New Issue: Moody's assigns Aaa to University of Notre Dame, IN's Series 2015 bonds; outlook stable

Global Credit Research - 19 Dec 2014

$1.0B rated debt includes CP at full authorization

UNIVERSITY OF NOTRE DAME DU LAC, IN
Private Colleges & Universities
IN

Moody's Rating

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<td>Taxable Fixed Rate Bonds, Series 2015</td>
<td>Aaa</td>
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<td>Sale Amount</td>
<td>$400,000,000</td>
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<td>Expected Sale Date</td>
<td>01/14/15</td>
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<td>Rating Description</td>
<td>Revenue: 501c3 Unsecured General Obligation</td>
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Moody's Outlook STA

Opinion

NEW YORK, December 19, 2014 --Moody's Investors Service assigns a Aaa rating to the University of Notre Dame du Lac's (Notre Dame) Taxable Fixed Rate Bonds, Series 2015. We also affirm the outstanding ratings. The rating outlook is stable.

SUMMARY RATING RATIONALE

University of Notre Dame's Aaa rating is based on its national prominence as a premier, academically selective Catholic research university, excellent balance sheet cushion with good liquidity supporting debt and operations, strong operations and cash flow generation, and a history of strong fundraising. Offsetting challenges are an increasingly competitive higher education market for high quality students and significant capital plans.

The VMIG 1 rating on the Series 2003, 2005 and 2007 Variable Rate Revenue Bonds and P-1 on the Standard Commercial Paper Notes reflect Standby Bond Purchase Agreements (SBPAs) from P-1 rated banks to support the tender features in the event of a failed remarketing.

STRENGTHS

*University of Notre Dame enjoys very strong national student demand as a premier, highly selective Catholic research university with a strong undergraduate residential education, with fall 2014 enrollment of over 12,000 full-time equivalent (FTE) students.

*Balance sheet resources and liquidity are strong, with cash and investments growing to $9.8 billion and $1.4 billion of unrestricted monthly liquidity, translating to 549 days cash on hand and 421% monthly liquidity to demand debt.

*Consistent operating surpluses, with a 21% operating cash flow margin in FY 2014, are driven by prudent financial management, as reflected in a strong positive 6.4% operating margin, excluding gifts.

*Notre Dame's investment management function provides active oversight, contributing to high performance and exceptional long-term investment returns.

*Strong fundraising bolsters resource growth, with $407 million of contributions in FY 2014 and $260 million for the three-year average.
CHALLENGES

*The university faces intense national competition for the most talented students with the other leading universities. Notre Dame has policies of "need-blind" admissions as well as a commitment to fund unmet need of admitted students with limited loans.

*Notre Dame has significant plans for new capital projects and maintenance projects that will be partly funded by debt, with the next issue tentatively planned for FY 2018.

*With investment income comprising 33% of operating revenues, as calculated by Moody's, Notre Dame is vulnerable to the impact of investment losses from market downturns, and the resulting drag on endowment spending.

*A majority of the university's debt is in long-dated bullet maturities, which increases the importance of sound fiscal and investment management.

DETAILED CREDIT DISCUSSION

USE OF PROCEEDS: Proceeds from the Series 2015 bonds will be used to fund capital projects, refinance a portion of the University's outstanding bonds, and pay issuance costs.

LEGAL SECURITY: The Series 2015 bonds are general obligations and on parity with Notre Dame's other bonds and commercial paper obligations.

DEBT STRUCTURE: Upon the issuance of the Series 2015 bonds, Notre Dame has 20% demand debt, consisting of commercial paper at the full $200 million of the program size.

Tender features of the Series 2003 and 2005 variable rate demand bonds are supported by SBPAs from The Northern Trust Company (rated A1/P-1) that terminate on May 17, 2015 and February 28, 2015, respectively. Tender features of the Series 2007 are supported by an SBPA from Bank of New York Mellon (rated Aa2/P-1) terminating on May 17, 2015.

Notre Dame's commercial paper can be issued as Taxable or Tax-Exempt Standard Commercial Paper or Taxable or Tax-Exempt Extendible Municipal Commercial Paper (EMCP) up to a maximum $200 million total issuance. Standard Commercial Paper Notes are secured by a standby credit agreement issued by JPMorgan Chase Bank, N.A. terminating on March 1, 2018. Extendible Municipal Commercial Paper is supported by Notre Dame's market access and its unrestricted liquidity. Extendible Municipal Commercial Paper notes have an original maturity of 1 to 90 days and Notre Dame can extend the maturity up to 270 days from the original date of issuance. No note may mature later than December 1, 2035.

DEBT-RELATED INTEREST RATE DERIVATIVES: Notre Dame is counterparty in five interest rate swaps, with a negative $14.5 million value at November 30, 2014. Given the university's ample financial resources, strong cash flow, and sophisticated management, the risks associated with these arrangements are manageable within the Aaa rating.

MARKET POSITION/COMPETITIVE STRATEGY: PROMINENT MARKET LEADERSHIP AS ACADEMICALLY SELECTIVE, CATHOLIC UNIVERSITY DRIVES STRONG STUDENT DEMAND

University of Notre Dame will continue to enjoy strong national student demand driven by its market leadership as a premier academically selective, national Catholic research university. Fall 2014 enrollment of over 12,000 FTEs, with about 70% undergraduate, is stable over the past five years.

