**New Issue: Moody's assigns A1 to Case Western Reserve University, OH's $45M Ser. 2013 and related ratings; outlook stable**

Global Credit Research - 31 Oct 2013

$535M debt affected

CASE WESTERN RESERVE UNIVERSITY, OH
Private Colleges & Universities
OH

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<th>Moody's Rating</th>
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<td>Revenue Refunding Bonds, Series 2013</td>
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<td>Sale Amount</td>
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Moody's Outlook STA

Opinion

NEW YORK, October 31, 2013 --Moody's Investors Service has assigned an A1 rating to Case Western Reserve University's (CWRU) 2013 Series revenue refunding bonds issued through the Ohio Higher Educational Facility Commission. We have affirmed existing ratings for all rated debt (see RATED DEBT). The rating outlook is stable.

The rating and outlook are based on the university's sizeable operations, ample total financial resources and national reputation counterbalanced by moderate unrestricted liquidity, a complex debt structure, and narrow operating margins.

**SUMMARY RATING RATIONALE**

The A1 rating reflects Case Western Reserve University's substantial financial resources driven by healthy fundraising and strong reputation as a comprehensive urban research university with prominent graduate and professional programs in science, technology, engineering, and mathematics (STEM) fields and growing undergraduate reputation. The university's strengths are offset by a complex debt structure which could result in calls on the university's moderate liquidity, as well as modest operating performance and debt service coverage for the rating category. The stable outlook is driven by our expectation that the university will generate close to breakeven operating performance and that the cushion of expendable financial resources to debt will not materially decrease nor will unrestricted liquidity. It also assumes no additional debt plans beyond issuing debt for a potential housing project.

The VMIG 1 ratings on Series 2001 and Series 2002A bonds reflect the presence of standby bond purchase agreements supporting the tender feature of those bonds.

The short-term P-1 rating on CWRU's commercial paper programs (authorized up to $90 million) reflects the university's access to adequate daily liquidity, including two backup bank facilities provided by JPMorgan Chase and Northern Trust, as well as the available funds with weekly liquidity which could be shifted to investments with same-day liquidity should the bank liquidity facilities be terminated prior to the expiration date.

**STRENGTHS**

*The university's total financial resources of $1.7 billion are sizeable, reflecting a history of philanthropic support. Investment income is a relatively small (9.3%) but important component of the university's revenue base. Expendable financial resources provide an adequate cushion of pro-forma debt of 1.3 times.*
Case Western Reserve is building on its strong reputation as a large private research university with a wide array of graduate and professional programs to become increasingly selective at the undergraduate level.

A history of healthy philanthropic support is evidenced by raising gift revenue averaging more than $72 million annually from FY 2010 - FY 2013. The university has raised more than 90% toward its $1 billion campaign goal.

A large revenue base and revenue diversity are a distinct advantage to leverage economies of scale and achieve greater levels of efficiency in an increasingly competitive environment.

CHALLENGES

The university’s debt structure could result in unexpected calls on liquidity, with 57% of pro-forma variable rate demand debt (before swaps), and an extensive swap portfolio. The university also has large unfunded investment commitments.

A large portion of the university’s net assets are permanently restricted, limiting financial flexibility. Unrestricted monthly liquidity of $323 million provides a modest 166 days cash on hand and includes $25 million drawn on an operating line of credit for seasonal cash flow.

The university operates in a highly competitive undergraduate student market, evidenced by a relatively low matriculation rate of 16% in fall 2013 and modest decline in net tuition per student.

CWRU may face challenges in growing its research endeavors given the increasingly competitive environment for federal research funding. Grants and contracts comprise over 40% of total revenues.

Tepid investment returns relative to peer institutions and an elevated endowment spend rate to fund the capital campaign have limited financial resource growth.

DETAILED CREDIT DISCUSSION

USE OF PROCEEDS: The proceeds of the bonds will be used to refund all or a portion of the currently outstanding Series 2004A bonds and pay issuing costs.

