

Rating Update: Moody's downgrades Wright State University, OH's General Receipts Bonds to A2; outlook stable

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\$73M rated debt

WRIGHT STATE UNIVERSITY, OH
Public Colleges & Universities
OH

NEW YORK, October 16, 2015 --Moody's Investors Service downgrades Wright State University's ("WSU") General Receipts Bonds to A2 from A1. The outlook is stable.

SUMMARY RATING RATIONALE

The downgrade to A2 is based on Wright State University's continuing poor financial performance leading to operating deficits and decline in liquid reserves as well as the uncertain impact of a federal investigation.

The A2 rating acknowledges the university's relatively large scale of operations, still sizeable financial reserves, moderate financial leverage, recent enrollment growth, and good revenue diversity.

The rating also reflects revenue constraints and an inflexible expense base given a highly unionized workforce, and the absence of concrete plans for materially reducing expenses. The A2 rating additionally recognizes the near term challenges of synergizing members of a new senior leadership team at a time of financial stress and distraction from the federal investigation.

OUTLOOK

The stable outlook at the A2 rating level is based on the university's sizeable financial reserves and cushion relative to debt and expenses that mitigate what we expect to be a small operating loss in FY 2016 while the university strengthens fiscal oversight. It also incorporates our expectation that any fine resulting from the federal investigation will be manageable.

WHAT COULD MAKE THE RATING GO UP

- Sustained positive operations and cash flow that provides a cushion for debt service
- Resumed growth in balance sheet reserves
- Strengthening of liquidity

WHAT COULD MAKE THE RATING GO DOWN

- Material diminishment of spendable cash and investments or liquidity
- Failure to improve operating performance and generate cash flow to cover debt service

STRENGTHS

- Diverse revenue base with a relatively large combined total cash and investments held by the university and its foundation
- Manageable financial leverage
- Healthy level of fundraising and private grants for a regional university
- Stabilization of enrollment and expectations for increased state funding

- Conservative fixed rate debt structure with no plans to increase debt in the next two to three years

CHALLENGES

- Historically weak cash flow, which did not cover debt service for FY 2013-FY 2015
- Regaining fiscal balance since tighter expense controls will be new to the university and there are no material expense cuts currently planned
- Use of liquid reserves to fund strategic initiatives which has weakened liquidity, providing just an estimated 98 monthly days cash on hand for FY 2015
- State-mandated tuition freezes leading to lack of tuition pricing flexibility
- Ongoing federal investigation exposes the university to the possibility of additional financial burdens and reputational damage
- Several years of senior leadership turnover in key positions

RECENT DEVELOPMENTS

Wright State is under federal investigation by the Department of Justice for illegal administration of the H-1B visa program. Four university employees have been implicated: the provost and a researcher were stripped of their administrative duties but remain employed as faculty members under collective bargaining agreements; the provost's senior advisor was dismissed by the university and the general counsel resigned and subsequently retired.

Since uncovering the violation, WSU has reorganized the provost and financial management offices to enhance oversight and there is currently a national search for a new general counsel.

For reasons unrelated to the federal investigation, the CFO/COO will be leaving at the end of the calendar year to assume a similar role at a large, regional public university in Ohio.

DETAILED RATING RATIONALE

MARKET POSITION: LARGE REGIONAL PUBLIC UNIVERSITY OPERATING WITHIN A COMPETITIVE ENVIRONMENT

WSU continues to serve an important role as a regional public university for the greater Miami Valley region and surrounding counties in southwest Ohio. Total full-time equivalent (FTE) enrollment stands at 16,134 students for fall 2015, representing growth of about 3% over the past two years, but still lower than prior to the Great Recession. Unique to its service area is the Wright Patterson Air Force Base from which the university enrolls approximately 200 students each year providing a stable source of students in a market with shrinking numbers of high school graduates. The university is seeing benefits from its collaboration with Dayton Regional STEM Schools which is serving as a pipeline for high school graduates.

The university has carved out a niche as a provider of scientific and technical education. Its comprehensive academic program offerings include a community-based medical school, computer science, and engineering. In addition, it has leveraged its relationship with the Wright Patterson Air Force Base, Premier Health, and other nearby employers to support the growth of the Wright State Research Institute.

WSU is competitively priced against other major Ohio public institutions, stemming from its access-oriented mission as 40% of the typical entering class comprises first generation college students. While multi-year caps and freezes mandated by the state on undergraduate tuition constrains tuition pricing flexibility, the lower sticker price tuition may help WSU attract and retain students. In addition, those same tuition constraints are not imposed on graduate and professional programs, which comprises approximately 20% of total FTE enrollment, though we anticipate increases to remain moderate, around inflation.

OPERATING PERFORMANCE, BALANCE SHEET, AND CAPITAL PLANS: EROSION OF FINANCIAL RESOURCES DRIVEN BY VERY WEAK CASH FLOW FROM LARGE INVESTMENTS IN PROGRAMMATIC AND CAPITAL INITIATIVES

WSU's decentralized expense and reserve management structure has been a key factor driving deficit operations, which were exacerbated as the university chose to fund strategic initiatives from reserves. While operations have

never been robust, operating performance has deteriorated since FY 2012, averaging a 5% operating deficit over FYs 2012-2014. The operating cash flow margin was negative 0.1% in FY 2014 and unaudited financial statements indicate similar performance for FY 2015.