Notre Dame shows steady net tuition revenue growth, with net tuition per student rising to $24,066 for FY 2014 from $22,247 in FY 2010, and greater than the median for large Aaa-rated institutions. The growing net tuition revenues are noteworthy, as the university practices a policy of need-blind admission with a commitment to fund the unmet need. Total tuition discount rose to 45% in FY 2014 from 38% in FY 2010, funded from the endowment and operations. The rise during this period is driven by graduate student fellowships, specifically due to rising graduate enrollment and a policy change within the University's Graduate School.

OPERATING PERFORMANCE: CONSISTENTLY STRONG OPERATING PERFORMANCE AND CASH FLOW GENERATION
Notre Dame's very strong operations will continue as a result of its diversified revenue base, strong unrestricted gift revenue, and careful financial management. For FY 2014, the university produced a three-year average operating margin of 11.0%, as calculated by Moody's, with the FY 2014 margin alone of 14.5%. Notre Dame has worked to manage its expenses, reflected in the improvement in operating margin excluding gifts from a positive 0.4% in FY 2012 to a positive 6.4% in FY 2014. Cash flow is strong, with a 21% operating cash flow margin.

The University of Notre Dame is substantially more reliant on tuition and auxiliary revenues, at 44% of FY 2014 operating revenues, than its Aaa-rated peers, primarily due to its relatively lower, but growing, research activity. Notre Dame received $113 million in research awards in FY 2014, up from $96 million the prior year. This is in addition to the University's investment of internal resources to fund new research initiatives. The success is particularly noteworthy as Notre Dame has no medical school, often an important driver of institutional research activity.

BALANCE SHEET POSITION: HEALTHY RESOURCES AND LIQUIDITY CUSHIONS FOR DEBT AND OPERATIONS WITH EXPECTED STRONG GROWTH OVER THE LONG-TERM

The University of Notre Dame will continue to show strong balance sheet resources and internal liquidity. Cash and investments, excluding those funds managed for other religious organizations, grew to $9.5 billion for FY 2014, up from $8.1 billion the prior year and well above the $7.1 billion pre-recession peak in FY 2008. Expendable financial resources of $7.1 billion, as calculated by Moody's, provide strong cushions of pro-forma debt (including the Commercial Paper Note program at the full size of $200 million) and operations of 6.3 times and annual operations of 7.0 times, respectively.

Notre Dame has a strong internal investment management function overseeing its investment portfolio, with a Chief Investment Officer overseeing 16 investment professionals. For the twelve month period ending 6/30/2014, it reported a 19.7% annual investment return, above most institutions. Five and ten-year returns have been consistently greater than benchmarks and many peer institutions. The investment portfolio is highly diversified, with target allocation of 35% in public equities, 15.0% in marketable alternatives, 27.5% private equity, 15% real assets and 7.5% fixed income, with holdings close to the targets.

Liquidity within its endowment is very good, with $1.4 billion of unrestricted monthly liquidity, as calculated by Moody's, or 549 days, substantially higher than the $705 million and 328 days for FY 2010. Monthly liquidity to demand debt is strong at 421%, mitigating the debt structure comprised largely of long-dated bullet maturities with relatively lower principal amortization in early years.

The university is fairly conservative in its debt policy, a key underpinning of the Aaa rating. Notre Dame reports substantial capital plans, although much of them will be funded by gifts and operating cash flow. The next debt issuance is not expected for three to four years. The current capital and financing plans are manageable, particularly given expected balance sheet growth through fundraising and operating cash flow.

Notre Dame demonstrates excellent fundraising in $407 million of reported contributions in FY 2014. Its prior "Spirit" campaign raised $2.0 billion against the $1.5 billion goal, with nearly 68% alumni participation, reflecting its highly supportive, loyal alumni base. Notre Dame is considering a new comprehensive campaign but has not yet determined the size or the timing for a new campaign.

OUTLOOK

The stable outlook reflects expected strong national student demand and continued strong and growing balance sheet reserves, strong cash flow generation and no new debt for the next two years.

WHAT COULD MAKE THE RATING GO UP

Not applicable

WHAT COULD MAKE THE RATING GO DOWN

A rating downgrade could result from weakened balance sheet reserves and liquidity from investment losses, particularly with significant debt issuance, deterioration of operations and cash flow generation to levels inconsistent with Aaa rating, and weakened philanthropic support.

KEY INDICATORS (FY 2014 financial data, fall 2014 enrollment data)

Full-Time Equivalent Enrollment: 12,054 students
Total Financial Resources: $8.7 billion
Total Cash & Investments: $9.8 billion
Total Pro-forma Direct Debt: $1.0 billion
Total Operating Revenue: $1.2 billion
Reliance on Tuition & Auxiliaries Revenue (% of Moody's Adjusted Operating Revenue): 44.5%
Reliance on Investment Income Revenue (% of Moody's Adjusted Operating Revenue): 33.4%
Monthly Days Cash on Hand: 549.2 days
Operating Cash Flow Margin: 21.2%
Three-Year Average Debt Service Coverage: 8.7 times

RATING METHODOLOGIES

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 Variable Rate Instruments Supported by Conditional Liquidity Facilities published in May 2013. Please see the Credit Policy page on www.moodys.com for a copy of these methodologies.

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