LEGAL SECURITY: General obligation of the university; the bonds and CP are also secured by a guaranty agreement under which the university unconditionally guarantees full and prompt payment of principal and interest on the bonds and CP.

DEBT STRUCTURE: In FY 2013, total debt was approximately $588.5 million, including the fully drawn CP program authorized at $90 million. Of total debt, 57% has a variable interest rate and could be put back to the university. Peak debt service of $41.4 million occurs in FY 2023. There was no extension of maturity with the refunding.

DEBT-RELATED DERIVATIVES: CWRU has entered into five floating-to-fixed interest rate swap agreements for a total notional amount of approximately $177.2 million. All but one are non-amortizing and Morgan Stanley (rated Baa1/P-2 on review for downgrade) is the counterparty. Under the agreements, CWRU may be and has been required to post collateral at its current rating level if the liability to the university exceeds $20 million with a minimum transfer of $1 million. The swaps had a market valuation of $25.7 million against CWRU as of October 25, 2013. As of that date, the university was posting $4.8 million of collateral. If the rating were to deteriorate, the collateral posting thresholds would decline.

SHORT-TERM RATINGS: The Series 2001A and 2002A bonds are supported by standby bond purchase agreements (SBPA) from Wells Fargo Bank, National Association (rated Aa3/P-1) with a scheduled expiration date of June 15, 2015. For more information on the SBPA terms, please refer to Moody’s report dated May 25, 2012.

The Series 2008A bonds are supported by a letter of credit (LOC) agreement with PNC Bank (rated A2/P-1). Management reports that it has a tentative agreement with PNC to extend the LOC beyond the January 1, 2014 expiration date. The Series 2008B-1 and 2008B-2 bonds are supported by an LOC with US Bank, NA (Aa3/P-1). For more information on the LOC terms for the Series 2008A bonds and 2008B bonds, please refer to Moody’s reports dated January 3, 2011 and April 27, 2011, respectively.

Case Western Reserve has a commercial paper program sized at $90 million, the full amount of which is outstanding. The obligation to pay CP at maturity is a general obligation of CWRU, and the university expects to
pay for any CP which is not rolled over from its internal liquidity as well as two Credit Agreements (liquidity facilities) provided by JPMorgan not to exceed $60 million and Northern Trust not to exceed $30 million. The university currently has $90 million in commercial paper issued.

The liquidity facilities are dedicated to the purchase of CP and cannot be used for other operating purposes. The termination date for both facilities is February 25, 2015.

MARKET POSITION/COMPETITIVE STRATEGY: LEADING PRIVATE RESEARCH UNIVERSITY WITH STRONG GRADUATE PROGRAMS AND HIGHLY COMPETITIVE MARKET FOR UNDERGRADUATES

CWRU’s student market position is gradually improving as it has been able to successfully translate its strong reputation at the graduate level into overall enrollment growth and increased undergraduate demand. Total full-time equivalent (FTE) enrollment of 9,622 students is up nearly 8% over the past five years, and around 20% since 2005. Significant first-year application growth has resulted in the university becoming more selective, now accepting 42% of applicants compared to over 70% five years ago. At the same time, the university has been able to increase the geographic diversity of its entering class, with over 70% of students now drawn from outside of Ohio, compared to less than half in the mid-2000s. As CWRU becomes more national, its exposure to regional Ohio high school demographics, which are weak, lessens.

Located in Cleveland, Ohio CWRU offers a wide array of undergraduate, as well as graduate and professional programs including a law school and medical school. Approximately 48% of students are graduate. The university's medical school is principally affiliated with University Hospitals Health System Inc.(rated A2), but also has collaborative relationships with a number of Cleveland healthcare providers, such as the Cleveland Clinic Health System Oblig. Group (rated Aa2) and county hospitals. The university continues to expand its masters programs, particularly in the health science areas.

CWRU has a strong research profile with a significant amount of federally sponsored research, which exposes it to the weak federal research environment. Research is also relatively concentrated, a vulnerability with the majority of its grants from federal agencies, including the largest share from the National Institutes of Health (88%) followed by the National Science Foundation and then the Department of Education. Research expenses were FY 2013 with $257 million in research expenditures, representing 33% of operating expenses.

