A3
	Liquidity (Monthly Days Cash on Hand)	210	A3
Factor 4:	**Leverage (20%)**		
	Financial Leverage (Spendable Cash & Investments to Total Debt) (x)	1.3	A2
	Debt Affordability (Total Debt to Cash Flow) (x)	4.9	Aa2
	Scorecard-Indicated Outcome		A3
	Assigned Rating		A2

Data is based on most recent fiscal year available. Debt may include pro forma data for new debt issued or proposed to be issued after the close of the fiscal year.

For non-US issuers, nominal figures are in US dollars consistent with the Higher Education Methodology.

Source: Moody's Investors Service

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