Vanderbilt University, TN

Update following upgrade to Aa1; outlook stable

Summary

Vanderbilt University’s (Aa1 stable) superior credit strength reflects its ongoing asset growth enhancing already strong credit fundamentals, and contributing to improved, excellent strategic position. Vanderbilt’s pro forma total cash and investments of $6.9 billion including over $2 billion of unrestricted monthly liquidity provide it with significant flexibility, and partially mitigate some ongoing risk associated with the still relatively new organizational reorganization with VUMC. Our opinion and pro forma data includes the anticipated $1.4 billion increase to unrestricted liquidity in July 2018 as the university monetized a portion of the trademark license royalties it receives from its clinical partner, Vanderbilt University Medical Center (VUMC, A3 stable), for 30 years. The university’s excellent student market position, sponsored research prowess, manageable capital needs and prospects for ongoing donor support also support strengthening credit quality. These credit strengths are counterbalanced by indirect exposure to patient care revenue from VUMC, and strong competition for students.

On July 5, 2018 Moody’s upgraded Vanderbilt’s revenue bonds to Aa1 from Aa2 and changed the outlook to stable from positive.

Exhibit 1

Recent trademark license revenue monetization strengthens the university’s total wealth and wealth relative to expenses following medical center reorganization

Source: Moody’s Investors Service
Credit strengths

» Substantial total wealth with pro forma total cash and investments of $6.9 billion

» Excellent student demand for comprehensive university with yield on admitted students of 47% in fall 2017

» Strong donor support aids competitive strength with total gift revenue of $92 million in fiscal 2017

» Highly manageable financial leverage with multiple sources of funding for capital projects limiting prospects for dramatic change in total debt

» Capable treasury management and strong self liquidity supporting commercial paper program

Credit challenges

» Significant indirect exposure to more volatile healthcare enterprise that comprised 23% of operating revenue in fiscal 2017

» Stiff competition from reputational peers including those with much higher wealth per student and strong philanthropic support

» Increasing reliance on investment income underscores the potential vulnerability to market losses

Rating outlook

The stable outlook assumes the maintenance of the university’s core credit strengths including student market, donor support and a substantial cushion of total cash and investments relative to debt and expenses. The stable outlook is predicated on expectations of at least adequate operating performance at VUMC.

Factors that could lead to an upgrade

» Marked increase in total wealth including flexible reserves

» Ongoing momentum in student market and donor support profile

Factors that could lead to a downgrade

» Material and sustained decline in credit health of VUMC

» Deterioration of operating performance

» Steep decline in total wealth including unrestricted liquidity

» Significant increase in financial leverage

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Key indicators

Exhibit 2

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<tbody>
<tr>
<td>Total FTE Enrollment</td>
<td>12,229</td>
<td>12,143</td>
<td>12,060</td>
<td>12,085</td>
<td>12,052</td>
<td>12,052</td>
<td>3,110</td>
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<tr>
<td>Operating Revenue ($000)</td>
<td>3,704,338</td>
<td>3,917,740</td>
<td>4,152,458</td>
<td>1,259,375</td>
<td>1,329,667</td>
<td>1,329,667</td>
<td>256,351</td>
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<tr>
<td>Annual Change in Operating Revenue (%)</td>
<td>-0.8</td>
<td>5.8</td>
<td>6.0</td>
<td>-69.7</td>
<td>5.6</td>
<td>5.6</td>
<td>4.3</td>
</tr>
<tr>
<td>Total Cash &amp; Investments ($000)</td>
<td>5,173,781</td>
<td>5,574,393</td>
<td>5,868,323</td>
<td>5,009,687</td>
<td>5,431,077</td>
<td>6,861,077</td>
<td>1,255,627</td>
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<tr>
<td>Total Debt ($000)</td>
<td>1,319,128</td>
<td>1,275,999</td>
<td>1,222,339</td>
<td>299,980</td>
<td>366,480</td>
<td>538,000</td>
<td>269,880</td>
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<td>Spendable Cash &amp; Investments to Total Debt (x)</td>
<td>3.1</td>
<td>3.5</td>
<td>3.9</td>
<td>12.7</td>
<td>11.4</td>
<td>10.4</td>
<td>3.5</td>
</tr>
<tr>
<td>Spendable Cash &amp; Investments to Operating Expenses (x)</td>
<td>1.1</td>
<td>1.2</td>
<td>1.2</td>
<td>3.4</td>
<td>3.5</td>
<td>4.7</td>
<td>2.9</td>
</tr>
<tr>
<td>Monthly Days Cash on Hand (x)</td>
<td>201</td>
<td>220</td>
<td>218</td>
<td>654</td>
<td>620</td>
<td>769</td>
<td>458</td>
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<tr>
<td>Operating Cash Flow Margin (%)</td>
<td>10.8</td>
<td>10.3</td>
<td>11.0</td>
<td>17.6</td>
<td>16.7</td>
<td>16.7</td>
<td>15.8</td>
</tr>
<tr>
<td>Total Debt to Cash Flow (x)</td>
<td>3.3</td>
<td>3.2</td>
<td>2.7</td>
<td>1.4</td>
<td>1.7</td>
<td>2.4</td>
<td>5.0</td>
</tr>
<tr>
<td>Annual Debt Service Coverage (x)</td>
<td>3.9</td>
<td>3.9</td>
<td>4.6</td>
<td>3.2</td>
<td>13.0</td>
<td>13.0</td>
<td>3.1</td>
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2017 pro forma column estimates impact of receipt of $1.43 billion of cash in July 2018 invested in the long-term endowment with 32% liquid within one month as well as $185 million net increase in debt for student housing and other capital projects through fiscal 2019.