OPERATING PERFORMANCE: MANAGEMENT COMMITMENT TO IMPROVE OPERATING PERFORMANCE PROVES CHALLENGING

Through a combination of deliberate expense containment and net tuition revenue growth, the university has achieved improved financial performance from prior years. The university’s operating margin for the past two years was close to breakeven. The cash flow margin was nearly 10% in FY 2013 producing a three-year average debt service coverage of 2.1 times.

Based on the university’s 2014 budget and its growth in enrollment for Fall 2013, we expect CWRU to continue to generate balanced operational performance. Improvement of operating performance to consistently produce at least breakeven results and healthier cash flow margin, as calculated by Moody’s, would be credit positive.

BALANCE SHEET POSITION: SIZEABLE FINANCIAL RESOURCES BUT A LARGELY RESTRICTED ENDOWMENT LIMITS FINANCIAL FLEXIBILITY

Case Western Reserve maintains solid financial resources with total financial resources of $1.7 billion in FY 2013. We anticipate growth of overall financial resources in FY 2014 as the university is in the midst of a $1 billion comprehensive campaign, with 90% raised to date. Gift revenue has increased for three consecutive years, averaging over $72 million in gifts per annum from FY 2011-FY 2013.

While fundraising is favorable, we don't anticipate substantial improvement in unrestricted financial resources over the next several years due to still thin operating margins, various capital initiatives, and history of largely receiving restricted gifts.

The university plans to issue approximately $40 million to construct a 300-bed residence hall, which will increase the on-campus housing stock to around 4,200 bed to accommodate its 2-year residency requirement for undergraduate. We believe the university can absorb this debt at the current rating given strong housing occupancy (100%) and demand, with associated new revenues.

Additional capital plans include construction of a medical education building with the Cleveland Clinic. The university plans to fundraise its portion of the construction costs. At this time, approximately $20 million has been
pledged to the project by two foundations. Other projects include renovation of existing buildings into a performance arts center and small studio arts school. Management indicates no additional debt will be issued but it will continue to draw the full $90 million of its CP program, $27 million of which it is currently using to bridge finance pledge payments.

As of June 30, 2013, the university’s $1.3 billion investment pool produced a modest 7.5% return compared to an 11.2% return experienced by universities with endowments between $1-$3 billion. The university’s investment portfolio was allocated as follows: 21% hedge funds, 17% private equity, 16% international equity, 13% domestic equity, 10% cash, 9% commodities, 7% real estate and 6% fixed income. The investment portfolio is highly diversified among funds and managers, with the largest exposure of 5% to one manager across different asset classes in the portfolio. The university reported $161 million in unfunded commitments at June 30, 2013.

MANAGEMENT AND GOVERNANCE: FINANCIAL MANAGEMENT TEAM FOCUSED ON IMPROVING OPERATING PERFORMANCE AND INCREASING LIQUIDITY

The financial leadership team continues to focus on improving operating performance, increasing liquidity, and growing philanthropy. Management’s strategy for improved operations is to increase revenue through addition or enhancement of higher net revenue graduate programs but the primary focus is on expense monitoring and containment. This focus is evident in improved results.

To manage the university’s large investment portfolio, CWRU has an in-house investment office with an investment staff that has deep expertise to manage its diverse portfolio, including a chief investment officer, three directors, a manager of operations, and a new investment analyst. The university does not utilize a consultant to select its managers and the board’s investment committee remains active.

