FITCH AFFIRMS VANDERBILT UNIVERSITY (TN) REVS AT 'AAA'; OUTLOOK STABLE

Fitch Ratings-New York-15 November 2018: Fitch Ratings has affirmed the 'AAA' long term ratings on the following bonds issued by the Health and Educational Facilities Board of the Metropolitan Government of Nashville and Davidson County, Tennessee on behalf of Vanderbilt University (VU):

--$2.4 million revenue bonds, series 2009A;
--$106.2 million revenue refunding bonds, series 2012D;
--$127.9 million taxable revenue bonds, series 2016.

In addition, Fitch has affirmed the 'F1+' short-term ratings on VU's $200 million taxable and tax-exempt commercial paper (CP) program.

The Rating Outlook is Stable.

SECURITY

The bonds are an unsecured general obligation of VU, payable from all legally available funds.

KEY RATING DRIVERS

VERY STRONG OPERATING PROFILE: A leading academic reputation and market position drive strong student demand with a broad draw, very selective admissions and high student quality. VU's research enterprise and fundraising also support its strong operating profile.

SOLID FINANCIAL PERFORMANCE: VU has generated consistent and solid operating margins averaging around 6% since the April 2016 reorganization in which the previously consolidated Vanderbilt University Medical Center (VUMC) became a separate legal entity. VU's operating revenue sources are balanced between net student fees, research grants, VUMC contractual payments, and investment income and distributions. Fitch expects future performance in line with recent trends.

SUBSTANTIAL BALANCE SHEET RESOURCES: VU's available funds (cash and investments not permanently restricted) of $4.3 billion at June 30, 2018 equaled 360% of operating expenses and over 900% of debt, well exceeding 'AA' category medians. The recent securitization of 30 years of base payments from VUMC under a Trademark License (TML) agreement generated an additional $1.4 billion of unrestricted proceeds, which VU will invest alongside the endowment over the course of fiscal 2019.

LOW LEVERAGE: The university will maintain a relatively low debt burden despite approximately $275 million of new money debt plans through 2022. Pro-forma maximum annual debt service (MADS) equals only 2.6% of 2018 operating revenue, and 2018 operating cash flow covers pro-forma MADS by a very strong 5.7x. Sizable capital plans, dominated by construction of residential colleges to replace traditional campus housing, are manageable in context of VU's resource base and philanthropic capacity.

SELF-LIQUIDITY COVERAGE: The 'F1+' short-term rating reflects VU's ability to cover the maximum potential liquidity demands presented by its CP program by at least 1.25x from its available liquid resources, including cash, liquidity facilities and highly-rated, liquid investments.

RATING SENSITIVITIES

VUMC EXPOSURE: VU remains strategically aligned with VUMC and receives contractual payments from VUMC for infrastructure, purchased services, research and academic initiatives and trademarks/licensing that are expected to account for approximately 20% of VU's operating revenue going forward. VU has strong standalone financial flexibility, but severe financial stress at VUMC could pressure its operating results.

CREDIT PROFILE

VU is a private comprehensive university located in Nashville, TN. The university serves a total enrollment of 12,824 as of fall 2018 including traditional undergraduates (53%) and graduate and professional students (47%). The previously consolidated VUMC became an independent and legally separate entity in April 2016; the reorganization materially reduced VU's leverage and healthcare exposure. VU and VUMC remain affiliated and strategically aligned, including through ongoing agreements and academic initiatives.

TML SECURITIZATION

In July 2018, VU securitized the next 30 years of base payments due from VUMC under a perpetual Trademark License Agreement (TML). The base TML payment (net) was about $59 million in 2018 and escalates at 3% annually. In exchange for 30 years of TML base payments and certain payments under a promissory note from VUMC, VU received $1.43 billion that will be deployed as quasi-endowment. In addition to increasing VU's available funds, the transaction further reduces VU's revenue exposure to VUMC and replaces a portion of VUMC healthcare risk with investment risk for the 30-year term. VU retains all its enforcement rights under the TML and other VUMC separation agreements, and the university does not expect to securitize other VUMC-related revenue streams at this time.

VERY STRONG MARKET POSITION

VU has a leading academic reputation with highly ranked undergraduate, graduate and professional programs. Enrollment has been held generally flat, with no major growth plans beyond incremental graduate enrollment. VU maintains very strong and still-improving student demand indicators through fall 2018 with growing applications, a freshman acceptance rate below 10% and a matriculation rate approaching 50%. VU has excellent student quality, strong retention and graduation rates and a broad draw, with over 90% of incoming freshmen from out-of-state, including over 10% international.

Fitch believes VU's demand and selectivity provide capacity to generate additional revenue if needed by growing enrollment or increasing net charges per student. However, tuition discounting is nominally high, around 44% in fiscal 2018 for mission-related reasons, as VU has need-blind admissions and commits to meeting all demonstrated need. In addition, a large and growing portion of institutional aid is funded from endowment support dedicated to student aid. VU has a sound fundraising track record supporting scholarships as well as operating and capital needs; its last campaign concluded in 2011 after raising $1.94 billion versus a goal of $1.75 billion. Gifts and pledges have averaged approximately $200 million annually over the past three years.