Source: Moody’s Investors Service

Profile

Vanderbilt University is a private research university located in Nashville, Tennessee. Total full-time equivalent (FTE) enrollment for the university’s comprehensive array of undergraduate, graduate, and professional programs stood at 12,052 in fall 2017. Undergraduate students comprised approximately 57% of the University's total FTE enrollment.

Detailed Rating Considerations

Market profile: comprehensive research university with excellent demand

Vanderbilt’s diverse academic programs and solid reputation will continue to translate into very strong student demand. Demand for academic programs when combined with its financial strength and exceptional strategic planning provide the university with excellent strategic positioning. The university benefits from demand for graduate and professional programs that comprise around 43% of enrollment. Declining selectivity and increasing yield on admitted students indicates strengthening demand for undergraduate programs. For fall 2017 selectivity was 10.9% while yield came in at 47.1%. Management guidance for fall 2018 indicates ongoing gains.

Net tuition per student has grown steadily, reaching $23,308 in fiscal 2017. The university’s commitment to socioeconomic diversity within its student body has translated into increasing tuition discounting which reached 45% in fiscal 2017. Vanderbilt increasingly competes with other top private universities across the US. Those top competitors typically have more than twice the wealth per student than Vanderbilt, allowing them greater ability to fund merit and need based student aid.

The university’s sizeable research enterprise remains stable, with significant exposure to federal funding. Grant and contract revenue totaled $237 million in fiscal 2017, not including the research activities of VUMC. Similar to other research universities, Vanderbilt faces the challenge of an increasingly competitive federal research funding environment and likely increased reliance on private funding and internal support.

Operating performance: strong performance aided by diverse revenue streams and reduced indirect patient care exposure

Vanderbilt’s operating performance will remain strong with prospects buoyed by sound financial planning and prudent endowment spending. The reorganization of VUMC favorably altered the university’s operating performance and revenue diversity. In fiscal 2015 before restatement, 68% of the university’s $4 billion of operating revenue came from patient care, in fiscal 2017 the largest revenue source was tuition and auxiliaries at 32% of operating revenue. The university’s operating health, however, will remain tethered to the fiscal health of the separate VUMC. The affiliation agreement between the university and the new not-for-profit includes various flow of funds and exchanges. On a combined basis these revenue sources comprised 23% of the university fiscal 2017 revenue base.

The reconfigured university has more favorable operating cash flow performance, moving to a 17% cash flow margin in fiscal 2017. Vanderbilt’s practice of spending less than 5% of trailing average of endowment value translates into stronger operating performance
and supports growth of the endowment’s inflation adjusted spending power over time. Investment income as a portion of overall revenue was 21% in fiscal 2017 and will edge upward from the revenue monetization of a portion of the trademark license royalties for 30 years.

