Duquesne University, PA

New Issue: Moody’s assigns A2 to Duquesne University’s (PA) 2016 Bonds; outlook stable

Summary Rating Rationale
Moody’s Investors Service has assigned an A2 rating to Duquesne University of the Holy Spirit’s proposed $50 million Series 2016 Refunding Bonds to be issued through Allegheny County Higher Education Building Authority. We have also affirmed the A2 on outstanding rated debt. The outlook is stable.

The A2 rating reflects Duquesne’s close financial management that results in consistently strong operating performance, providing resources for regular capital investment and contributes to balance sheet reserve growth. The rating also incorporates the university’s market profile as an urban, Catholic institution with a breadth of programming for undergraduate and graduate students. These strengths are offset by a high reliance on student charges, elevated leverage, and the highly competitive student market.

Credit Strengths
» Consistently healthy operations, reflected by a 15% cash flow margin in fiscal 2015 and 3.1 times average debt service coverage (fiscal 2013-15)
» Very good strategic positioning, supported by multi-year planning, regular capital investment, and overall market stability
» Established market position as a private, Catholic institution with comprehensive undergraduate and graduate programming
» Predictable debt structure with all fixed-rate and amortizing debt

Credit Challenges
» Very competitive core market, evidenced by recent years of modest enrollment declines, limits pricing flexibility and suppresses tuition revenue growth
» High reliance on student charges, which represent 88% of fiscal 2015 operating revenue
» Thin, but improving coverage of balance sheet reserves to debt and operations of 1.5 times and 0.85 times, respectively
» Modest fundraising profile, with average gifts per student of $1,310, which represents about one-third of the A-rated private university median
Rating Outlook
The stable outlook reflects expectations that Duquesne will maintain cash flow in the 13-15% range, and has no additional debt plans.

Factors that Could Lead to an Upgrade
» Significant growth in spendable cash and investments, providing a stronger cushion to debt and operations
» Substantial increase in flexible reserves
» Demonstrated ability to increase operating revenue

Factors that Could Lead to a Downgrade
» Continued softening in student demand leading to reduction of net tuition revenue
» Deterioration in operating performance
» Large debt issuance, absent concurrent growth in balance sheet reserves

Key Indicators

Recent Developments
Incorporated in Detailed Rating Considerations

Detailed Rating Considerations
Market Profile: Urban, Catholic Institution with Solid Demand Despite Heightened Competition
Duquesne's stable market position will continue to be supported by its comprehensive programming, urban location, and established regional presence as a private, Catholic university. In fall 2015, the university enrolled 8,876 full-time equivalent (FTE) students, which represents a 7% decline from the fall 2010 peak. These declines were largely driven by falling enrollment in certain graduate programs, including law. However, based on volumes of admission and indications of intentions to enroll, modest increases in both undergraduate and graduate enrollment are expected in fall 2016.

Fierce regional competition from both private and public institutions will remain a key market challenge and suppress net tuition revenue growth. Improving the geographic concentration of the student body is critical, as about 71% of students are from...
Pennsylvania, a state with declining numbers of high school graduates. In addition, the university has a high reliance on student charges, representing 88% of fiscal 2015 operating revenue, which could result in operating pressure in the event of student demand softening. Favorably, efforts to better align programs with market demand, increase retention, and improve recruitment practices will contribute overall enrollment stability.

**Operating Performance: Budget Discipline Yields Consistent Surplus Operations**
A culture of fiscal discipline, with a particular focus on expense containment, will contribute to ongoing healthy operating margins. Over the last three years, cash flow has remained steady at around 15%, which provided ample debt service coverage, resources for capital investment, and balance sheet reserve growth. Fiscal 2016 operating performance will be comparable to slightly weaker than fiscal 2015, as missed enrollment targets required the university to implement mid-year budget adjustments. Favorably, management identified a series of measures that will generate sustainable cost savings and will contribute to surplus operations beyond fiscal 2016. This ability and willingness to reduce expenses is a source of operating stability, and is especially important during periods of revenue moderation.

**Wealth and Liquidity: Balance Sheet Reserve Growth Largely Driven By Retained Cash Flow**
Balance sheet reserve growth will continue to be anchored by the healthy operations, leading to retained excess cash flow. Over the last three years, spendable cash and investments increased a substantial 42% to $230 million in fiscal 2015. This growth was primarily supported by surplus operations, donor support, and solid investment returns in fiscal years 2013-14.