SELF-LIQUIDITY: ADEQUATE COVERAGE OF COMMERCIAL PAPER PROGRAM; PRESENCE OF DEDICATED BANK LINES IS IMPORTANT GIVEN OTHER POTENTIAL CALLS ON LIQUIDITY

As of September 30, 2013, the university had approximately $239.2 million in discounted daily liquid assets, with approximately $175.1 million across multiple 2a-7 compliant money market funds meeting Moody’s criteria for a Aaa-mf rating [State Street Global Advisors (SSgA), JP Morgan, Federated Bank, and Blackrock]. The remaining $64.1 million is across three checking accounts of P-1 rated banks. The coverage of the fully drawn $90 million of the CP program was 3.66 times with the JP Morgan and Northern Trust backup bank facilities (currently sized at $60 million and $30 million, respectively) and 2.66 times without the facilities. When excluding the largest SEC 2a-7 compliant money market fund that meets Moody’s criteria for a Aaa-mf rating, $145.6 million with State Street, CWRU’s daily liquidity with the backup bank facility was 2.04 times coverage of debt. Without the backup bank facility coverage falls to 1.04 times. The university had $62.9 million in discounted weekly liquidity, which could be converted to daily liquidity if the bank lines were terminated.

OUTLOOK

The stable outlook reflects our expectation that the university will maintain at least balanced operating performance, no significant deterioration in unrestricted liquidity and no additional debt in the near-term.

WHAT COULD CHANGE THE RATING UP

The university’s rating could be upgraded with a material growth in unrestricted liquidity and strengthening of operating cash flow.

WHAT COULD CHANGE THE RATING DOWN

The rating could be lowered with additional borrowing, a return to larger deficit operations, or weakening liquidity.

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

Full-Time Equivalent Enrollment: 9,622 students
Primary Selectivity: 41.9%
Primary Matriculation: 19.3%
Net Tuition per Student: $22,600
Educational Expenses per Student: $48,750
Average Gifts per Student $7,008
Total Cash and Investments: $1.5 billion
Total Pro-forma Direct Debt: $628.5 million
Total Prof-forma Comprehensive Debt*: $669.3 million
Expendable Financial Resources to Pro-forma Direct Debt: 1.3 times
Expendable Financial Resources to Operations: 1.0 times
Monthly Days Cash on Hand: 165.5 days (excluding CCLCM expenses); 259.0 days (excluding all research expenses)
Monthly Liquidity to Pro-forma Demand Debt: 101.2%
Operating Revenue: $767.5 million (excluding CCLCM revenue)
Operating Cash Flow Margin: 9.9%
Three-Year Average Debt Service Coverage: 2.88 times
Reliance on Tuition and Auxiliaries Revenue (% of Moody's Adjusted Operating Revenue): 36.6% (excluding CCLCM revenue)
Reliance on Grants and Contracts Revenue (% of Moody's Adjusted Operating Revenue): 42.9%; (excluding CCLCM revenue)
* Comprehensive Debt includes direct debt and pension obligation.

RATED DEBT
Series 2004A: A1 rating, certain maturities of the Series 2004 bonds are insured by Ambac [Expected to be refunded with the Series 2013 bonds]
Series 2006: A1 rating, insured by National Public Finance Guarantee Corp, formerly MBIA
Series 2008A: A1 underlying rating, Aa2/VMIG1 rating (based on letter of credit provided by PNC Bank, N.A. (rated A2/P-1) and Moody's joint support analysis; LOC expires on 1/1/2014)
Series 2008 B-1 and B-2 bonds: A1 underlying rating, Aa1/VMIG1 rating (based on letter of credit provided by U.S. Bank National Association (rated Aa3/P-1) and Moody's joint support analysis; LOC expires on 04/01/2014)
Commercial Paper Program: P-1 (self liquidity, including two back up bank facilities)
The principal methodology used in the commercial paper rating was Rating Methodology for Municipal Bonds and Commercial Paper Supported by a Borrower's Self-Liquidity published in January 2012. The principal methodology used in the variable rate rating was Variable Rate Instruments Supported by Conditional Liquidity Facilities published in May 2013. The principal methodology used in the long-term rating was U.S. Not-for-Profit Private and Public Higher Education published in August 2011. Please see the Credit Policy page on www.moodys.com for a copy of these methodologies.

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Analysts

Erin V. Ortiz
Lead Analyst
Public Finance Group
Moody's Investors Service

Diane F. Viacava
Backup Analyst
Public Finance Group
Moody's Investors Service

Susan Fitzgerald
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
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