For FY 2016, we anticipate that operations will remain thin, but improved as the university recently implemented more centralized decision-making over significant expenses, including hiring and space management. These decisions were previously made at the department level. Given no concrete plans to reduce expenses, the low revenue growth environment will challenge the university to stabilize operations. Favorably, the university met its enrollment revenue target and state appropriations are budgeted to increase from FY 2015. WSU's FY 2016 appropriations will increase approximately 3.8%. While positive, this increase is below the aggregate statewide increase of 4.5% due to the revised performance funding formula.

The university is in the midst of a \$150 million comprehensive campaign, raising \$84 million to date when excluding bequests, of which \$77 million has been raised in cash or pledges, boosting cash and investments at the foundation to \$121 million, up nearly 40% since FY 2010.

Wright State does not currently have any substantive additional new money debt plans, as it recently made substantial investments in campus. These improvements were paid with proceeds from the 2011 and 2012 debt issuances, capital funding, gifts, and reserves.

The bulk (85%) of Wright State's housing stock is owned and operated by a private developer. The current agreement expires in 2017, which could present some volatility, but management indicates the negotiation process has already begun. WSU does not have a legal obligation to support this housing and would only be expected to compensate the developer up to a pre-defined fixed occupancy level should WSU construct additional housing or advise students to occupy other housing not provided by the developer and that agreed upon occupancy is not met. Management reports that all housing is at or close to 100% occupancy.

Liquidity

The lack of a centralized budget administration function and investment in strategic priorities contributed to the decline in cash over the last four years, depleting unrestricted liquidity. Estimated liquidity of approximately \$92 million for FY 2015 is down from a high of \$171 million in FY 2011, with monthly days cash on hand covering just 98 days of expenses. While investment in facilities and strategic priorities is important to a university's competitive position, the magnitude of these investments materially weakened WSU's financial profile.

DEBT AND OTHER LIABILITIES: LOW FINANCIAL LEVERAGE, BUT UNFUNDED PENSION LIABILITIES ARE SIZEABLE

Benefitting from historical capital support from the State of Ohio, WSU has relatively low financial leverage, with expendable financial resources to debt of 2.0 times and debt to operating revenue of 0.3 times for FY 2014. The university has no plans to increase debt materially within the next two to three years. Our debt metrics include a \$3 million guarantee entered into by the university's foundation with Dayton Regional STEM Schools, Incorporated. We no longer include debt issued by Wright State Physician's Incorporated ("WSP") because the foundation is no longer guarantying debt service payments.

Debt Structure

All of the university's outstanding debt is fixed rate and amortizing.

Debt-Related Derivatives

Not applicable

Pensions and OPEB

Wright State has elevated exposure to defined benefit pension and other post-employment benefit plans. Its combined Moody's adjusted net pension liability in FY 2014 is \$831 million representing 2.4 times operating revenue and employer contributions to both defined benefit and defined contribution plans were 7% of total FY 2014 operating expenses.

The state legislature controls pension benefits and employer and employee rates for the two multiple employer cost-sharing defined benefit pension plans in which WSU participates. Though the funded ratio of the two multiple employer cost-sharing plans in which WSU participates, the State Teachers' Retirement System of Ohio (STRS)

and Ohio Public Employees Retirement System (OPERS) has improved since 2012 when the state implemented pension reforms, OPERS is 51% funded and STRS is just 45.6% funded according to Moody's adjustments. Currently, all Ohio public universities' contributions to STRS and OPERS are capped at 14% of covered payroll, with the exception of law enforcement whose rate is 18.1%. Any increase in this required employer contribution would add additional stress to WSU's budget.

With the implementation of GASB 68 for FYE 2015, the university expects to report a sizeable \$228 million net pension liability for its share of the state-run defined benefit plans.

MANAGEMENT AND GOVERNANCE: TURNOVER IN KEY POSITIONS REMAINS A RISK TO EXECUTE NEW PROCESSES

Over the past several years, Wright State has hired many new administrators and key members of its leadership team and is again in transition, for reasons related and unrelated to the federal investigation. While the university has already begun making changes to strengthen weak administrative and financial practices, and is taking steps to ensure compliance with government regulations, the ongoing investigation serves as a distraction as the university executes new processes to strengthen financial performance.

KEY STATISTICS (FY 2014 Financials; Fall 2014 Enrollment Data)

- Total FTE Enrollment: 15,823 students
- Total Financial Resources: \$246 million
- Total Direct Debt: \$105 million
- Total Operating Revenue: \$342 million
- Reliance on Tuition and Auxiliary Revenue (as % of operating revenue): 46%
- Reliance on State Appropriation Revenue (as % of operating revenue): 25%
- Monthly Days Cash on Hand: 128 days
- Operating Cash Flow Margin: -0.1%
- Three-Year Average Debt Service Coverage: 0.6 times
- State of Ohio G.O. rating: Aa1 stable

OBLIGOR PROFILE

Wright State University is a large comprehensive regional public university with headcount enrollment of more than 17,000 students. The main campus is located 12 miles northeast of downtown Dayton, Ohio and there is a branch campus in northwest Ohio on the shores of Grand Lake St. Marys in Celina, Ohio.

LEGAL SECURITY

The bonds are secured by a broad pledge of the university's General Receipts, which includes all legally available revenue of the university, except money raised by taxation, state appropriations, or restricted gifts.

USE OF PROCEEDS

Not applicable

PRINCIPAL METHODOLOGY

The principal methodology used in this rating was U.S. Not-for-Profit Private and Public Higher Education published in August 2011. Please see the Credit Policy page on www.moody.com for a copy of this methodology.

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