Although donor support contributed to reserve growth, the university’s fundraising lags peers. The three-year average gift revenue (fiscal 2013-15) of $11.6 million remains comparably weaker than the fiscal 2014 A-rated large private university median of $20.3 million. The university is investing in its fundraising infrastructure, with a particular emphasis on the annual fund growth and financing strategic capital projects.

The university’s endowment, which is managed through the board with assistance of an external investment advisor, has generated five and 10-year annualized returns of 4.8% and 4.5%, respectively as of December 31, 2015. This return is lower than NACUBO benchmarks. Over the last two years, the university has added more investment expertise to its board and has revised its asset allocation benchmarks to align more closely with peers, shifting more funds towards alternative investments.

**LIQUIDITY**
Duquesne’s unrestricted liquidity will continue to provide a solid cushion to any unexpected financial pressures. The fiscal 2015 monthly liquidity of $172 million provides 252 days cash on hand. With an all fixed-rate debt structure, level debt service payments, and continuously healthy operations, potential unexpected calls on liquidity are limited to a $3 million unfunded commitment.

**Leverage: Relatively Thin Coverage of Balance Sheet Reserves to Debt and Operations**
With no upcoming debt plans and ongoing principal amortization, the coverage of balance sheet reserves to debt and operations will continue to strengthen. In fiscal 2015, spendable cash and investments cushioned debt and operations 1.5 times and 0.85 times, respectively. Although modest relative to A2 rated peers, the university’s leverage position has improved significantly, despite a five-year period of capital spending that averaged nearly 2 times depreciation. This strategy of consistent capital investment mitigates the need for debt funded projects in the future.

**DEBT STRUCTURE**
All debt is fixed rate and amortizing, which provides predictable costs to incorporate into budget models. Debt service is level through 2031, before stepping down through the 2034 final maturity. A rate covenant requires the university to establish charges that are sufficient to meet debt service payments. Debt service coverage, at 2.8 times in fiscal 2015, will remain healthy given the ongoing student demand.

**DEBT-RELATED DERIVATIVES**
None
PENSIONS AND OPEB
Exposure to post-employment benefits is manageable within the scope of operations, and poses minimal credit risk. Combined annual expense for the defined contribution plans and retirement healthcare plan was $9 million, representing a modest 3% of fiscal 2015 operating expenses.

Governance and Management: Strong Oversight and Integrated Planning
Duquesne’s very good strategic positioning is supported by its multi-year financial planning, consistent capital investment, and market strengthening initiatives. Strong fiscal management is demonstrated by consistent surplus operations despite modest enrollment declines. Budgets are conservative, incorporating depreciation and contingencies, and the university maintains very good operating flexibility to adjust expenses during periods of revenue pressures. Through careful planning, the university has grown balance sheet reserves, while concurrently investing in capital upgrades with limited use of debt.

Legal Security
All of the university’s rated debt is a general obligation of the university, secured by student tuition and fees. There is no debt service reserve fund.

Use of Proceeds
Proceeds of the Series 2016 bonds will be used to refund all or a portion of the 2008A and 2011A bonds for net present value savings.

Obligor Profile
Duquesne University of the Holy Spirit is a private, Catholic university located in Pittsburgh, PA. Originally established in 1878, the university now offers a broad menu of undergraduate and graduate programs, including business, law, health sciences, liberal arts, music, pharmacy, education, environmental/natural sciences, and nursing. Duquesne had fiscal 2015 operating revenue of $285 million and fall 2015 enrollment of 8,876 full-time equivalent students.

Methodology
The principal methodology used in this rating was Global Higher Education published in November 2015. Please see the Ratings Methodologies page on www.moodys.com for a copy of this methodology.

Ratings

<table>
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<tr>
<th>Issue</th>
<th>Rating</th>
<th>Rating Type</th>
<th>Sale Amount</th>
<th>Expected Sale Date</th>
<th>Rating Description</th>
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<tbody>
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<td>University Revenue Refunding Bonds, Series of 2016</td>
<td>A2</td>
<td>Underlying LT</td>
<td>$50,345,000</td>
<td>04/11/2016</td>
<td>Revenue: 501c3 Unsecured General Obligation</td>
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Source: Moody’s Investors Service
Moody’s Investors Service

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