SOLID FINANCIAL PERFORMANCE

VU has generated strong financial results since the reorganization, with an average operating margin around 6% (including endowment draw) since fiscal 2016 and a 7% margin in 2018. Strong operating performance and cash flow should continue based on steady, moderate revenue growth and continued management of expense growth within the pace of revenue growth. The TML base payment securitization should be generally neutral to cash flow, as a sustainable spending policy applied to the quasi-endowed proceeds will offset the TML base payments.

VU's operating revenue mix is well-balanced between net student fees (about 32% including auxiliaries in fiscal 2018), VUMC payments (about 25%), grants and contracts (18%), and investment income (about 10% including endowment draw). The TML base payment securitization will reduce VUMC exposure to about 20% of total operating revenues in fiscal 2019. Roughly 80% of the remaining VUMC-sourced revenues will be for purchased services and infrastructure charges or for academic and research support -- previously internal transfers that were defined in the separation agreements. The remaining 20% of VUMC-sourced revenue will mainly reflect the un-securitized portion of TML payments, which are variable and depend formulaically on VUMC's financial performance.

SUBSTANTIAL BALANCE SHEET RESOURCES

Substantial balance sheet resources relative to debt and operating expenses are a key credit strength for VU. Available funds totaled $4.4 billion at June 30, 2018, equal to a very strong 360% of operating expenses ($1.2 billion) and a superior 940% of debt ($461 million, including operating leases, outstanding CP and unamortized premium/discount). These measures together are well ahead of 'AA' category peers rated by Fitch.

After factoring in the TML sale proceeds together with upcoming new money debt and capital plans, Fitch expects VU's available funds should remain exceptionally strong and able to absorb periods of market losses at the current rating level. Like other institutions with large endowments, VU maintains significant exposure to alternative and illiquid assets as part of its long-term investment strategy. However, a professional investment management team, detailed oversight and sound liquidity relative to potential cash needs mitigate related risks. Endowment draws are made for operating support according to a sustainable spending policy.

VERY LOW DEBT BURDEN

VU has simplified its debt structure in recent years, and it has a low debt burden after shedding the majority of its debt in the reorganization. VU's debt portfolio (par outstanding) now consists of about $244 million of fixed-rate, amortizing bonds and $115 million of taxable commercial paper. The university terminated $100 million of fixed-payor swap notional value over fiscal years 2017 and 2018. Remaining fixed-payor swaps had a notional value of $112 million at fiscal year-end 2018 (within the $200 million CP authorization) and require no collateral posting.

The university also closed on a $300 million private placement in November 2018. The fixed-rate debt will amortize over 30 years and is on parity with outstanding bonds. Proceeds refunded the $115 million of outstanding CP (as reported at June 30, 2018) and will provide roughly $185 million of total new money. The 2018 new money and an additional $90 million of CP expected to be issued through fiscal 2022 will support the next phases of VU's continuing investment in its approximately $500 million program to move traditional student housing to a residential college model. The remainder of the program will be funded with philanthropy and institutional cash.

Including the 2018 new money, MADS of $34 million still accounts for a very low 2.6% of 2018 operating revenues, and VU generated very strong 5.7x MADS coverage from 2018 operating cash flow.

Liquidity Supports Short-Term Debt

The 'F1+' rating is based on the availability of liquid resources, including cash, liquidity facilities and highly liquid, highly rated securities to cover the maximum liquidity demands presented by VU's CP program. VU maintains available liquid resources (discounted per Fitch's criteria) that are sufficient to cover its maximum potential liquidity requirements of $200 million by more than 1.25x.

VU's maximum authorization for its taxable and tax-exempt CP program is $200 million. In addition, to minimize potential calls on its liquidity, the university limits the amount of CP notes that can come due on a given day to $50 million and in a given week to $100 million. VU regularly updates its key contacts and liquidation procedures detailing the process by which a failed remarketing would be managed.

Contact:

Primary Analyst
Tipper Austin
Director
+1-212-908-9199
Fitch Ratings, Inc.
33 Whitehall Street
New York, NY 10004

Secondary Analyst
Emily Wadhwani
Director
+1-312-368-3347

Committee Chairperson
Kevin Holloran
Senior Director
+1-512-813-5700

Media Relations: Sandro Scenga, New York, Tel: +1 212 908 0278, Email: sandro.scenga@thefitchgroup.com.

Additional information is available on www.fitchratings.com

Applicable Criteria
Rating Criteria for Public-Sector, Revenue-Supported Debt (pub. 26 Feb 2018)
https://www.fitchratings.com/site/re/10020113
U.S. Public Finance College and University Rating Criteria (pub. 26 Apr 2017)
https://www.fitchratings.com/site/re/897285