Prospects for solid operating performance over time are also bolstered by management’s close attention to overhead costs. Concerted efforts to rein in the costs of support functions and enhance administrative efficiency should continue to support both solid operating performance and programmatic investments.

**Wealth and liquidity: growth aided by monetization and donor support**

Vanderbilt remains well poised to continue to increase its wealth through donor support, prudent investment management and retained surpluses. Total cash and investments were $5.4 billion at fiscal year end 2017, underpinning its credit strength and providing a substantial buffer. Favorably, over $4 billion of the university’s cash and investments are spendable.

On July 3, 2018 the university received $1.43 billion of net proceeds from the sale of a portion of its base trademark license revenue from VUMC. The sale involves only a portion of the revenue its receives from VUMC and runs through fiscal 2048 for that portion.

Exhibit 3

**Vanderbilt sold a portion of its trademark license revenue including a base payment with 3% inflation rate from VUMC for $1.4 billion**

Source: Vanderbilt University

With engaged alumni and a solid track record of donor support, the university will continue to fund incremental program investments made possible through philanthropy. Total gift revenue was $92 million in fiscal 2017. This is a strong level but below some of the university’s competitive peers.

Vanderbilt’s well diversified endowment had an 11.5% return in fiscal 2017. Endowment liquidity remains solid with 45% of the pool available within one quarter. Unfunded commitments as of June 30, 2017 were approximately 12% of the total pool.

**Liquidity**

With a variety of potential liquidity demands from university operations, self liquidity debt, less likely swap collateral posting and private capital commitments, Vanderbilt maintains strong liquidity. Monthly liquidity at June 30, 2017 of $1.9 billion translates to a strong 620 monthly days cash on hand.

As of March 31, 2018, Vanderbilt had $408 million of discounted daily liquidity, providing strong coverage of $115 million of commercial paper backed by the university’s self-liquidity program. In addition to its internal liquidity, Vanderbilt has a dedicated lines of credit in place for a combined $200 million of external liquidity.

**Leverage: low leverage for comprehensive university**

The reorganization materially reduced Vanderbilt’s financial leverage. With limited plans for additional debt, we expect the university’s financial leverage to remain highly manageable. In May the university executed term sheets for $300 million of taxable private placement debt which it will draw on in November 2018. Management anticipates that $115 million of the proceeds will be used to
retire all of the commercial paper outstanding. The remaining $185 million will fund a portion of the cost of its residential college program. CP use will likely remain limited over the next several years.

**Debt structure**

Since 2010 the university has continued to reduce debt structure related risks. All of the university's bonded debt is fixed rate, with commercial paper comprising variable rate debt. As of October 1, 2017 commercial paper comprised 32% of total debt. Following the expected retirement of all outstanding CP later this year all of the university's debt will be fixed rate.

**Debt-related derivatives**

Vanderbilt's swap exposure has been significantly reduced though the exercise of termination options, with $164 million of remaining fixed-payer swaps as of fiscal 2017. The notional amount has since reduced to $112 million. Collateral posting requirements also declined over time with no collateral posted as of or since fiscal year end 2017. The remaining derivative risks are partially mitigated by management’s close attention to liquidity management and modeling of exposure to potential changes in LIBOR.

**Pensions and OPEB**

Vanderbilt's eligible employees participate in a defined contribution plan. The university's manageable contributions were $18.6 million in fiscal 2017, just over 1% of operating expenses.

**Legal security**

Debt repayment is a general unsecured obligation of the university.

**Governance and management: leadership stability and strategic planning enhance profile**

Vanderbilt University's governance and management should continue to enhance its credit strength. The strategic planning involved in the decision to proceed with the reorganization of the medical center is emblematic of a broader approach to position the university for long-term strength. A recently completed strategic planning process reaffirmed the university’s commitment to offer both a highly residential undergraduate education as well as remaining a leading research university.

Key management positions have remained stable. While the reorganized medical center not-for-profit has a separate board, some key members of Vanderbilt University’s leadership also have roles on the new corporation’s board. The assessment of the ties and the working relationship of the two organizations will help inform our assessment of the degree of risk transfer under the reorganization.
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